

# Commodity derivatives: new scenarios for the energy markets in the light of recent developments of the European regulation

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## 1. The European regulatory framework

The actions recently undertaken by the European Union seeking to implement the functioning and transparency of commodity derivatives trading systems (both as regulatory markets and alternative trading systems), have recently been reflected in a series of regulatory proposition likely to strongly affect the current configuration of energy markets.

In general terms, the above mentioned actions provide the basis for an integration process between the financial and commodity derivatives markets (where the presence of financial investors keeps increasing) and pursue the realization of a more balanced relationship between the regulatory markets and the alternative trading systems' regulations, with the ultimate purpose of reducing the volatility and the growth of the commodities' prices (including, primarily, oil).

Underneath this reform process is the awareness that an improvement in the stability, integrity and in the controlling activity on the wholesale energy markets may lead to a concrete benefit for end-users - both individuals and companies - in terms of access costs to the energy market. The pursuit of this goal, however, is not possible without an evaluation of risks connected to the rise of administrative and compliance costs on energy/commodity derivatives traders, likely to be reflected in the short term on the same end-users that it is aimed to protect.

In this paragraph we will briefly refer to the main regulatory propositions under discussion in the European Union; while in the second part attention will be drawn on the European Parliament and European Council Regulation approved on October 10, 2011 regarding the integrity and transparency of the wholesale energy market ("Regulation on wholesale Energy market integrity and transparency - **REMIT**"), focusing in particular on impacts on the Italian legal framework.

**Revision of the MiFID Directive and MiFIR Regulation draft:** the MiFID Directive revision draft preliminarily provides a specific regulation for the commodity derivatives also carrying a broader definition of the derivatives financial instruments on commodities (also including forwards on commodities either physically-settled and traded over the counter and emission quotes). The proposed draft also refers to subjects authorised to trade on commodity derivatives, allowing specialised operators to continue to operate, even if not qualified as investment firms, provided that such activity is ancillary to the core business. The same draft provides for the adoption of a regulation ("**MiFIR Regulation**") which provides the basis for the creation of a new trading platform ("organized trading facilities") of derivatives characterized by high levels of liquidity. The proposed draft has been presented by the Commission on October 20, 2011 and is currently under the review of the European Parliament and the European Council

**EMIR Regulation draft:** this regulation is aimed at improving organization, transparency (pre and post trading) and supervision in those market segments where the financial instruments – in particular commodity derivatives – are mainly traded over the counter. The primary goal is to lead all derivatives trading in regulated systems (multilateral trading facilities or organized trading systems) with rules of conduct and compensatory obligations allowing to reduce the market systemic risk connected with such transactions. The draft is currently before the European Parliament and the publication of its final version is scheduled for the end of 2012.

**MAR Regulation draft:** in the light of the proposed amendments to the MiFID Directive and in the view of the adoption of regulations mentioned above, a further intervention of the European Union concerning the market abuse and the use of inside information regulations has become necessary. The pursued goal is to extend the guidelines of such regulations to the trading of commodity derivatives conducted over the counter, through organised trading facilities or other trading systems. The draft was submitted by the European Commission on October 20, 2011, and is currently under the review of the European Parliament and the European Council.

## 2. The REMIT Regulation and its application in Italy

The prevention of market abuses in the energy market has been the core of a legislative process already closed that brought to the adoption of the REMIT which specifically deals with abuses influencing the wholesale energy markets. Provided the specific characteristics of such markets, the REMIT is aimed at extending to such a sector the same inside information and market manipulation rules already applicable to financial markets.

More specifically, the REMIT regulation applies to contracts and derivatives related to the supply, production and transportation of natural gas or electricity in the European Union, although with some limits for the wholesale energy products classified as financial instruments (applying in this case the Directive 2003/6/CE).

In other words – and with respect to commodity derivatives – it is possible to see how the REMIT completes the regulatory framework described in the previous paragraph (although with the need of a better coordination between the various regulatory measures) extending the market abuses applicable regulation to all derivative contracts on electricity or natural gas products (commercialized or delivered in the European Union) as well as to derivatives on the transportation of electricity or natural gas in the European Union not included in the definition of financial instruments.

With reference to specific provisions, the REMIT intervenes in two ways: on the one hand by prohibiting market abuses in the form of "inside information abuses and insider trading" and "market manipulation"<sup>1</sup>, on the other hand by requiring market operators to disclose the so-called inside information. Finally, the REMIT introduces a monitoring system for the energy products trading activity by granting an agency ("Agency for the cooperation between the energy national regulators - ACER") with the task of opposing eventual abuses. In order to clarify the scope of certain REMIT provisions, on December 20, 2011, ACER has published specific guidelines<sup>2</sup>.

REMIT Regulation, directly applicable in the Member States and already effective in the part related to the prohibition of market abuses<sup>3</sup>, requires the adoption of certain executive acts to be issued over a period of up to 18 months; at the end of this period the full ACER effectiveness will be guaranteed, in particular with reference to the processes of monitoring and the data collection by operators.

<sup>1</sup> Pursuant to REMIT Regulation "inside information" means information of a precise nature which has not been made public, relates directly or indirectly to one or more wholesale energy products and which, if it were made public, would be likely to significantly affect the prices of such wholesale energy products; while "market manipulation" means: (a) entering into transactions or the issuing of orders to trade in wholesale energy products which: (i) give, or are likely to give, false or misleading signals as to the supply of, demand for or price of wholesale energy products; (ii) secure or attempt to secure, by a person or by persons acting in collaboration, the price of one or several wholesale energy products at an artificial level, unless the person who entered into the transactions or issued the orders to trade establishes that his reasons for doing so are legitimate and that these transactions or orders to trade conform to accepted market practices on the wholesale energy market concerned; or (iii) employ or attempt to employ fictitious devices or any other form of deception or contrivance which give or are likely to give, false or misleading signals regarding the supply of, demand for, or price of, wholesale energy products; or (b) dissemination of 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, 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.

<sup>2</sup> These guidelines are available at the following website: [http://www.acer.europa.eu/portal/page/portal/ACER\\_HOME/Activities/REMIT](http://www.acer.europa.eu/portal/page/portal/ACER_HOME/Activities/REMIT).

<sup>3</sup> In particular, the Regulation was published on December 8, 2011 and entered into force on December 28, 2011.

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Considering the REMIT Regulation in the light of the legal and regulatory Italian framework it is possible to see how a set of informative obligations introduced by the regulation were already provided (and subject to disclosure to the market) pursuant to the integrated text of monitoring of the wholesale electricity market and dispatching services market ("TIMM"), published on August 5, 2008 by the Electricity and Gas Authority ("AEEG") and subsequently integrated.

With the entry into force of the REMIT, in the light of the new provisions, a reassessment of the informative obligations on operators is needed and, in particular, an extension of the same to the gas market (out of the scope of the TIMM provisions). It will also be necessary a coordination activity between the AEEG and the ACER, which will be required to establish a cooperation with local and European financial markets supervisory authorities.

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