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CESR / ERGEG

www.cesr.eu

CESR / ERGEG consultation paper on draft advice to the European Commission proposing an EU market abuse framework for energy markets

British Energy welcomes the opportunity to comment on the above CESR/ERGEG consultation. British Energy is the UK's largest generator of electricity, producing around one sixth of the UK's electricity from our eight nuclear power stations and one coal-fired power station. We are also one of the largest suppliers of electricity to the UK's industrial and commercial sector. In addition British Energy operates a dedicated trading function that arranges the sale of some of our electricity output into the wholesale market, as well as providing risk management and balancing services to the BE group.

British Energy fully recognises the need for properly functioning energy markets that operate in a transparent and orderly fashion. Like other markets, the scope for market abuse can exist. It is important, therefore, that an appropriate regulatory framework is in place to deter and protect against abusive behaviour to the benefit of competition and market integrity generally. That framework already exists through the provisions of existing European and national competition law and specific market rules and regulations. We therefore have very serious concerns with the proposals put forward by CESR and ERGEG, where we believe the case has neither been made, or that a need exists, for an EU-wide sector specific market abuse regime for the energy markets. In addition, given the risks of imposing duplicate regulation, and in accordance with Better Regulation principles, we would expect to see a comprehensive regulatory impact assessment and further consultation prior to any sector- specific regime proposals.

Key Points

- **We do not support the proposals for an energy specific market manipulation offence. Previous experience in the UK illustrates the difficulties with a broadly framed prohibition of the type envisaged. Existing European competition law and where appropriate specific changes to relevant market rules are sufficient to tackle market abuse in the energy sector.**

- **British Energy supports the proposals for mandatory and minimum transparency standards across the EU that encompasses the disclosure and publication of fundamental data. The ERGEG guidelines on Good Practice on Information Management and Transparency in Electricity Markets would provide a good starting point.**

- **We object to the notion that information on unplanned or unexpected outages of generating plant should be regarded as 'inside information' and should therefore be disclosed to the market before it can be acted upon by asset owners/operators.**

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Q1 Do you agree with the analysis of the market failures in the electricity and gas markets as described above? If not, please provide reasons for your disagreement.

The tone of the consultation document implies that the energy markets are both vulnerable to market abuse and that market abuse has, and continues to occur, unchecked. However, with the exception of the single example of trade-based manipulation quoted at paragraph 36, many of the statements contained in the consultation document are based on supposition with no substantial evidence of market failure.

Indeed, we note that the proposals contained in the consultation document appear to be premised on general concerns regarding the degree of vertical integration and concentration in some Member States and the problems this can give rise to. Seeking the introduction of a sector specific market abuse regime for the energy markets to address these shortcomings is misplaced. Rather, the Commission should instead focus on the continued liberalisation and unbundling of EU energy markets to the benefit of competition and consumers alike, recognising that existing European competition law is sufficient to deal with the issue of market abuse across all sectors, including the energy markets.

If this was not deemed to be effective, then, as the UK Competition Commission concluded in its 2000/1 inquiry into Ofgem's proposed market abuse licence condition, specific and tightly defined changes to the relevant market rules would be more appropriate than a broad abuse prohibition. Indeed, the introduction of a sector specific market abuse framework runs the risk of being counter productive; it would significantly increase the regulatory and commercial risk of asset ownership and operation and potentially harm new entry and investment, with consequent adverse effects on competition, security of supply and customer prices.

The market failure analysis contained in paragraphs 26 to 42 of the consultation document focuses primarily on three issues: information asymmetry, scope to withhold capacity and scope to price excessively. Our comments on information asymmetry appear below, with our comments on the latter two 'abuses' contained in our response to question 6 of the consultation paper.

<u>Information Asymmetry</u>

Information asymmetries can exist in any market. The key question is whether they are unfair and distort competition. In this context we are concerned that CESR and ERGEG appear to view the information advantage held by physical asset owners over other market participants as inherently wrong. Rather, and as observed by the UK Treasury and Financial Services Authority, this should be viewed as a natural economic rent accruing to those firms that have invested in the underlying commodity market. Indeed, many financial firms are seeking to, or have entered the underlying markets for that reason.

It should also be noted that non-physical traders have information which is not available to other market participants, yet there is no suggestion in the consultation document that this undermines market integrity or that such participants should be forced to disclose the information to which the advantage relates.

In considering this issue, a distinction needs to be drawn between information that should be released to the market in the interests of greater market transparency and commercial information on unplanned power outages that owners of generating assets should quite rightly be allowed to act upon. British Energy objects strongly to the notion that information on unplanned or unexpected outages of generating plant should be regarded as 'inside information' and therefore disclosed to the market before it can be acted upon by asset owners/operators. It is essential that

generators are able to manage effectively the risks arising from the operation of their assets. The ability of a generator to act on plant information before that information becomes publicly available is a legitimate risk management activity that should not be prohibited or discouraged by regulation.

