

## Wholesale Energy Markets: European Commission Proposes Regulation to Prevent Insider Trading and Market Manipulation

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In December 2010, the European Commission ("the Commission") published a proposal for a *Regulation on Energy "Market Integrity and Transparency"* (the "Draft Regulation": often abbreviated to *REMIT*).<sup>1</sup>

The Draft Regulation aims to prevent traders in wholesale energy markets from using *inside information* in order to benefit from their transactions or to *manipulate the market* by artificially causing prices to be higher than would be justified by the availability, production cost, or capacity to store or transport energy.

In the Commission's view, the way to achieve this goal is: to establish clear prohibitions of illegal behaviour and enforce them; to create a high degree of market transparency; and to give regulators the means to effectively monitor and detect abuses (through data submission to regulators and broad investigatory and decision-making powers).

Clearly this is controversial and is expected to be the subject of much debate in coming months, insofar as this may mean, amongst other things:

- possible "walling off" of traders from other commercial activities;
- considerable disclosure obligations for energy producers and traders, in some cases publicly and in some cases to regulators, at significant cost; and
- uncertainty as to the dividing line between ordinary trading and market manipulation.

The Draft Regulation is now in the legislative process with the European Parliament and the EU Council, with meetings scheduled for the end of this month and in June, after a public consultation last year and previous discussions with interested parties in 2009.

It is important for all those involved in energy production and trading to watch and be involved now, as the Draft text goes into more detailed consideration by the European Parliament and EU Council and as further "*delegated acts*"<sup>2</sup> are contemplated, specifying key definitions and procedures.

The Commission has set a target for the final Regulation to be in force by the end of 2012, which at present appears ambitious.

## Concept

The Draft Regulation is designed to cover a wide range of industry-specific transactions (especially over-the-counter trades ("OTC")), including those that currently escape both EU and national regulation. The Draft Regulation would apply to transactions and conduct which at the moment do not fall within the *EU Market Abuse Directive* ("MAD")<sup>3</sup> or the *Markets in Financial Instruments Directive* ("MiFID")<sup>4</sup>, because they do not qualify as financial instruments admitted to trading on a regulated market or as commodity derivatives.

The underlying idea is that there is a gap in enforcement and monitoring, insofar as financial trading of wholesale energy is regulated by these Directives, but OTC trading is not, even though such trading accounts for the bulk of trading activity. For example, in 2009, 75% of EU electricity transactions were OTC, while only 25% were *via* power exchanges. The Commission argues therefore that *both types* of energy trading have to be covered to provide for effective regulation against market abuse.

The Commission also notes that energy trading is increasing and is often cross-border, with trading often through intermediaries who are based outside the country concerned. The effects of trading in one country can also quickly affect trading in others.

The Commission is not saying that there is already evidence of unlawful practices of this type in the EU (although there is reference to one EU Competition law case concerning alleged practices on *the German Electricity Wholesale Market and the German Electricity Balancing Market*<sup>5</sup>). The Commission's approach appears rather to be that there is a need for such regulation for the reasons explained. It also refers to an American case called *Amaranth Advisors LLC*, concerning a hedge fund which accumulated massive natural gas holdings in derivatives between 2006 and 2010, pushing up prices, and then sold at huge profit.<sup>6</sup>

## Main Provisions

### Scope

The Draft Regulation focuses on *abusive practices on wholesale energy markets*, including transportation, coherent with the rules applicable to financial markets. It covers contracts for physical delivery of electricity and natural gas, as well as *derivatives trading*. Accordingly, it would affect a wide range of companies active in the wholesale energy markets, including *energy producers, large energy users, traders, investment banks and funds selling and buying gas and electricity*.

The Draft Regulation would prohibit *insider trading and market manipulation*, including any attempt

to manipulate the market.

It also provides for the *monitoring* of wholesale energy markets. ([Art.1](#))

The Draft Regulation is expressly "without prejudice" to application of MAD or MiFID or European Competition law to the practices concerned.

