

Reporting Virtual PPA contracts under EMIR

Introduction

As it was already said – rising interest in procuring energy from renewable sources, brought about numerous publications on corporate power purchase agreements (Corporate PPAs), describing in a more or less general way their two principal types: Physical PPAs and Virtual PPAs. With regard to the latter, many publications mention that they constitute financial derivative or - even more precisely - contract for difference. Unfortunately, even if they indicate related regulations, like MiFID¹ or EMIR², they let it go with that. Taking into consideration the complexity of those regulations and obligations arising from them, the promotion of Virtual PPAs should be done along with a presentation of the legal background of those contracts. The objective of this article is to present basic information on reporting obligation, to which Virtual PPAs are subject to, pursuant to EMIR. The article approaches such aspects of said obligation as identification of Virtual PPAs within MiFID and EMIR classification, establishing a party responsible for reporting concluded Virtual PPA contract or sanctions for non-compliance.

Qualification of the Virtual PPA contracts

In the first place, it should be noted that Virtual PPAs, as contracts for difference, are considered generally as “financial instruments” within the meaning of art. 4(1)(15) of MiFID and more precisely as “derivatives” or “derivative contracts” as defined in art. 2 (5) of EMIR. However, the exact qualification (under MiFID) is a little bit problematic.

Currently, Virtual PPAs may be seen as:

- *Financial contracts for differences* - from Section C(9) of Annex I to MiFID or
- *Options, futures, swaps, forwards and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties other than by reason of default or other termination event* - from Section C(5) of Annex I to MiFID.

This qualification is important for two reasons. First, the requirement of obtaining relevant authorization to provide investment services and/or to perform investment activities arising from art. 5(1) of MiFID, which applies to offering and concluding Virtual PPAs. Second, the possibility to benefit from adequate exemptions set out in art. 2(1) of MiFID by developers (project owners/ electricity generators) marketing this type of Corporate PPAs.

¹ Directive 2014/65/EU of The European Parliament And Of The Council of 15 May 2014 *on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU* (MiFID)

² Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 *on OTC derivatives, central counterparties and trade repositories* (EMIR)

The complexity of the classification of Virtual PPAs according to MiFID taxonomy and its explanation seems to exceed the frames of this article. Detailed reasoning and the author's position on the subject was presented in the article "Virtual PPA contracts - qualification under MIFID and its consequences"³.

For the purposes of this article, it may be stated generally that there are motives to qualify Virtual PPAs "directly" as CfDs indicated in Section C(9) of Annex I to MiFID and, thus, "financial instruments other than commodity derivatives" referred to in art. 2(1)(d) of MiFID, which is a legal basis for a so-called "dealing on own account exemption".

When it comes to EMIR itself, Virtual PPA contracts, as CfDs from Section C(9) of Annex I to MiFID, constitute "derivatives" or "derivative contracts" referred to art. 2(5) of EMIR, according to which *'derivative' or 'derivative contract' means a financial instrument as set out in points (4) to (10) of Section C of Annex I to Directive 2004/39/EC as implemented by Article 38 and 39 of Regulation (EC) No 1287/2006.*

Legal basis of the reporting obligation

The legal basis of reporting Virtual PPA contracts lies in art. 9(1) of EMIR stating that *Counterparties and CCPs shall ensure that the details of any derivative contract they have concluded and of any modification or termination of the contract are reported in accordance with paragraphs 1a to 1f of this Article to a trade repository registered in accordance with Article 55 or recognised in accordance with Article 77. The details shall be reported no later than the working day following the conclusion, modification or termination of the contract.* Given the wording of the above-quoted provision, it seems necessary to explain a few questions.

First of all it should be indicated that according to art. 9(1) of EMIR reporting obligation is imposed on "counterparties", without any further distinguishing or providing additional conditions. It means that the said obligation concerns both types of counterparties referred to in EMIR - "financial counterparties" and "non-financial counterparties".

Based on art. 2(2) of EMIR it can be said that "financial counterparties" are those counterparties, that are subject to and obtained relevant authorisations for carrying defined business activities in accordance with directives and regulations enumerated therein. According to art. 2(9) of EMIR "Non-financial counterparties" are entities, which don't fall into the scope of the definitions of "financial counterparty" or "CCP".

As art. 2(1) provides "CCP" *means a legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer.* Such wording makes rather clear that neither developers (project owners; electricity generators), nor off-takers fall under this definition.

³ Available: <https://www.cire.pl/item,193638,2,0,0,0,0,virtual-ppa-contracts---qualification-under-mifid-and-its-consequences.html>

Assuming that developers (project owners; electricity generators), in most cases, benefit from relevant exemption set out in MIFID, they will be considered as “non-financial counterparties” under EMIR.

