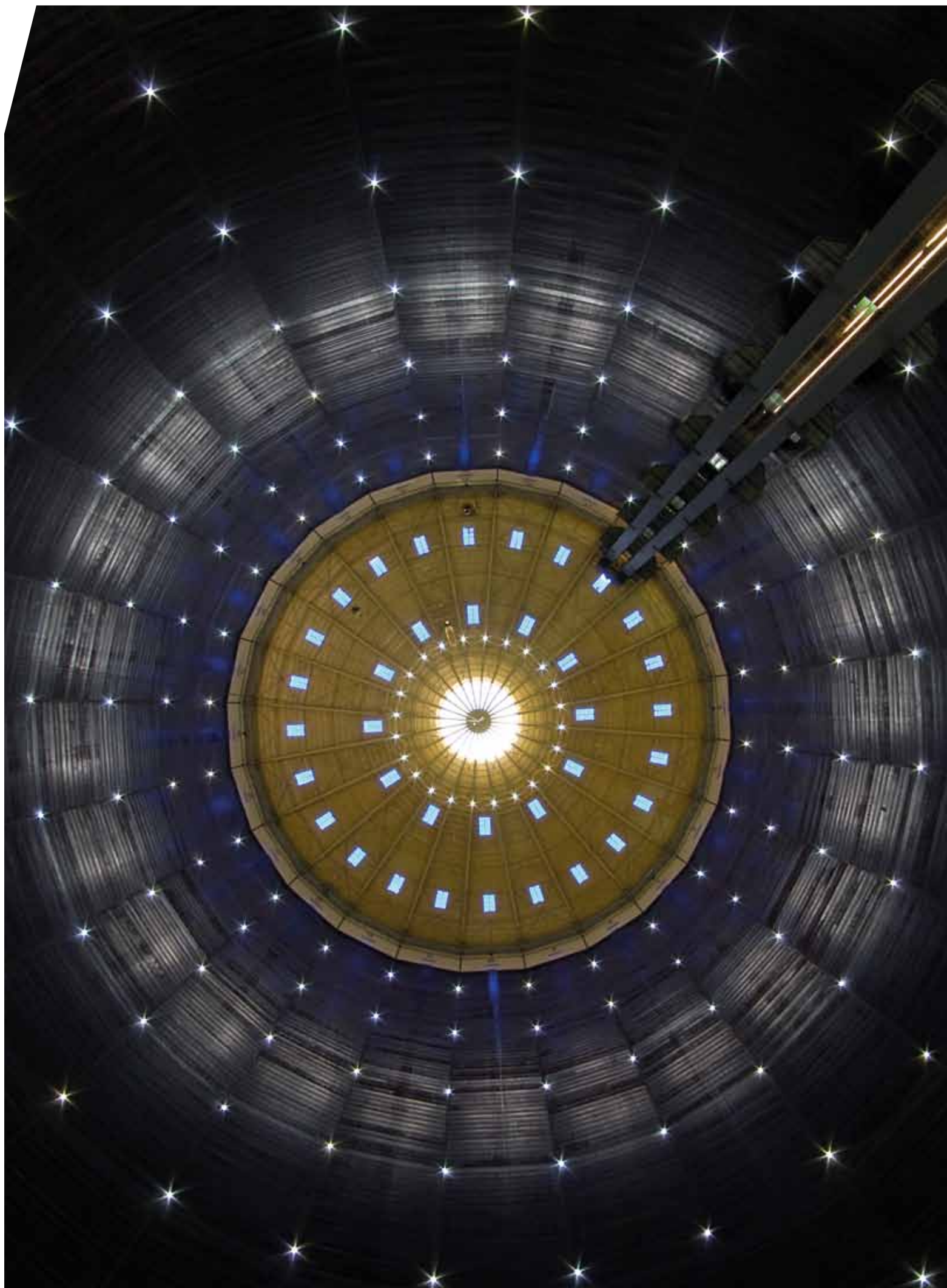


The CMS REMIT healthcheck

Market abuse, reporting and registration
framework for the EU energy market

February 2013

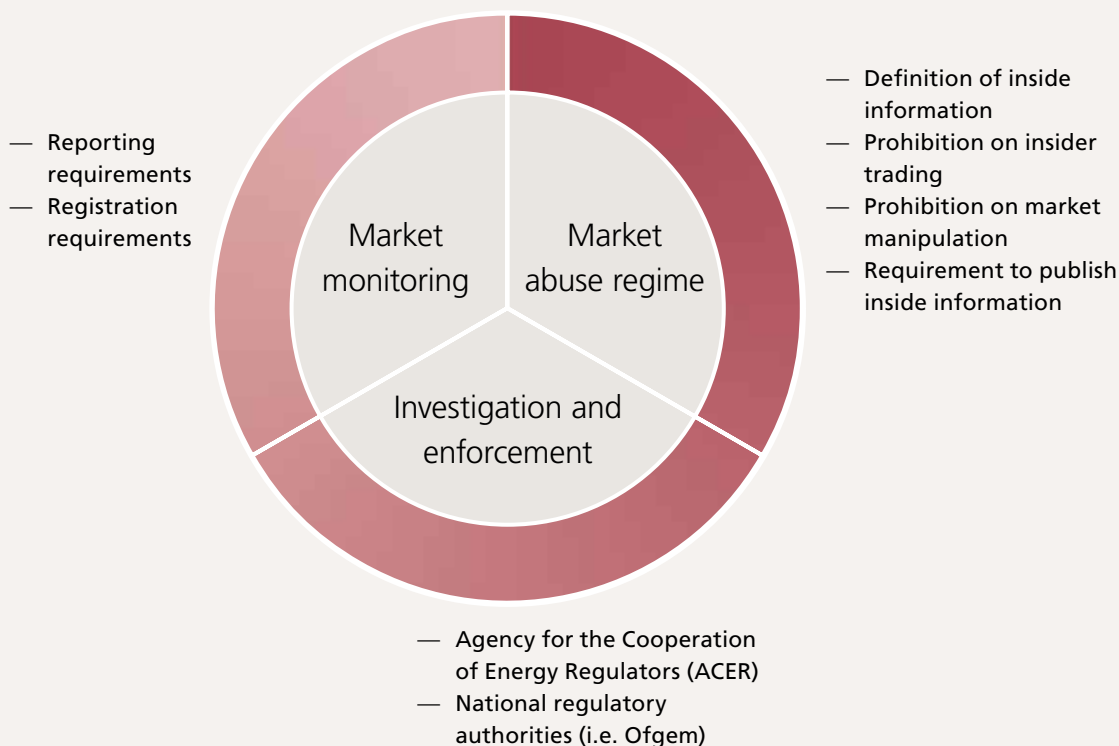


Background

The EU Regulation on Energy Market Integrity and Transparency (Regulation (EU) No. 1227/2011) (REMIT) entered into force on 28 December 2011.

In the face of increased trading and volatility in energy products and a lack of sector-specific legislation to address market integrity issues, REMIT seeks to provide an EU-wide legislative framework to prevent market abuse and increase price transparency in wholesale energy trading, ultimately to protect end consumers.

The three areas of REMIT



Scope

REMIT applies to trading in wholesale energy products, defined as the following contracts and derivatives:

- contracts for the supply of electricity or natural gas where delivery is in the EU
- derivatives relating to electricity or natural gas produced, traded or delivered in the EU
- contracts and derivatives relating to the transportation of electricity or natural gas in the EU.

Contracts for the supply and distribution of electricity or natural gas to final customers with a consumption capacity greater than 600 GWh per year also fall within the scope of REMIT.

All persons who enter into transactions or place orders to trade in the EU wholesale energy markets ('market participants') will be affected by REMIT. This includes transmission system operators, firms involved in commodities and emissions trading and major electricity and gas customers. ACER guidance has confirmed that persons in non-EU and non-EEA countries will also fall within the scope of REMIT if they enter into transactions in any EU wholesale energy markets.

The prohibitions on insider trading and market manipulation in REMIT do **not** apply to those wholesale energy products which are financial instruments covered by the Market Abuse Directive (e.g. financial instruments such as futures and options admitted to trading on a regulated market, or for which a request for admission to trading has been made, irrespective of whether or not the transaction itself takes place on that market).



REMIT provisions in a nutshell

Prohibition of insider trading

REMIT prohibits market participants from using inside information in acquiring or disposing (or trying to acquire or dispose) wholesale energy products to which the information relates; disclosing such information outside the normal course of their employment or duties; or recommending or inducing the acquisition or disposal of wholesale energy products on the basis of inside information. Limited exemptions are available, for example, for transactions entered into to cover unplanned outages.

Obligation to publish inside information

REMIT requires market participants to publicly disclose inside information in respect of business or facilities which they own, control or for which they have operational responsibility, including information on capacity and the planned or unplanned unavailability of facilities. Publication may be delayed if it would prejudice a market participant's legitimate interests, provided that the delay is not likely to mislead the public and the information is kept confidential and not used to make energy trading decisions. The information must however be provided to ACER and the relevant national regulator, with a justification for the delay.