### *Insider Trading*

The Draft Regulation would prohibit the use of "*inside information*" when buying or selling at wholesale energy markets ([Art. 3](#)). The Draft Regulation would also prohibit recommending or inducing another person, on the basis of inside information, to acquire or dispose of wholesale energy products to which that information relates.

"Inside information" means precise information, which has not been made public, relating directly or indirectly to one or more wholesale energy products and which, if it were made public, could significantly affect the prices of such wholesale energy products.

Such information is said to include information related to the capacity of facilities for production, storage, consumption or transmission of electricity or natural gas, as well as information required to be disclosed in accordance with legal or regulatory provisions. ([Art.2\(1\)](#))

The European Commission is authorised to specify more precisely what constitutes inside information and which wholesale energy products and markets fall within the scope of the Regulation through "delegated acts" ([Art. 5\(1\)](#)). It must take into account "the specific functioning of wholesale energy markets and the interaction between commodity markets and derivative markets." ([Art. 5\(2\)\(a\)](#)).

The insider trading provisions apply to the following persons who possess inside information in relation to a wholesale energy product:

- members of the administrative, management or supervisory bodies of an undertaking;
- persons with holdings in the capital of an undertaking;
- persons having access to the information through the exercise of their employment, profession or duties;
- persons who acquired such information through criminal activity; and
- persons who know, or ought to know, that it is inside information ([Art.3\(2\)](#)).

Importantly, the provisions on insider trading in the Draft Regulation are directed at both companies *and the individuals* involved ([Art. 3\(3\)](#)).

Market participants would be required to publicly disclose inside information in respect of businesses or facilities which the participant concerned owns or controls or for which the participant

is responsible for operational matters, either in whole or in part. Such information would include information relevant to the capacity of facilities for production, storage, consumption or transmission of electricity or natural gas ([Art.3 \(4\)](#)). Market participants would be required to disclose exclusive and price-sensitive information which they have before trades take place.

### *Market Manipulation*

The Draft Regulation would prohibit market manipulation, or attempts at such manipulation, on wholesale energy markets ([Art.4](#)). More specifically, the Draft Regulation would prohibit the entering into of transactions or issuing of orders to trade in wholesale energy products, which:

- give, or are likely to give, false or misleading signals as to the supply of, demand for or price of wholesale energy products;
- secure or attempt to secure the price of wholesale energy products at an abnormal or artificial level; *unless a person who entered into the transactions or issued the orders to trade establishes that the reasons for doing so were legitimate and that the transactions conform to accepted market practices on the wholesale energy market concerned*; or
- employ or attempt to employ fictitious devices or any other form of deception or contrivance ([Art. 2.2\(a\)](#)).

The Draft Regulation also would prohibit the dissemination of information which gives, or is likely to give, false or misleading signals as to wholesale energy products, including the dissemination of rumours and false or misleading news, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading ([Art. 2.2\(b\)](#)). Again, the European Commission can specify the definitions of market manipulation and the products and markets to which the Regulation applies through "delegated acts" ([Art. 5\(1\)](#)).

### *Monitoring and Data Provision*

The recently established Agency *for the Cooperation of Energy Regulators* (ACER) is to be responsible for monitoring trading activity in wholesale energy markets in order to detect and prevent the market abuses described. (There is discussion of some 15 staff in ACER, apart from external expertise setting up the database.) However, it is clearly envisaged that ACER will work closely with national regulatory authorities ([Art. 6](#)).

The Draft Regulation foresees that ACER *"shall be provided" with a record of wholesale energy transactions, including orders to trade for market monitoring purposes* ([Art. 7](#)). The Commission is to adopt "delegated acts" laying down the timing, form and content of the data collection.

Market participants, organized markets, trade-matching and trade reporting systems, trade repositories and competent authorities would be required to provide data regarding their trades, including prices, gas and electricity volumes sold and parties involved in wholesale energy markets.

