EXPLANATORY MEMORANDUM TO

THE ELECTRICITY AND GAS (MARKET INTEGRITY AND TRANSPARENCY) (ENFORCEMENT ETC.) REGULATIONS 2013

2013 No. 1389

1. This Explanatory Memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 The purpose of this instrument is to establish an investigatory, enforcement and penalty regime for breaches of the EU Regulation on wholesale energy market integrity and transparency (REMIT).

3. Matters of special interest to the JCSI

None.

4. Legislative Context

4.1 This instrument puts in place an investigatory, enforcement and penalty regime for breaches of REMIT. REMIT requires the publication of inside information and prohibits insider trading and market manipulation in wholesale gas and electricity markets. It requires member States to put in place rules on penalties for breaches of REMIT and to ensure that national regulatory authorities (in the case of GB, Ofgem) have powers to investigate and enforce breaches.

4.2 REMIT places an obligation on the Agency for the Cooperation of Energy Regulators (ACER) to monitor wholesale energy trades across the EU. It provides for the registration of market participants with a national regulatory authority and for the reporting of transactions to ACER. Registration and transaction reporting will only apply once the European Commission has made implementing acts. Enforcement of those requirements will be provided for in a further instrument.

4.3 An Explanatory Memorandum on Council doc no. 17825/10 “Proposal for a Regulation of the European Parliament and of the Council on energy market integrity and transparency” was submitted by the Department of Energy and Climate Change (DECC) on 7 January 2011. The Lords Select Committee cleared it on 3 March 2011 (Sift 1413, Session 10/11). The Commons European Scrutiny Committee considered it politically important but not legally important and cleared it on the 8 June 2011 (Report 33, Session 10/11).

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 REMIT prohibits abusive practices affecting wholesale gas and electricity markets, which are analogous to the prohibitions in EU financial regulations. This is the first time that insider dealing and market manipulation prohibitions have been applied to energy wholesale trades at EU level and this is required because energy markets are becoming increasingly interlinked across the EU.

7.3 The investigatory, enforcement and penalty regime for wholesale energy markets provided for in this instrument aligns, as much as possible, with the existing regime for financial markets, including the power to impose unlimited fines. (The regime for financial markets is mostly within the Financial Services and Markets Act 2000 (FSMA).) It is important to have consistent regimes because energy markets include both commodity and derivative markets and price formation in both sectors is interlinked. Only a civil enforcement regime has been implemented by this instrument. The UK is considering criminal sanctions and will take a decision in due course.

Summary of Regulations

7.4 Investigatory Powers for Ofgem

As required by REMIT, the Regulations allow Ofgem to commence an investigation if there are circumstances suggesting that there has been a breach of article 3, 4, 5 or 15 of REMIT. These articles set out the prohibition on insider trading, obligation to publish inside information, prohibition of market manipulation and obligations of persons professionally arranging transactions. To facilitate the investigation, Ofgem will be able to require any relevant information or documents; appoint or require that a skilled person be appointed to aid with an investigation; carry out onsite inspections. To ensure that relevant information is available to Ofgem when carrying out an investigation, these Regulations also require market participants to record and retain relevant telephone conversations and electronic communications.

7.5 Monitoring

In addition to its investigatory role Ofgem will be able to require information from market participants for the purpose of monitoring the integrity and transparency of the market. It is hoped that this will facilitate better regulatory practices, foster cooperation between Ofgem and market participants and avoid the cost of a full scale investigation.

7.6 Enforcement

The enforcement provisions in the Regulations are split into two: injunctions and restitution.

As required by REMIT, the Regulations furnish Ofgem with the power to apply to seek an order from a court requiring the cessation of any practice that is contrary to REMIT, preventing a person from disposing of assets, or temporarily suspending professional activity.

7.7 Penalties

The Regulations allow Ofgem to impose, and determine the amount of, a financial penalty, if it finds a breach of the REMIT prohibitions. Ofgem may, alternatively, publish a statement to the effect that a person has failed to comply with a REMIT requirement. In order to provide clarity on the penalties that will apply to breaches of REMIT, the Regulations require Ofgem to consult on and issue a statement of its policy on the imposition of financial penalties and on certain procedural matters relating to the use of its enforcement powers under REMIT. Ofgem intends to carry out this consultation once the draft Regulations are laid to enable publication of its penalties policy as soon as practicable after the Regulations come into force. The Regulations provide for a transitory penalty policy until Ofgem's policy under these Regulations is published.

7.8 Appeals

The Regulations provide for an appeal process against decisions made by Ofgem. Those subject to an Ofgem penalty or restitution decision will be able to appeal by application to the Upper Tribunal. Prospective appellants against an Ofgem penalty decision will have a full merits appeal; mirroring recent amendments to FSMA, appeals against restitution decisions will only cover issues of fact, law and procedure (not matters of judgement).

8. Consultation outcome

8.1 As REMIT is a directly applicable EU Regulation, the only implementing action required is to ensure that the regulatory authorities have the investigatory, enforcement and penalty powers necessary to tackle market abuse, and these are framed in REMIT. As this leaves little scope for discretion, it was decided that no consultation was required. However, there was regular contact with stakeholders and they were given an opportunity to comment on a draft of the Regulations at a stakeholder briefing event held in March 2013.

9. Guidance

9.1 The Regulations require Ofgem to consult on and issue a statement of its policy on the imposition of financial penalties and on certain procedural matters relating to the use of its enforcement powers under REMIT. Ofgem intends to carry out this consultation once the draft Regulations are laid to enable publication of its penalties policy as soon as practicable after the Regulations come into force.

10. Impact

10.1 The impact on business, charities or voluntary bodies is largely on energy market players.

10.2 The impact on the public sector is largely on Ofgem.

10.3 Ofgem intends to take a filtering approach similar to that used by the Financial Services Authority (now Financial Conduct Authority), so that only a limited number of reported breaches will result in a full investigation. It is not anticipated that the number of full investigations conducted under REMIT will exceed one per year. If there is full compliance with REMIT by industry, and no suspected breaches of the Regulation, investigatory costs will, of course, not arise.

10.4 An impact assessment was not prepared for this instrument as it was considered to be a low cost measure.

11. Regulating small business

11.1 The legislation applies to small business. The instrument applies to all businesses which trade in wholesale energy markets. The nature of wholesale energy markets means that market manipulation can be carried out by any business, both small and large. Its effect can be significant regardless of the size of the business and so it is necessary for the Regulations to apply to all wholesale energy market participants. Ofgem's regulatory regime will, however, take into consideration the principle of proportionality

11.2 To minimise the impact of the requirements on small firms employing up to 20 people, Ofgem will take a proportionate approach. This will be addressed in Ofgem's statement of policy.

12. Monitoring & review

12.1 The Secretary of State for Energy and Climate Change will conduct a review of this legislation. The conclusions of the review will be set out in a report assessing the extent to which the objectives of the regulation have been achieved and whether those objectives remain appropriate. The first report will be published within 5 years from the date the instrument enters into force.

13. Contact

Pamela Lathbridge at the Department of Energy and Climate Change Tel: 0300 068 5308 or email: Pamela.Lathbridge@decc.gsi.gov.uk can answer any queries regarding the instrument.