The use of a transparency platform, for example operated by a Transmission System Operator ("TSO") or an energy exchange, is recommended by ACER as the best method of public disclosure. ACER considers that certain inside information should be published by system operators on behalf of market participants, although market participants should ensure they have back-up arrangements for publication.

Inside information

REMIT defines 'inside information' as non-public information of a precise nature relating to a wholesale energy product which, if it were made public, would be likely to significantly affect the price of that product. 'Information' includes various information required to be made public as well as, more generally, any information that a reasonable market participant would be likely to use in its decision to trade in a wholesale energy product.

Information must be crucial enough to have a potential to significantly affect prices, although no actual price effect is required. ACER suggests the following as useful indicators of whether information is likely to have a significant price effect:

- The type of information is the same as information which has previously had a significant effect on prices
- Analysts' research reports, price reporter publications and opinions indicate that the type of information has a significant effect on prices or
- The market participant itself or another reasonable market participant has already treated similar events as inside information.

The REMIT definition of inside information is significantly broader than the equivalent definition in the Market Abuse Directive relating to commodity derivatives. REMIT does however clarify that information regarding a market participant's own trading plans and strategies will not be considered inside information.

Prohibition of market manipulation

REMIT prohibits engaging in, as well as attempting to engage in, market manipulation on wholesale energy markets. The offences are defined as entering into transactions which give or have the intention of giving false or misleading signals as to the supply, demand or price of a product, or which secure or have the intention of securing prices at artificial levels; as well as disseminating false or misleading information through the media. It is a defence to prove that a trade was entered for legitimate reasons and that it conformed to accepted market practices on the wholesale energy market concerned.

ACER has provided examples of the types of practices which could constitute market manipulation and are considered particularly relevant for wholesale energy markets, based on the examples of market abuse practices produced by CESR (the Committee of European Securities Regulators) for the Market Abuse Directive. The examples include wash trades; placing orders with no intention of executing them; cross-market manipulation; and pre-arranged trading.

Obligation to report suspicious transactions

Persons professionally arranging transactions in wholesale energy products, for example exchanges and brokers, must notify the national regulatory authority without delay if they reasonably suspect that a transaction might breach the prohibition on insider trading or market manipulation. They must also establish and maintain effective compliance arrangements in order to identify potential breaches.

Reporting

Market participants will be required to report to ACER details of their transactions and orders in relation to wholesale energy products, including the price, quantity, date and time of trades. Details of the contracts and derivatives to be reported will be specified by the Commission through implementing acts. To assist the Commission, ACER has recommended that the following should be reported:

- Records of transactions and orders to trade in wholesale energy contracts executed or placed at organised market places;
- Confirmations of records of standardised transactions and transactions in standardised wholesale energy contracts (including derivatives);
- Confirmations of records of transactions in non-standardised energy commodity contracts; and
- Scheduling/nomination information.

Double reporting of information already reported under MiFID or EMIR will be avoided.

Registration

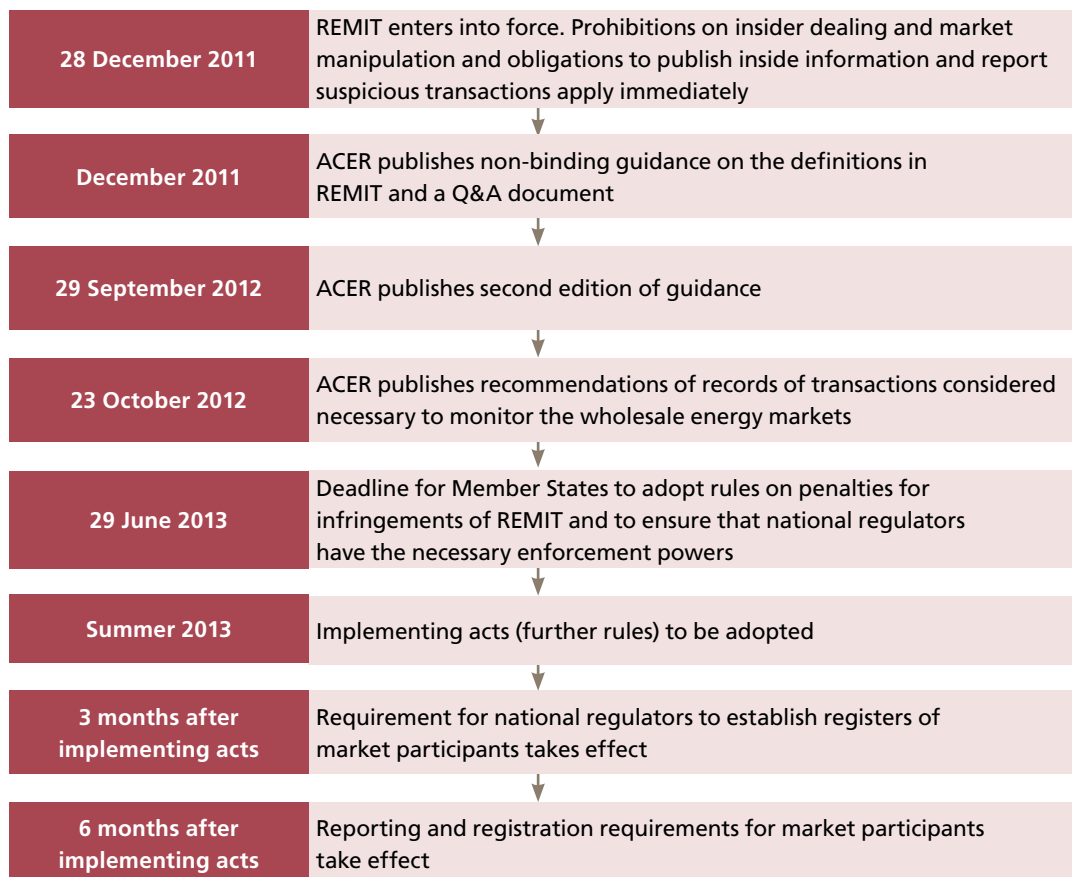
Market participants must register with the national regulatory authority in the Member State in which they are established, resident or active. National regulatory authorities will establish registers of market participants which they will provide to ACER in order for ACER to maintain a European register.