Market participants would also be required to provide ACER and national regulatory authorities with information related to the capacity of facilities for production, storage, consumption or transmission of electricity or natural gas.

The Draft Regulation also sets up a framework to share such data between competent EU and national authorities ([Art. 8](#)). This would include not only national energy regulators, but also the competent financial agencies, competition authorities and other relevant authorities.

The Draft Regulation also lays down rules for data protection, operational reliability and professional secrecy ([Arts. 9 and 12](#)).

### *Enforcement*

According to the Draft Regulation, ACER will ensure that the rules are coherently enforced across the European Union. National regulators are expected to take the lead in enforcement and investigations of abuse ([Art. 10](#)). In cross-border cases, the Draft Regulation foresees the establishment of an 'investigatory group' made up of representatives of the concerned agencies and coordinated by ACER ([Art. 11](#)).

Member States are required to grant national regulators the necessary investigatory powers to carry out enforcement, including the right: to have access to any relevant document and to receive a copy of it; to demand information from any person; to carry out on-site inspections; to require telephone and data traffic records; to request a court to freeze or sequester assets; and to request temporary prohibition of professional activity ([Art.10](#)).

Member States are also to lay down rules on penalties, which are to be "effective, proportionate and dissuasive" ([Art. 13](#)).

### **Some Issues Being Debated**

- Whether electricity and gas should be singled out for sectoral regulation like this, when trading "abuses" can occur with all sorts of products.
- Whether electricity and gas should be treated in the same way, when they are very different: electricity being sold as it is made, whereas gas may be stored and supplied in various ways over time.
- Consistency with *MAD* and *MiFID* (both of which are currently under review) and other EU Energy legislation.
- What more will be required by *REMIT*, given that energy producers, which are generally listed companies, already have stock exchange disclosure requirements?
- Will more be caught by *REMIT* than is already subject to abuse of dominance control under Article 102 of the EU Treaty on the Functioning of the European Union ("TFEU")?
- Whether producers should have to reveal all these facts about their property and ordinary commercial decisions? Does that not go too far?

- What about other non-European energy companies supplying the EU?

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<sup>1</sup>See *EU Commission Press Release IP/10/1676 and MEMO/10/655, 8 December 2010 at* [europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1676&format=HTML&aged=0&language=EN&guiLanguage=en](http://europa.eu/rapid/pressReleasesAction.do?reference=IP/10/1676&format=HTML&aged=0&language=EN&guiLanguage=en). The Commission's draft is available at [ec.europa.eu/energy/gas\\_electricity/markets/doc/com\\_2010\\_0726\\_en.pdf](http://ec.europa.eu/energy/gas_electricity/markets/doc/com_2010_0726_en.pdf).

<sup>2</sup> These acts are to be adopted under the new procedure of the Lisbon Treaty (Art. 290 of the Treaty on the Functioning of the European Union, "TFEU"), whereby the Commission adopts a delegated act and then the European Parliament and the EU Council have two months in which to object from the date when they are notified of the act.

<sup>3</sup>*Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)*, EU Official Journal ("OJ") L 96, 12 April 2003, p.16.

<sup>4</sup>*Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC*, EU OJ L 145, 30 April 2004, p.1.

<sup>5</sup> Commission Decision of 28 November 2008, E.ON, COMP/39.388 and 39.389, available at [ec.europa.eu/competition/antitrust/cases/dec\\_docs/39389/39389\\_2761\\_1.pdf](http://ec.europa.eu/competition/antitrust/cases/dec_docs/39389/39389_2761_1.pdf).

<sup>6</sup> See summary in the Commission Staff Working Document, Impact Assessment on the Draft Regulation, pp.14-17 available at [ec.europa.eu/energy/gas\\_electricity/markets/doc/com\\_2010\\_0726-ia.pdf](http://ec.europa.eu/energy/gas_electricity/markets/doc/com_2010_0726-ia.pdf).

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