Party obliged to report the conclusion of Virtual PPA

As it was mentioned earlier, art. 9(1) of EMIR imposes reporting obligation on “counterparties”, without additional clarifications. In consequence, both financial and non-financial counterparties fall under said obligation. Such interpretation finds justification also in the third sentence of recital (37) of EMIR, which provides that (...) ***a retrospective reporting obligation is needed, to the largest possible extent, for both financial counterparties and non-financial counterparties, in order to provide comparative data, including to ESMA and the relevant competent authorities*** [emphasis added].

With regard to non-financial counterparties, it is worth noting that reporting obligation applies to them regardless of being under or above the clearing threshold set out in art. 11 of EMIR Supplementing Regulation No 149/2013⁴. Here, it can be also mentioned that for OTC commodity derivative contracts and other OTC derivative contracts (not provided in other points of this provision) clearing threshold is established at the amount of *EUR 3 billion in gross notional value*.

However, the recent amendment of EMIR, introduced by EMIR Refit⁵, brought some facilitation in that matter for non-financial counterparties not exceeding clearing threshold. According to newly added paragraph 1a in art. 9 of EMIR *Financial counterparties shall be solely responsible, and legally liable, for reporting on behalf of both counterparties, the details of OTC derivative contracts concluded with a non-financial counterparty that does not meet the conditions referred to in the second subparagraph of Article 10(1), as well as for ensuring the correctness of the details reported*. In other words, in case of transactions between financial and non-financial counterparty, which is under the clearing threshold, reporting obligation lies only with the financial counterparty.

Another facilitation, that might be quite important for small non-financial counterparties, is a possibility to entrust EMIR reporting to another entity(-ies) (based on art. 9(1f) of EMIR). Good explanation in that matter provides M. Głowacki, who presents the following practical configurations concerning reporting:

- 1) one counterparty delegates on the other counterparty;
- 2) one counterparty delegates on a third party;

⁴ Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 *supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP*

⁵ Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 *amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories*

- 3) both counterparties delegate on a single third party;
- 4) both counterparties delegate on two different third parties⁶.

Nevertheless, parties entering into Virtual PPA contract and having to report it should keep in mind that according to ESMA *The delegation of reporting however does not transfer the allocation of responsibility which ultimately lies with the counterparty having the reporting obligation or entity responsible for reporting on behalf of the counterparty*⁷.

The entity to which Virtual PPA contracts should be reported

Pursuant to art. 9(1) of EMIR OTC derivatives are to be reported to registered or recognised “trade repository”. Within the meaning of EMIR “trade repositories” are entities, the objective of which is to collect and maintain information on derivatives for regulatory purposes (see: recital (74) and art. 2(2) of EMIR).

Since EMIR doesn’t contain any further conditions or provisions concerning the competence trade repositories, it can be said that counterparties and CCPs have free choice in that matter. Such conclusion may be also drawn from ESMA’s explanation that *Under Article 9 of EMIR, both the counterparties and the CCP have an obligation to ensure that the report is made without duplication, but neither the CCP nor the counterparties have the right to impose on the other party a particular reporting mechanism. However, when offering a reporting service, the CCP can choose the TR to be used and leave the choice to the counterparty on whether to accept or not the service for its trade to be reported by the CCP on its behalf* [emphasis added]⁸.

On its sites⁹ ESMA provides a list of trade repositories registered in accordance with EMIR.

In Poland entity being registered trade repository is The Central Securities Depository of Poland (Krajowy Depozyt Papierów Wartościowych – KDPW)¹⁰.

Basic information on reporting to KDPW

The principal condition of reporting to KDPW is being a repository participant. To acquire this status, counterparty shall submit an application¹¹ and, if the application is approved, sign a repository participation agreement¹².

⁶ Reporting obligation under EMIR - <https://www.emissions-euets.com/emirreporting>

⁷ See: “Consultation Paper. Technical standards on reporting, data quality, data access and registration of Trade Repositories under EMIR REFIT” – p. 17; available:

https://www.esma.europa.eu/sites/default/files/library/esma74-362-47_cp_on_the_ts_on_reporting_data_quality_data_access_and_registration_of_trs_under_emir_refit.pdf

⁸ See: TR Answer 7 [in:] “Questions and Answers. Implementation of the Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)” – p. 83; available:

https://www.esma.europa.eu/sites/default/files/library/esma70-1861941480-52_qa_on_emir_implementation.pdf

⁹ Link: <https://www.esma.europa.eu/supervision/trade-repositories>

¹⁰ Link: <https://www.kdpw.pl/en/Trade%20Repository%20EMIR/Pages/default.aspx>

There are four types of participation, which differ from each other in possibility of reporting and/or doing it on behalf of other counterparty¹³. Given the above-mentioned configurations concerning reporting, it seems that party to a Virtual PPA contract may be:

- so-called “individual repository participant (IUR) – who reports only on its own behalf or
- so-called “ordinary repository participant” (ZUR) – who reports on its own behalf or on behalf of a counterparty being the other party to that participant’s own trade¹⁴.

