



Department  
of Energy &  
Climate Change

## Strengthening the regulation of wholesale energy markets through new criminal offences

Government response to consultation

January 2015

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# General information

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## Territorial extent:

The United Kingdom

References in this document to “the regulator” are to Ofgem in Great Britain and to the Northern Ireland Authority for Utility Regulation (NIAUR) in Northern Ireland.

## Additional copies:

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## Chapter 1: Introduction

### Executive Summary

1. This document sets out the Government's response to the consultation, published on 6th August 2014, to create new criminal offences of energy market manipulation and insider trading. The proposed offences would give UK energy regulators<sup>1</sup> new powers to prosecute people suspected of abusing the wholesale electricity and gas markets.
2. This response should be read in conjunction with the final stage Impact Assessment that the Government has also published and the draft Regulations for the Electricity and Gas (Market Integrity and Transparency) (Criminal Sanctions) Regulations 2015 which were laid in draft before Parliament on 22<sup>nd</sup> January 2015.
3. The consultation document set out a number of key questions which were designed to elicit stakeholders' views on new criminal offences for energy market manipulation. The Government held a joint stakeholder event on the 26th September 2014 with Energy UK that examined the consultation questions and draft Regulations in more depth.
4. Chapter 2 sets out the consultation proposals and Chapter 3 sets out the responses. Chapter 4 presents the Government's response to the consultation and Chapter 5 describes the next steps.

### Summary of consultation responses

5. Fourteen responses were received to the consultation from a range of organisations including large vertically integrated energy companies, trade associations, sector services organisations, legal organisations, a small supplier, and a private individual. The key points are:
  - None of the respondents provided specific examples of energy market manipulation or insider trading.
  - 12 respondents accepted the case for criminal sanctions and gave cautious support for the proposed legislative approach. Two respondents did not support the case for criminal sanctions.
  - 10 respondents agreed with the case for alignment with financial services. Two respondents did not.
  - 12 respondents did not envisage any change to their internal processes or additional costs. The two respondents who did not support criminal sanctions stated there may be some additional costs but did not specify what they were or who would face them.

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<sup>1</sup> Ofgem for Great Britain; NIAUR for Northern Ireland.

- 12 respondents did not see any additional benefits or increased confidence in the fairness of the markets. A respondent at the consultation event indicated there could be increased confidence for consumers but not for market participants.
- Through their responses and at the stakeholder event respondents identified areas of uncertainty many of which were not material to the proposed offences. Respondents welcomed the prospect of clarification from DECC, which the Government is providing in this Government response, and further guidance from Ofgem on a range of issues.

## Decision and next steps

6. Following the outcome of the consultation and stakeholder event on the 26th September the Government is going ahead with the implementation of new criminal sanctions through regulations for the offences of insider dealing and market manipulation as set out in chapter 2 of the consultation. The Regulations were laid in draft before Parliament on 22<sup>nd</sup> January 2015. Subject to the will of Parliament, the Regulations are expected to come into force in April 2015.
7. These Regulations are being made under the powers in section 2(2) of the European Communities Act 1972. As a consequence the sanctions cannot exceed two years imprisonment. It may be necessary to review the Regulations in light of any revision of UK financial markets legislation in order to align sentences for similar offences.

## Chapter 2: Summary of proposals

8. The consultation published in August 2014 set out the rationale for the Government's proposed intervention to create new criminal offences of wholesale energy market manipulation and insider dealing. The Government proposed to make Regulations under section 2(2) of the European Communities Act 1972 to create the offences which would strengthen the sanctions available to the regulators to address energy market abuse.

