IN THE SUPREME COURT **UKSC/2025/0047**

On Appeal from The Court of Appeal

BETWEEN:

THE COMMISSIONERS FOR HIS MAJESTY'S REVENUE AND CUSTOMS

Appellants

-and-

SCOTTISHPOWER (SCPL) LIMITED
SCOTTISHPOWER RENEWABLES (UK) LIMITED
SCOTTISHPOWER (DCL) LIMITED
SCOTTISHPOWER ENERGY RETAIL LIMITED

Respondents

STATEMENT OF AGREED FACTS AND ISSUES

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1. The Respondents are all companies in the Scottish Power Group. They are referred to as SCPL, SRL, SPDCL and SPERL respectively. SPERL was, at all relevant times, the holder of gas and electricity supply licences. The other three Respondents were holders of electricity generation licences.

2. Section 1 of the Utilities Act 2000 created the Gas and Electricity Markets Authority ("GEMA"). The Office of Gas and Electricity Markets ("Ofgem") carries out GEMA's day to day work and investigates matters on its behalf. The negotiations described

below were negotiated by Ofgem but the settlements made were settlements with GEMA.

3. Section 4 of the Electricity Act 1989 (the "1989 Act") makes it an offence to supply or generate electricity without a licence. The 1989 Act vests in GEMA the power to grant such a licence. Such a licence may incorporate conditions imposed by GEMA and must, by section 8A of the 1989 Act, contain the Standard Licence Conditions ("SLCs").

4. The relevant enforcement powers conferred on GEMA by the 1989 Act are:

   (i) under section 25, GEMA may order compliance with a licence condition or a statutorily specified condition ("a relevant requirement");

   (ii) under section 27A, where GEMA is satisfied that an electricity supplier has contravened any licence condition or relevant requirement it may "*impose… a penalty of such amount as is reasonable in all the circumstances of the case*"; and

   (iii) under section 27G (introduced by the Energy Act 2013 with effect from 18 February 2014), where GEMA is satisfied there has been any such contravention and as a result consumers have suffered loss or inconvenience, it may make a Consumer Redress Order. No such Orders were made in any of the settlements at issue in these proceedings.

5. Section 27A of the 1989 Act requires GEMA to publish notice of a proposed penalty, to consider any representations made in relation to the proposal before imposing the penalty, and once the penalty has been imposed, to give notice that it has done so.

6. Section 27E provides for an appeal against the imposition of a penalty or the amount thereof or against the date of payment.

7. Penalties are paid to the Treasury via the Consolidated Fund.

8. There are similar provisions in the Gas Act 1986 in relation to the supply of gas.

9. Section 27B of the 1989 Act requires GEMA to publish a policy statement in relation to the determination and imposition of penalties and their amounts.

10. GEMA issued a policy statement on penalties and Consumer Redress Orders on 6 November 2014. Ofgem also published Enforcement Guidelines on 12 September 2014 and further Guidance on 14 December 2015.

11. Between 2010 and 2014, Ofgem opened four investigations into SPERL. In outline, these investigations concerned: (i) mis-selling; (ii) costs reflectivity;[1] (iii) compliance with the Community Energy Saving Programme ("CESP"); and (iv) complaints handling.

12. From about 2010, Ofgem's approach to dealing with breaches of licence conditions changed from simply imposing penalties to seeking settlement agreements involving substantial "consumer redress payments" coupled with a nominal penalty.

[1] The FTT described this as "reflexivity" but it is agreed that "reflectivity" is the proper description.

The mis-selling investigation

13. SLC 25 imposes obligations on energy suppliers in relation to marketing activities. In particular, SLC 25 regulates sales by way of doorstep marketing. At the relevant time, 40% of SPERL's sales arose from doorstep marketing.

14. On 2 September 2010, Ofgem opened an investigation into SPERL's compliance with SLC 25. As a result, SPERL provided information to Ofgem. Ofgem concluded that SPERL did not have robust arrangements in place for training in relation to, and the monitoring of, doorstep sales and telesales. As a result, misleading information had been provided to customers.

15. SPERL accepted that it had breached SLC 25. However, it did not initially agree with Ofgem as to the seriousness of the breach or the quantum of harm caused to consumers. Ofgem suggested a significant penalty and negotiations followed.

