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26. Juli 2004

EEX-Position regarding CESR Call for Evidence CESR/04-323 Date 29 June 2004

Dear Sir or Madam,

As operator of the largest regulated derivatives exchange for energy products in Central Europe we are directly affected by CESR's position regarding commodity derivatives.

We stand for 117 participants which are based in 14 different countries. Our shareholders come from 13 member states of Europe and the USA. Currently, the trading volume in our electricity futures is approximately equivalent to Germany's electricity consumption. In addition to our futures we will introduce options contracts in November and Emission Certificates in January 2005.

State supervision and capital adequacy requirements represent additional effort to many of our market participants. This creates an incentive to find ways to conduct their business outside the scope of the MiFiD. The current wording especially of Annex I C leaves space that could be used for this purpose. The result would be that the MiFiD would factually be ineffective because it would not include the part of the business that is being conducted via bilateral trades and/or through voice brokers.

We are convinced that those products that generate or hedge identical risks should be treated equally to the ones covered explicitly by MiFiD. For the practical implementation of this idea we propose a so called "close-out test". You may find a description of this test in our attached position paper.

Yours sincerely,

Dr. Hans-Bernd Menzel

Dr. Stefan Nießen

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Ad 3.1 List of Financial Instruments (Article 4 – Annex I Section C)

Ad (1) *definition of "commodity"*

Electricity and gas should be within the scope of the term "commodity" in the context of the directive. As a consequence of the liberalization of the markets for electricity and gas, electricity and gas derivatives are traded within the European Union by professional energy trading houses, financial institutions and others. Trading is carried out via regulated markets, MTFs, voice brokers and bilaterally.

Ad (2) *Conditions, under which an option, future, swap forward rate agreement or other contract related to commodities (which can be physically settled and is not otherwise covered by Section C.6) should be determined not to be for a commercial purpose*

The criterion should be an explicit declaration by the management upon the conclusion of a contract. A company's management shall determine by declaration before a transaction is closed, whether the purpose of this transaction is hedging, procurement or speculation. The auditors shall verify during their routine checks the veracity of these declarations, an activity that they have to perform anyway when auditing on the basis of IAS39.

Ad (3) *The conditions (other than cleared and settled through recognised clearing houses or subject to regular margin calls) for considering when a derivative contract of the type included in Annex I Section C 7 has the characteristics of other derivative financial instruments.*

A good criterion would be whether a position closeout with any derivative contract of the type included in Annex I Section C 7 is possible with no other risk remaining but the counterparty risk. This "**closeout test**" would ensure that products that generate identical price risks would be treated alike.

Also there would be an independence of the product definition from the trading or clearing platform. Using only the criteria "Clearing house" and "regular margin calls" is not adequate because these describe trading activities with relatively less risk as the counterparty risk is basically excluded, whereas trading without the interposition of a clearing house is relatively more risky.

The closeout test is also very important for the supervision of the market. If products that pass the closeout test would not be within the scope of the MiFiD, this would mean that parts of the market are not subject to state supervision. Due to the arbitrage with products that pass the "closeout test" state supervision would be without effect: manipulation and insider trading would be done in the more liquid products that are not within the scope of the directive. The prices of the supervised products within the scope of the directive would then simply follow the prices of the unsupervised market.

Ad (5) *The conditions (other than cleared and settled through recognised clearing houses, subject to regular margin calls or traded on a Regulated Market or an MTF) under which an option, future, swap forward rate agreement or other derivative contract relating to the underlying referred to in 4 and, if any, in 5 above should be determined to have the characteristic of other derivative financial instruments where the contract must be settled in cash or may be settled in cash at the option of one of the parties – otherwise than by reason of a default or other termination event -)*

Settlement in cash is not a reasonable criterion because cash settlement itself does not increase or reduce the risk. E.g. speculation with physically delivered forwards is just as risky or even more risky than hedging with cash-settled futures. Options, futures, swaps forward rate agreement or other derivative contracts that are not cleared an settled

through clearing houses or subject to regular margin calls are more risky than those settled through clearinghouses an with regular margin calls because they are subject to counterparty risk.
Due to the costs and effort related to installation and operation of a financial service provider license and due to the capital costs for the fulfilment of the capital adequacy directive, there is an incentive for commodity trading entities to avoid falling within MiFiD. If only the cleared contracts fell within the scope of MiFiD and the non-cleared did not, this would lead to a flight away from secure cleared futures and options towards more risky un-cleared forwards, options, swaps forward rate agreements. It can not have been the intention of the legislator to generate an incentive to abstain from secure clearing systems.
Therefore any option, future, swap forward rate agreement or other derivative contract that can be used to offset a position in any contract within the scope of MiFiD due to other parts of Annex I Section C must be within the scope of MiFiD as well (“closeout test”).