### Background to REMIT

9. The Government announced in the Annual Energy Statement in October 2013, that it would consult on strengthening the existing civil enforcement regime by creating new criminal offences in line with prohibitions relating to market abuse in REMIT (Articles 3 and 5 of REMIT).
10. REMIT has been in force since 28 December 2011. It prohibits insider trading and market manipulation in wholesale energy markets across the EU and establishes a monitoring regime for wholesale energy trades by:
  - introducing explicit prohibitions of market manipulation, attempted market manipulation and insider trading in wholesale energy markets;
  - requiring the effective and timely public disclosure of inside information by market participants;
  - introducing an obligation to report suspicious transactions;
  - establishing a new framework for the monitoring of wholesale energy markets to detect and deter market manipulation and insider trading; and
  - requiring national regulatory authorities (NRAs) to be given enforcement and investigatory powers and requiring member states to establish a penalty regime for sanctioning of breaches at a national level.
11. The Government's REMIT civil enforcement Regulations entered into force on 29 June 2013. The Northern Ireland REMIT Regulations came into force on 31 August 2013. These Regulations together created a civil enforcement regime for market abuse in wholesale energy markets in the UK (hereafter "the 2013 Regulations" or "the civil enforcement regime"). In Great Britain, the regulatory authority responsible for the civil regime is Ofgem; in Northern Ireland, it is the Northern Ireland Authority for Utility Regulation. This document uses the terms "the regulators" or "regulator" to refer to both.
12. Amongst other matters, the 2013 Regulations gave the regulators the power to request any relevant information; carry out onsite inspections; and impose unlimited fines for breaches of a REMIT requirement.
13. Creating the proposed criminal sanctions for energy market abuse and insider trading would be consistent with the implementation that is required by REMIT. REMIT creates requirements and prohibitions mainly on market participants trading wholesale energy and requires Member States to create penalties for breach of the regulation that are proportionate, effective and dissuasive. Criminal sanctions are more dissuasive than civil sanctions alone.

14. REMIT does not set out how Member States should create penalties for breaches of the Regulations. The 2013 regime was put in place to protect consumers from the earliest possible date.
15. At that point it was not possible to also put in place a criminal regime and so to ensure a regime that addresses the most serious offences and align more closely with the UK financial services regime.

## The central prohibitions in REMIT

16. In the consultation the Government set out the detail of the proposed offences which would follow the central prohibitions set out in Articles 3 and 5 of REMIT:

*Article 3 states that:*

*“Persons who possess inside information in relation to a wholesale energy product shall be prohibited from:*

*(a) using that information by acquiring or disposing of, or by trying to acquire or dispose of, for their own account or for the account of a third party, either directly or indirectly, wholesale energy products to which that information relates;*

*(b) disclosing that information to any other person unless such disclosure is made in the normal course of the exercise of their employment, profession or duties;*

*(c) recommending or inducing another person, on the basis of inside information, to acquire or dispose of wholesale energy products to which that information relates.*

*And Article 5 of REMIT prohibits market manipulation.*

*“Market manipulation” means:*

*(a) entering into any transaction or issuing any order to trade in wholesale energy products which:*

*(i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of wholesale energy products;*

*(ii) secures or attempts to secure the price of one or several wholesale energy products at an artificial level; or*

*(iii) employs or attempts to employ a fictitious device which gives, or is likely to give, false or misleading signals regarding the supply of, demand for, or price of wholesale energy products; or*

*(b) disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of wholesale energy products.”*



## Wider REMIT requirements

17. The Government proposed not to create new criminal offences for breaches of the other REMIT requirements and prohibitions covering behaviours including the provision of information to the regulator (Articles 4, 8, 9 and 15 of REMIT). The Government considers that criminal sanctions would create no additional dissuasive effect in these cases and that it would not be proportionate to criminalise these actions and omissions. These other aspects of REMIT would continue to be covered by the REMIT civil regime that the Government has already put in place.

## The territorial scope of the offences

18. In the consultation document the Government proposed that the offences relating to insider dealing would cover:

- acquiring or disposing of a wholesale energy product where:
  - the defendant (which could be any party to the trade) is in the UK or is registered with a UK energy regulator;
  - the subject matter gas or electricity being traded originates in, is for delivery in, or transits through the UK; or
  - the transaction takes place in the UK (for instance, on a trading platform based in the UK).
- the disclosure of price sensitive information about a wholesale energy products where:
  - the subject matter gas or electricity being traded originates in, is for delivery in, or transits through the UK;
  - the defendant is in the UK, or is registered with a UK energy regulator; or
  - the defendant is outside the UK but the recipient of the dissemination is in the UK.
- recommending or inducing another person to acquire or dispose of a REMIT product where:
  - the defendant recommending or inducing is in the UK, or is registered with a UK energy regulator;
  - the defendant is outside the UK but the recipient of the recommendation or inducement is in the UK;
  - the subject matter gas or electricity originates in, is for delivery in or transits through the UK; or
  - the transaction takes place in the UK (for instance, on a trading platform based in the UK).

19. In the consultation document the Government proposed that the offences relating to market manipulation would cover:

- entering into transaction to give false or misleading impression where:

- the defendant (which could be any party to the trade) is in the UK or is registered with a UK energy regulator;
- the gas or electricity being traded originates in, is for delivery in, or transits through the UK; or
- the transaction takes place in the UK (for instance, on a trading platform based in the UK or is subject to a jurisdiction clause in favour of a UK legal jurisdiction).
- disseminating information which gives or is likely to give a misleading impression where:
  - the subject matter gas or electricity originates in, is for delivery in, or transits through the UK;
  - the defendant person disseminating is in UK, or is registered with a UK energy regulator; or
  - the defendant is outside UK but the alleged recipient of the dissemination is in UK.