16. Towards the end of 2011, discussions came close to agreeing a settlement payment by SPERL of £17.5 million. That amount exceeded SPERL's estimate of the consumer detriment caused by its actions. However, SPERL contemplated paying it to bring the investigation to an end. The negotiations broke down because (i) SPERL did not agree with Ofgem's desire to include a £1 penalty in addition to the £17.5 million settlement package; and (ii) SPERL considered that the proposed sum exceeded the consumer detriment.

17. Negotiations later resumed. In the correspondence between the Scottish Power and Ofgem leading up to the agreement, Scottish Power stated that their understanding was that payments would be made "*'in lieu of' financial penalty*" and asked Ofgem to

consider levying no formal penalty at all and thereby avoiding the statutory process, which Ofgem refused to do (in emails of 4, 5 and 10 January 2012).

18. The overall amount to be paid was then the subject of negotiation, as made clear by Scottish Power's internal emails of 25 July and 7 August 2013.

19. On 10 October 2013, SPERL and GEMA entered into a settlement agreement pursuant to which:

(i) SPERL agreed to pay £7.5 million to vulnerable customers, identified through SPERL's 2012 Warm Homes Discount scheme;

(ii) SPERL agreed to set aside £1 million to make compensation payments to customers affected by mis-selling;

(iii) SPERL agreed that any money not paid out of the £8.5 million allocated under the two headings above would be paid to Scottish Power Energy People Trust ("SPEPT"), a charitable trust which supported people affected by fuel poverty and over which SPERL had no control; and

(iv) GEMA imposed a £1 penalty on SPERL.

20. Pursuant to the settlement agreement, GEMA published a formal Notice of Decision on 4 December 2013 which:

(i) stated that GEMA found that SPERL was in breach of SLC 25;

(ii) stated that the breaches had been admitted by SPERL and that, while there was no evidence that the contraventions had been deliberate or wilful, they could not be regarded as inadvertent or accidental; and

(iii) set out factors relevant to the level of the penalty. These included GEMA's view that the breaches were serious, the period of the breach, that customers may have been harmed, and the gains made by SPERL as a result of sales tactics in breach of SLC 25.

21. GEMA's Notice of Decision stated that these matters warranted a "*significant penalty*" but, having regard to SPERL's agreement to pay £8.5 million to consumers, the steps SPERL had taken to put things right and its agreement to settle the investigations, GEMA proposed a penalty of £1. The Notice of Decision also stated that the penalty would have been higher if SPERL had not: agreed a settlement and admitted the breaches, agreed to make payments of £8.5 million to benefit consumers, and taken steps to ensure future compliance.

22. The FTT was not able on the evidence to say that these breaches were "practically almost unavoidable".

23. In accordance with the settlement agreement, SPERL paid:

(i) £7,316,385 to vulnerable customers (each receiving a "round sum amount") identified under the Warm Homes Scheme. The remaining £183,615, being uncashed cheques, was paid to SPEPT;

(ii) £554,013 in cashed cheques or credits directly to affected customers, and the balance of the £1 million to SPEPT; and

(iii) £1 as a penalty to the Consolidated Fund.

24. The letters sent to the Warm Home Discount recipients (the content of which was agreed between SPERL and GEMA as part of the settlement agreement) recited that Ofgem accepted that SPERL had not deliberately misled or mis-sold but that SPERL accepted that it had not met the Regulator's standards of conduct. SPERL said that the payment was "*not being made because we think that you have been directly affected by these issues, but because we want to make payments to you as part of our apology*".

25. The agreed letters to the potential recipients of compensation (those who signed up with SPERL as a result of sales contact in a given period) contained a similar acknowledgement of non-deliberate failure and described the £1 million as compensation for customers who lost money as a result of SPERL's failings.

Costs Reflectivity

26. SLC 27.2A requires the differences in the terms and conditions between different payment methods should reflect the relative costs of the different methods. SPERL charged customers different rates depending on their payment methods.

27. In March 2011, Ofgem opened an investigation into SPERL's compliance with SLC 27.2A. Ofgem came to the conclusion that SPERL did not have robust procedures to justify its price differentials. Negotiations followed on the terms of a settlement.

Ofgem's initial proposal was for payment of £8.5 million; SPERL's initial estimate of harm was £250,000.

28. SPERL eventually accepted that it had breached SLC 27.2A. It was agreed that it would be difficult to identify customers who had suffered as a result of the breach.