REMIT defines 'inside information' as non-public information of a precise nature relating to a wholesale energy product which, if it were made public, would be likely to significantly affect the price of that product.



Timing



Compliance

Energy market participants such as energy companies, network operators, energy brokers and power station operators should already have determined whether the various areas of their business fall within the scope of REMIT. Suggested steps towards compliance are:

- Determine what information would meet the criteria for ‘inside information’ in the markets you trade in, and whether you could come into possession of such information.
- Establish an internal reporting system for insider information and ensure that you are able to carry out real time or close to real time disclosure of inside information.
- Identify employees who regularly come into contact with inside information (for example, trading staff) and ensure that they receive regular training on market abuse.
- Ensure that you have robust monitoring systems and controls to detect and prevent market abuse. Consider whether new compliance procedures are required, for example firewalls or new disclosure procedures.



How CMS can help – a European solution

In addition to facing new requirements under REMIT, energy market participants should be aware of a number of developments on the EU financial regulatory scene. The European Market Infrastructure Regulation (EMIR) will introduce reporting, central counterparty clearing and risk management measures in relation to OTC derivatives contracts from summer 2013. Legislative proposals for the reforms of MiFID and the Market Abuse Directive are currently being negotiated and their extension in scope could entail significant changes for the regulation and licensing of certain commodities traders to whom the regimes currently do not apply.

With 5,000 people working in 48 cities across 30 countries, CMS has the most extensive European footprint of any law firm. It is therefore ideally placed to deal with the pan-European challenges of financial and energy markets regulation and enforcement.

Our services include

- helping with investigations and enforcement
- market abuse training
- advisory work such as assurance and systems review

Market abuse investigations

We are familiar with the pitfalls which firms face when ‘suspicious transactions’, and other activities, are investigated as potential market abuse. We handle investigations; these may be domestic enquires or those that involve a number of different authorities in more than one country. Some of these involve the mutual assistance procedure.

We help firms familiarise themselves with the different procedures and assist and represent them during the investigatory and potential enforcement process. This includes investigation of individuals, firms and their senior management for failure in their internal compliance processes. We can assist with all aspects – reviewing evidence and advising on the position under the different national prohibitions, assisting in responding to documentary requests and handling interviews. We also prepare formal representations and handle any cases that proceed further to the enforcement stage.

Market abuse and REMIT training

CMS provides training to firms as part of their market abuse and REMIT compliance. We use our internal resources to develop a bespoke training programme that we deliver on site. We often provide multiple sessions, for example, when training an entire trading floor.

Assurance and systems review

We help firms to develop and benchmark their internal compliance procedures, taking account of the differing national regimes. We assist firms to assess and mitigate the risk of market abuse breaches. We provide advice to legal and compliance departments on individual scenarios and transactions that raise market abuse issues. We handle the complex issues that arise in determining the precise scope of the national regimes and what is and is not accepted by the different authorities. We also assist in dealing with the regulatory obligations concerning suspicious transaction reporting, research departments and Chinese wall procedures.

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