### Intentional or reckless behaviour

20. In the consultation the Government proposed that a person would have had to have acted intentionally or recklessly for an offence under the proposed Regulations to have been committed. Whilst this is a narrowing of the criminal offences in relation to the same behaviours under the civil regime, this is necessary because of the higher level of sanctions available for a criminal offence.

### Legal persons

21. In the consultation document the Government proposed that the offence of insider dealing and market manipulation could be committed by legal persons and the officers of legal persons i.e. it would include corporations (and their officers such as Board Members) as well as individuals. This follows the REMIT prohibition and ensures that the regulators are able to take effective action against legal persons and their officers where necessary.

## Chapter 3: Summary of questions and responses

22. The Government received 14 written responses to the consultation. The key responses were:

### Responses to questions

#### **Q1: Do you know of any evidence about or examples of energy market manipulation or insider trading practices**

- None of the 14 respondents were able to provide evidence or specific examples of energy market manipulation or insider trading. A few respondents cited hypothetical scenarios where market manipulation and inside information could potentially take place.

#### **Q2: Should the territorial reach of the regulators' functions in respect of REMIT enforcement be clarified?**

- All the respondents agreed that the territorial function of the regulator, under the enforcement regime should be clarified. One respondent raised concerns that the jurisdictional clause identifying the UK for the purposes of arbitration in many contracts agreed abroad could reduce the demand for GB legal services on international energy trading issues.

#### **Q3: Should the Government create criminal offences for the REMIT prohibitions on insider dealing and market manipulation?**

- 12 respondents agreed that new criminal offences for energy market manipulation and inside information should be created. Two respondents did not support the case for new offences.

#### **Q4: Do you agree that the civil enforcement regime that is being created provides an effective deterrence to breaches of the REMIT requirements listed in the 2013 Regulations – including those around registration and the provision of information?**

- All respondents to this question agreed that criminal provisions should not be extended to the wider REMIT requirements (Articles 4, 8, 9 and 15 of REMIT).

#### **Q5: Do you agree that an offence of insider dealing in wholesale energy products should be framed in this way?**

- All the respondents to this question agreed that the offence of insider dealing should be framed as stated in the consultation. Of the two respondents who did

not support the case for criminal sanctions, one said the offence should be framed as in the consultation, and the other did not comment.

- All respondents who supported the case for criminal sanctions agreed that the offences should only apply in cases of intentional or reckless behaviour.

**Q6: Do you consider that the exemptions set out above and in Chapter 4 are appropriate?**

- Most respondents agreed that the exemptions on insider dealing were appropriate.
- One respondent made a proposal for an additional exemption in the regulations for “inadvertent errors in information”. They proposed two options: clarifying that the mental element is “intentional only” or having a safe harbour defence in respect of good faith errors made in provision of information to PRAs.
- Three respondents stated that the exemptions should be similar to those in financial markets and one sought clarification on whether the defences under S53 of CJA/FSMA would be available to market participants.
- Two respondents stated that there should be safeguards or guidance so that recklessness is interpreted in order to avoid capturing accidental actions.
- One respondent stated that the exemption for energy market manipulation needs to cover the situation where the person establishes that all their reasons for entering into or refraining from a transaction is legitimate and conforms to accepted market practices. Another respondent wanted clarification on how the offences would be applied in the case of particular market behaviours such as distressed purchasing or selling.

**Q7: Do you agree that an offence of insider dealing should include legal persons and decision-makers?**

- There was a balanced view here. A number of respondents agreed that the offence of insider dealing should include both legal persons and decision makers.
- One respondent requested clarification on responsibility when a trade is decided and implemented by an algorithm such as an automated rules based engine or a high frequency trading system
- One respondent requested clarification on the behaviour that constitutes a safe harbour defence.
- One respondent observed that the inclusion of legal persons differs to the equivalent offence in financial markets.
- One respondent stated that further clarity and guidance was needed on “what constitutes neglect on behalf of an officer”.
- One respondent stated that the offence should be limited to natural persons.
- Two respondents stated that the offence of insider dealing should be more consistent with the approach under the Criminal Justice Act.

- One respondent did not agree that the offence of insider trading should include legal persons and decision makers because there was a risk that the introduction of new offences for key decision makers could reduce physical power trading activity of financial participants.