29. The FTT was not able on the evidence to say that these breaches were "practically almost unavoidable".

30. Ofgem wrote on 17 January 2014 encouraging settlement of the investigation and indicating that lower penalties would be imposed for early settlement. The letter stated that failure to reach a settlement by 14 March 2014 would "*likely result in a higher penalty*". By a letter dated 27 February 2014, Ofgem extended this period to 16 April 2024.

31. Internal Scottish Power correspondence records the progress of discussions over the total amount to be paid. An email of 11 March 2014 recites that "*if this were to be contested – they would be looking for a fine of £2.5m. If, however, SP is willing to settle then they would agree to £2m*." An email dated 28 March 2014 records: "*They are willing to negotiate a settlement "somewhere" between our £250K and their £2m*". On 15 April 2014, another email stated: "*They would be keen for us to commit to more than £0.5m but could commit to charging only a £1 fine if this sum is paid to an independent fund for customers…*". Ultimately, payment of £750,000 was agreed, as recorded in an email dated 30 April 2014: "*They're willing to settle for £750k!*"

32. On 15 May 2014, SPERL and GEMA entered into a settlement agreement pursuant to which:

(i) GEMA issued a Notice of Decision stating that SPERL had breached SLC 27.2A but that there was no evidence that there were *"deliberate actions in relation to the breach*";

(ii) SPERL agreed to pay £750,000 to Energy Best Deal Extra, a public awareness campaign run by Citizens Advice; and

(iii) GEMA imposed a £1 penalty on SPERL.

33. GEMA's Notice of Decision stated that "*the Authority considers it appropriate to impose a financial penalty on [SPERL] of £1*". It noted that this penalty *"*was *lower than* it *would have been if [SPERL] had not engaged in the settlement process… provided an admission of liability, and… made a payment of £750,000 to Energy Best Deal Extra*".

34. In accordance with the settlement agreement, SPERL made the £750,000 payment to Energy Best Deal Extra and paid the penalty of £1 to the Consolidated Fund.

Energy Saving: CESP

35. This investigation affected all four Respondents.

36. The Electricity and Gas (Community Energy Saving Programme) Order 2009 (the "CESP Order") required electricity generators and suppliers to achieve reductions in carbon emissions by promoting energy saving actions to domestic customers in low income areas. These were specified in terms of reductions in CO_2 emissions. Each of the Respondents was set a target, and SPERL carried out the delivery of the obligation

on behalf of all of them. Pursuant to an inter-company agreement, each accepted part of the cost of such delivery.

37. SPERL outsourced the greater part of these obligations to Carillion. However, Carillion failed to meet the targets. SPERL also considered that Ofgem's administration of the scheme adversely affected SPERL's ability to comply with it.

38. The Respondents all failed to meet the prescribed targets by four months. The FTT considered that these breaches were practically almost unavoidable. In May 2013, Ofgem opened an investigation into the Respondents' compliance with the CESP Order.

39. Ofgem sent a Without Prejudice letter on 6 November 2014. In the section of the letter headed "*Penalty policy on early resolution*", Ofgem set out how an early settlement would attract discounts at differing levels depending on date of settlement in comparison to a penalty of £3,600,00 which would be sought if the case were contested.

40. On 4 December 2014, SPERL and GEMA entered into a settlement agreement pursuant to which:

    (i) GEMA issued a Notice of Decision which stated that SPERL had breached the Order and that GEMA intended to charge a £1 penalty. The Notice of Decision did not suggest that the breach was deliberate and referred to mitigating activity undertaken by SPERL;

    (ii) £2.4 million would be paid by the Respondents (and another company which has since left the group) to SPEPT; and

    (iii) GEMA imposed a £1 penalty on SPERL.

41. Pursuant to the intercompany agreement, the payment to SPEPT was borne by the Respondents as follows:

(i) SPERL: £1,306,584;

(ii) SPDCL: £251,267;

(iii) SCPL: £112,239; and

(iv) SRL: £20,884.

The balance was paid by the company which has since left the group. SPERL also paid the penalty of £1 to the Consolidated Fund.

Complaints Handling

42. SLC 25C requires suppliers to take reasonable steps to achieve matters such as fair accurate and prompt behaviour. SLC 27 requires that bills be sent out within 6 months and errors be corrected speedily. The Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 (the "CHRs") deal with complaints handling standards and procedures, and were "relevant requirements" applicable to SPERL for the purpose of enforcement by Ofgem.