Participation fees for these types of repository participation are as follows:

- PLN 3,600 (c.a. EUR 840) – for individual repository participants;
- PLN 8,000 (c.a. EUR 1,870) – for ordinary repository participants.

When it comes to communication, KDPW provides special web application - KDPW Trade Repository (EMIR) and two channels with the use of which counterparties may report their derivative contracts:

- U2A (User to Application) - which is *a graphical user interface supporting manual exchange of data with a KDPW application*
- A2A (Application to Application) - which is *an interface supporting automated exchange of data between a KDPW application and a participant’s application*¹⁵.

According to KDPW’s explanations given in FAQ¹⁶, the former interface is better for the entities with small quantities of transactions to report, while the latter is dedicated to entities with higher volume of transactions.

Timing

According to the last sentence in art. 9(1) of EMIR *The details shall be reported no later than the working day following the conclusion, modification or termination of the contract.* In consequence, parties entering into Virtual PPA contract are to report it within one day, i.e. on the day following the transaction day at the latest.

Scope and format of information to be reported and LEI codes

Scope of information to be reported, their detailed content, brief description and structure is set out in so-called regulatory technical standards (RTS), i.e. Commission Delegated Regulation (EU) No 148/2013 of 19 December 2012 supplementing Regulation (EU) No

¹¹ §3.1 of Derivatives Trade Repository Rules; available:

http://www.kdpw.pl/en/rules/Documents/2020/KDPW_TR_Rules_01042020.pdf

¹² §6.1 of Derivatives Trade Repository Rules

¹³ §3.2. of Derivatives Trade Repository Rules

¹⁴ §3.2. of Derivatives Trade Repository Rules

¹⁵ §3.1 of Rules of Access to the IT Systems of Krajowy Depozyt Papierów Wartościowych

¹⁶ Link: https://www.kdpw.pl/en/Trade%20Repository%20EMIR/Documents/FAQ_KDPW_TR_EN.pdf

648/2012 of the European Parliament and of the Council *on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories*¹⁷.

Format of information that has to be contained in a report is specified in so-called implementing technical standards (ITS), i.e. Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012 *laying down implementing technical standards with regard to the format and frequency of trade reports to trade repositories according to Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories*¹⁸.

Here it's also worth mentioning that art. 3 of ITS establishes quite important obligation to use in reports legal entity identifier (so-called LEI code). Thus, reporting Virtual PPA contract will also require obtaining a LEI code. In Poland the only entity authorized to issue LEI codes is KDPW¹⁹.

Sanctions for non-compliance

According to art. 12(1) of EMIR *Member States shall lay down the rules on penalties applicable to infringements of the rules under this Title and shall take all measures necessary to ensure that they are implemented (...)*. Thus, sanctions for violation of reporting obligation under EMIR are set out in national legal acts. In Poland, this question is regulated within the art. 173a and art. 173b of Polish Act on the Trading in Financial Instruments (the "Act").

These provisions state that non-performance or undue performance of obligations referred to in EMIR or acts based on it may be, generally, sanctioned with pecuniary penalties totalling up to:

- PLN 10,000,000 (c.a. EUR 2,233,000), but no more than 10% of the revenue indicated in last financial statement – with regard to financial counterparties (art. 173a(1) of the Act);
- PLN 1,000,000 (c.a. EUR 223,300), but no more than 10% of the revenue indicated in last financial statement – with regard to non-financial counterparties (art. 173b(1) of the Act).

¹⁷ Amended by Commission Delegated Regulation (EU) 2017/104 of 19 October 2016 *amending Delegated Regulation (EU) No 148/2013 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories with regard to regulatory technical standards on the minimum details of the data to be reported to trade repositories*

¹⁸ Partially amended by Commission Implementing Regulation (EU) 2019/363 of 13 December 2018 *laying down implementing technical standards with regard to the format and frequency of reports on the details of securities financing transactions (SFTs) to trade repositories in accordance with Regulation (EU) 2015/2365 of the European Parliament and of the Council and amending Commission Implementing Regulation (EU) No 1247/2012 with regard to the use of reporting codes in the reporting of derivative contracts*

¹⁹ More information: <https://lei.kdpw.pl/>

Summary

Considering all of the above, developers (project owners; electricity generators) of renewable power plants interested in Virtual PPA contracts shall bear in mind that concluding this type of Corporate PPA will subject them to purely financial regulations. One of those regulations – EMIR – imposes on parties to the derivative contract obligation to report it within one day from its execution. To do so, they will have to either have already an access to a trade repository (to report on their own) or have relevant agreement priorly signed with an entity to which they delegate reporting. Clearly, it brings some additional elements to the Virtual PPA transaction and generates related costs.

Tadeusz Zieliński
Legal Counsel
TAURON Polska Energia S.A.