***Q8: Do you agree that the offence of energy market manipulation should be framed in the way described here?***

- Most respondents agreed with the framing of the offence of market manipulation including the requirement for intention or recklessness.
- A few respondents raised concerns that creating specific offences around benchmark manipulation would go beyond REMIT.
- Some respondents thought that significant amounts of extra information could be released in response to the criminal offences which could cloud visibility for the market participant and regulator but did not state what information or who would release it.
- Two respondents suggested changes to the proposed approach by aligning the defences and exemptions more closely with REMIT, or including the word “deliberate” in the market manipulation offence, which would provide assurance to market participants that they would be protected when providing information in good faith to price reporting agencies.

***Q9: Would the creation of these criminal sanctions change the processes that market participants are already putting in place to meet the requirements of the REMIT civil regime?***

- 12 respondents agreed that the new offences would not change the processes for market participants, who already comply with the prohibitions under the REMIT civil regime.
- One respondent thought that the new offence could lead company directors to take a more risk-averse approach to decision making than that they take under the civil regime (with unlimited fines).
- The two respondents who did not support criminal sanctions stated that the new offences could lead to greater provision of unnecessary information creating an opaque reporting environment and increased costs in employing new staff.

***Q10: Would the creation of these criminal sanctions change the level of confidence that market participants have in the fairness of the wholesale energy market?***

- 12 of the respondents did not envisage any additional benefits or increased confidence in the fairness of the market as a result of the new offences.
- Two respondents stated that it could lead to increased market confidence.
- At the consultation event one stakeholder indicated that the offences would increase confidence for consumers.

## Responses on other issues of interest

### Clarification and guidance

- Respondents indicated a wish for clarity and guidance on:
  - scope - territorial – particularly contracts where the only link to GB is jurisdiction clauses;
  - whether there is a risk of action being taken for the same offence under both the criminal and civil sanction regimes;
  - the definition of information which is “precise” and has “significant effect” on prices; and
  - the role of Ofgem in relation to policy, investigation and prosecution

### Alignment with the financial services regime

- 10 stakeholders agreed on the case for alignment with the financial services regime:
- Some of the respondents supported the argument that alignment between the two regimes would reduce incentives to manipulate the markets. Others stated that the legislative framework, including the defences and exemptions should align as closely as possible with financial services legislation. Two stakeholders did not agree with the case of alignment with the financial services regime.

## Chapter 4: Government response to consultation

23. This chapter discusses the key issues that respondents outlined in their responses to the consultation and how the Regulations address them.

### Rationale for criminal sanctions

24. While the civil sanctions regime provides a strong deterrent to market abuse, the Government considers that full implementation of REMIT regulations in the UK should see the existing enforcement arrangements supported by the introduction of criminal sanctions. There are three key reasons for this:

- the need for alignment with the financial market regime
- the additional dissuasive effect- some market participants may not be dissuaded by civil sanctions alone; and
- the most serious breaches can lead to significant harm and therefore very strong sanctions would be proportionate.

25. Whilst the majority of stakeholders responding to the consultation agreed that the Government should create the proposed offences, three respondents felt that criminal sanctions were unnecessary because the civil regime will be sufficiently effective. Respondents to the consultation did not indicate specific incidences of behaviour that would breach the REMIT prohibitions, but two indicated that there had been occasions on which they had some general concerns about market behaviours.

26. Respondents stated that market participants already comply with the current REMIT civil regulations, and additional criminal offences would not change their compliance processes or increase confidence in the market.

***The Government is therefore proposing to create the two criminal offences of wholesale energy market manipulation and insider dealing as set out in the consultation document.***

### Legal persons

27. The Government understands stakeholder concerns about the extension of offences to include officers of a company (such as its directors) that participated in the commission of a REMIT offence by a company, or were otherwise to be seen as responsible for a company's commission of a REMIT offence. The provision in question provides that where the commission of a REMIT offence by a company has been committed with the consent or connivance of an officer or attributable to that officer's neglect, then the officer as well as the company shall be guilty of an offence. Consequently, an officer can only be guilty of an offence under this provision if there has been the commission of an offence by the company of which they are an officer. In such circumstances, both the company and the individual officer is already liable to unlimited fines under the existing REMIT civil Regulations, owing to the operation of article 3(5) of REMIT for insider dealing or article 5 for market manipulation. The Government does not believe that the addition of criminal offences will significantly dissuade participation in the market by companies over and above exposure to unlimited



finer whereas it is likely to benefit business and consumers by acting as a deterrent to wrong-doing by officials in an organisation.