43. In November 2014, Ofgem opened an investigation into SPERL's compliance with these requirements. SPERL had had problems with billing and complaints handling which arose from the implementation of a new unified computer system in place of some 80 old systems. This was a mammoth task involving some 5 million customer accounts (there were 3 million customers but some had accounts both for gas and

electricity). SPERL sent out hundreds of thousands of bills each week using these systems, and had some 2,000 people (in 2020) engaged in query and complaint handling.

44. After 8 months of planning, the IT transition process took some 18 months. SPERL engaged IBM to support the project. They were one of only two firms of consultants who were considered to have the requisite knowledge and capabilities. However, when the implementation was underway, SPERL discovered that IBM was splitting its resources with npower who were conducting a similar exercise. The lack of resource provided by IBM led to difficulties and SPERL engaged Accenture and Deloitte. Despite careful planning, problems occurred at various stages which led to breaches of the relevant requirements. Ofgem noted that complex projects such as this were "*challenging*" but considered that SPERL had not done enough to identify and mitigate risks.

45. In the early stages of the investigation, SPERL made a number of commitments to improve aspects of its billing and complaints handling. It failed to meet those requirements and, in March 2015, Ofgem imposed a 12-day ban on its sales and marketing activities.

46. SPERL agreed that it had breached its obligations. Before the negotiations with Ofgem had even started, SPERL had written off some £8 million of consumers' bills in recognition that it had breached its duties and in recognition of consumer harm.

47. The FTT considered that these breaches were "practically almost unavoidable."

48. Ofgem sent out a Without Prejudice letter on 23 March 2015 which, in a section of it under the heading "*Penalty policy on early resolution*" mentioned an initial penalty figure of £23 million and set out various discounts for early settlement, including a discount to £18 million if a settlement was reached by 5pm on 25 April 2016. The letter then expressed a view as to whom payments might be made.

49. On 25 April 2016, SPERL and GEMA entered into a settlement agreement pursuant to which:

(i) GEMA issued a Notice of Decision stating that

SPERL had contravened some of the conditions and requirements, i.e. SLC 25C, SLC 27.17 and various of the CHRs. The Notice of Decision stated that the breaches were not trivial, but GEMA considered that SPERL had not sought to breach the requirements;

(ii) SPERL admitted the breaches and agreed to make £18 million of "consumer redress payments" of which:

(a) compensation of up to £15 million would go to priority or Warm Homes Discount "Qualifying Customers" whose bills had been issued more than 6 weeks late or who had made a relevant complaint. Each would receive between £50 and £150; and

(b) £3 million plus any of the £15 million which was unused would be paid to charities to be agreed within the next 2 months (and if not agreed to the Treasury via the Consolidated Fund);

(iii) GEMA imposed a £1 penalty on SPERL.

Those customers who had already been compensated by SPERL and who were Qualifying Customers also received the payments at (ii)(a) above.

50. SPERL agreed to these terms despite the fact that its estimate of the detriment suffered by customers was materially less than the settlement figure and it considered that it had voluntarily compensated affected customers.

51. The settlement agreement (like the other three) distinguished between the penalty of £1 and the redress payments. Clause 4 made provision for the reporting of the people identified as qualifying customers, the credit to them of between £50 and £150, and provided that such payment should not release SPERL from making payments arising out of the IT migration it would otherwise have to make to non-Qualifying Customers who had experienced problems. SPERL also agreed to take steps to improve its complaints handling procedures.

52. In accordance with the settlement agreement, SPERL paid or credited:

(i) £14,709,208 to Qualifying Customers (£73 to each such customer);

(ii) £3,290,741 to two charities (Energy Action Scotland and National Energy Action) over which SPERL had no control and which were concerned with energy supply to consumers; and

(iii) a £1 penalty to the Consolidated Fund.

Other Facts Found by the FTT

53. All of the settlement agreements described above were the result of negotiation between SPERL and Ofgem. SPERL was not compelled by force or by law to enter into any of them. It could in each case have refused to settle and either accepted a penalty or appealed against a penalty imposed by GEMA.

54. SPERL chose to enter into the settlement agreements for the following reasons:

(i) Settlement avoided the risks inherent in litigation, the possible adverse effects on its reputation of a large penalty and the diversion of management time in bringing the investigations to a close or litigating a penalty;

(ii) Settlement avoided adverse publicity and damage to SPERL's brand and maintained goodwill with Ofgem; payments to consumers also promoted goodwill with them; and

(iii) Settlement tended to compensate and could, where possible, be directed to those who had suffered harm; SPERL preferred to make payments for the benefit of consumers rather than paying monies to the Exchequer.

55. The essence of SPERL's trade was selling gas and electric energy. The settlement payments to consumers or charities (the "Redress Payments") were a consequence of not meeting the standards required of energy suppliers. The acts or inactions that gave rise to the Redress Payments were part of the activity of SPERL's trade and were done for the purpose of earning income from that trade

56. Generally, compensation payments made by SPERL in accordance with its published complaints handling procedure or by agreement ("ordinary compensation") will be incurred in the activities, and for the purposes, of the trade. In the case of the Redress Payments, whilst they were incurred in the course of activities carried on for the purpose of the trade, they were also made for the purpose of closing down the investigation and avoiding adverse publicity and so differed from ordinary compensation. But those two purposes were both purposes of the trade.

57. Although not inadvertent or accidental, the behaviour that gave rise to the settlements (and thus to the Redress Payments) was not conducted with the intention of breaching the relevant requirements.

58. Some of the breached requirements were or could have been reflected in the terms of the supply contracts with consumers.

59. In respect of each of the settlement agreements, the Respondents deducted the relevant Redress Payments when computing their profits for corporation tax purposes, in accordance with generally accepted accounting practice. They did not seek to deduct the £1 penalties imposed by Ofgem. The Appellant ("HMRC") subsequently denied those deductions, and the Respondents appealed to the FTT.

Proceedings and decisions in the tribunals/courts below

60. The FTT heard the appeal on 25-29 October 2021 (five days). The decision was released on 4 February 2022, dismissing the appeal save as to £554,013 paid under the mis-selling settlement, and is reported at [2022] UKFTT 41, [2022] SFTD 576 and [2022] 2 WLUK 88.

61. The UT heard the appeal on 16 and 17 May 2023, and released its decision on 5 September 2023, dismissing the appeal and allowing HMRC's cross-appeal. The decision is reported at [2023] UKUT 218, [2023] STC 2579, [2023] BTC 528, [2023] STI 1234 and [2023] 9 WLUK 7.

62. The Court of Appeal heard the appeal on 26 and 27 November 2024 and handed down judgment on 17 January 2025, allowing the appeal. The decision is reported at [2025] EWCA Civ 3, [2025] 1 WLR 2225, [2025] STC 227, [2025] BTC 2 and [2025] 1 WLUK 159.

Agreed Issues

63. The opening words of the Corporation Tax Act 2009 s.46(1) mandate that the profits of a trade must be calculated in accordance with generally accepted accounting practice and, as appears from the concluding words of s.46(1), that general rule may only be abrogated where an adjustment is required or authorised by law in calculating profits for the purposes of corporation tax.

64. The main issue in this appeal is whether (on the facts and bearing in mind that the payments at issue ("the Payments") were not statutory penalties) any law authorises or permits the Payments to be added back when calculating the relevant Respondent's profits for tax purposes (i.e. that the Payments are not deductible).

65. In order to determine whether there is a law which authorises or permits the adding back of the Payments it is necessary to resolve the following additional issues:

(i) Whether *McKnight v Sheppard* [1999] 1 WLR 1333 sets out a principle restricting deductions for penalties and if so, what that principle properly is, and in particular whether it is:

(a) an example of a requirement that only expenses incurred for the purposes of earning profits are deductible, with penalties (and similar payments) not being incurred for those purposes either:

1. because of the general *ex turpi causa* principle (which may also be the principle relating to the legitimate scope of trading activities recognised in *MacLaren Racing* [2014] STC 2417) (see Ground 1(a)); or

2. because penalties and similar payments follow after the earning of profits (see Ground 1(b)); or

(b) a general rule of public policy against sharing the burden of legal or regulatory sanctions (see Ground (2)); or

(c) a separate rule of public policy.

(ii) Whether any of the Payments fall within that principle (or one of those principles, if several distinct rules prohibiting deductions exist).

RE: HMRC v SCOTTISH POWER

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