***The Government is therefore proposing to create offences that apply to legal persons and the officers of legal persons.***

## Territorial extent

28. Respondents also raised concerns about the definition of the territorial extent of the criminal offences. In the consultation, the proposed extent was, broadly, where the person or the contract is based in the UK, where the energy product is produced in, transiting through, or for delivery to the UK, where the recipient of disseminated information is in the UK, or where a contract is part of the law of a UK legal jurisdiction, such as a contract having a dispute resolution clause in favour of the High Court in London.

29. Respondents to the consultation were keen that the territorial extent of the offences is clarified and accepted most of these proposals. The only aspect on which some concern was expressed was around the extension of the offences to contracts in which the only link to the UK is a dispute resolution clause. In practice, contracts in which the only link to the UK is such a clause would either be unlikely to be breaching REMIT (if the subject matter of the transaction was wholly outside the EU) or would be under the jurisdiction of another Member State (if partly in the EU). There was concern that this proposal might nonetheless cause a degree of jurisdictional flight with potential implications for the UK legal services sector.

30. The Government has weighed this potential impact on UK businesses against the very small chance that there is market abuse that the Government would wish to be captured where this is the only link to the UK. The Government considers that excluding such contracts would have no or little impact on market manipulation or insider trading in GB or the EU.

***The offences will follow the territorial provisions the Government set out in the initial consultation, with the exception that they will not extend to contracts solely on the basis of a jurisdiction clause in favour of a UK legal jurisdiction.***

## Guidance for market participants

31. At the consultation event and in written responses, stakeholders expressed a range of concerns around the meaning of certain terms such as “reckless” and “accepted market practice”. Where possible the Government is seeking to provide clarification through this Government response and Ofgem is planning to provide additional guidance.

***The Government will support regulators which will be required to produce guidance for market participants regarding its approach to prosecuting the new offences. The exact timing for developing this guidance has yet to be decided.***



## Intentional or reckless behaviour

32. Respondents to the consultation were unclear about the meaning of recklessness and its relation to genuinely accidental breaches. This is a particular concern for the price reporting agencies; especially that voluntary provision of information may be inhibited by the perception of increased risk.
33. Whilst the Government understands that the perception of risk may deter the provision of information, the Government believes that the inclusion of reckless behaviour is an important component of the criminal offences. Recklessness, as properly understood, does not capture all types of behaviour but only that where unreasonable risks are taken in relation to breaching a prohibition. Concerns about interpretation are best addressed through guidance.

***The Government anticipates that regulators will provide guidance on the behaviour that could constitute a breach of the law***

## Benchmarks

1. The voluntary reporting of wholesale energy market information strengthens transparency and so the market. Effective sanctions for those who abuse the reporting of market information are important way to underpin the quality of voluntary market reporting.
2. In the consultation it proposed that the offences of energy market manipulation would include the manipulation of benchmarks, where the behaviours fall within the scope of article 5 of REMIT (market manipulation). Some respondents queried whether specific offences of benchmark manipulation could be created within REMIT and also raised concerns that a perception of risk of breaching criminal offences inadvertently could reduce the voluntary provision of information. The Government did not however propose to create a specific offence covering the manipulation of benchmarks.

***The Government supports the voluntary provision of market information and is proposing safeguards within the regulations to ensure that the good faith provision and reporting of such information would not be a behaviour captured by the offence of market manipulation. The Government is not proposing a dedicated offence of manipulating benchmarks or of deeming REMIT to cover benchmarks other than it naturally would.***

## Alignment with financial services regime

3. In the consultation the Government set out that alignment with the financial services regime remained a key policy aim for the Government. Most respondents agreed with aligning with the financial services regime, although two respondents noted that equalisation of the two regimes would be difficult.
4. The Government continues to believe there is a strong case for alignment with the financial services regime as there is a risk of perverse incentives arising from the existence of criminal sanctions for insider trading in or manipulation of some energy related markets or products but not others. Alignment with

financial services regulation is desirable because, while there are products that are clearly physical energy products, or are clearly financial products, there is a significant amount of trading in products that can come under REMIT or financial regulation depending on the platform on which they are traded.

***The Government intends to align the regimes for financial and wholesale energy markets more closely over time.***

## Chapter 5: Next steps

5. Subject to parliamentary approval for the draft Regulations the Government anticipates that regulations will come into force in April 2015.
6. The regulators will provide guidance on their approach to the regulations when the regulations come into force.
7. The Government will review these regulations in light of any revision of the UK financial markets legislation, to ensure the regimes are closely aligned.

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