Restricting that ability would severely prejudice a generator's ability to efficiently balance and close-out trading positions, place them at a significant disadvantage to other market participants (in effect a generator would be placed in the position of a distressed buyer) and increase significantly the commercial and operational risk of asset ownership which will push up marginal costs, deter investment and lead to higher prices for customers. Furthermore, we are not aware of regulatory concerns regarding the 'intra-use' of such information. For example, the use of outage information by generators to close-out trading positions is common practice under the UK's market abuse framework and provided they go no further (i.e. do not take a position in the market) does not appear to have caused concern to either Ofgem or the FSA.

Notwithstanding our comments above, within the GB market, generator unplanned outages are published on close to real-time timescales to the market. In addition, the Grid Code (a code which all licensed generators are obliged to comply with) requires generators to submit and regularly update a variety of forecast planning data. This planning data is made available to the market in aggregated form. Consequently, in general within the GB market, participants have appropriate and timely access to both unplanned and planned generation data. We consider this regulatory/market rules approach strikes an appropriate balance between market transparency and individuals' commercial confidentiality.

Aside from our comments above, and as indicated in our response to question 4 of the consultation document, we support the proposal for the EU-wide disclosure of other types of fundamental data in line with ERGEG Good Practice Guidelines.

Q2 What is your opinion on the analysis provided on the scope of MAD in relation to the three different areas: disclosure obligations, insider trading and market manipulation?

We broadly agree with the analysis of the scope of MAD in relation to the three areas mentioned. However, it can be argued that there is a lack of consistency in the way in which some national regulators currently apply the MAD regime to the electricity and gas markets. In the UK for example, the Directive was implemented in such a way that physical energy markets can fall within the scope of the UK's market abuse regime. It would be helpful therefore if CESR and ERGEG could undertake a review in this area with a view to identifying any discrepancies.

As indicated in our response to question 1, and to the extent that it is deemed necessary, it will be important to ensure that any definition of insider-trading does not prevent generators using information on their assets for balancing purposes and to close-out trading positions.

As indicated elsewhere in this response, we do not support the introduction of a sector-specific market manipulation offence for the energy markets. Progress towards greater unbundling and improved transparency under the Third Liberalisation Package combined with existing EU competition law will provide a sufficient framework for dealing with the issue of market abuse.

Q3 Do you agree with the conclusion above that greater pre- and post trade transparency would not be sufficient in the context of market abuse

British Energy does not support the suggestion that greater pre- and post trade transparency is required to tackle market abuse. Such a requirement would likely be burdensome on smaller

market participants and new entrants and hence represent a barrier to entry. We also note that much information is already available from data providers such as Platts and Bloomberg. Similarly, and as indicated in our response to question 4 below, whilst we support increased transparency of fundamental data, this transparency together with appropriate use of the existing EU competition rules and national regulation (including specific rule changes where appropriate) does not need to be supplemented with a broad market abuse prohibition to ensure market integrity.

Q4 Do you agree with the analysis above on the importance of the transparency / disclosure of fundamental data? If yes, would you consider it useful to set up at the European level a harmonised list of fundamental data required to be published? Is an exhaustive list conceivable or is it necessary to publish additional data on an ad-hoc basis if it is considered to be price sensitive?

Q5 Which information retained by specific participants of the electricity and gas markets (e.g. generators, TSO) should be published on an ad-hoc basis if it is price sensitive?

British Energy recognises the importance of information relating to essential infrastructure in price formation and market integrity and therefore supports the general thrust of the proposals regarding improvements in the transparency and disclosure of information on fundamental data. As the consultation paper discusses, these should seek to deliver mandatory, harmonised and consistent transparency standards across the EU, comparable with the standards currently employed in the most open and competitive EU markets, notably GB and Scandinavia.

A harmonised list of data, based on the ERGEG Good Practice Guidelines is preferable to an ad-hoc approach, as this will help ensure consistency both in terms of the level of detail of published data and in the implementation of such a requirement across Member States. However, the framework would need to be sufficiently flexible so as to recognise and accommodate the characteristics of different markets across the EU, provided that any difference in standards did not affect trade.

It should be noted that regulators, through their market monitoring powers, will in any case be able to obtain commercially sensitive data from market participants for analysis if required. A clear distinction should be made between the information routinely provided to the market for transparency reasons and that provided to regulators for specific market monitoring purposes. Commercially sensitive information should not be published.

Q6 What is your opinion on the proposals of CESR and ERGEG in the three different areas: disclosure obligations, insider trading and market manipulation?

British Energy does not support the proposals for an energy specific market manipulation offence. Experience in the UK of Ofgem's proposed Market Abuse Licence Condition (MALC)[1], which was considered at length by the UK Competition Commission in 2000/1, illustrates the practical difficulties with a broadly framed prohibition of the type envisaged by CESR and ERGEG. In rejecting the MALC, the Competition Commission emphasised the detrimental effects of such a power, stating that the MALC '*would cause uncertainty, because of the difficulty of distinguishing between abusive and acceptable conduct, and would risk deterring normal competitive behaviour*'. Moreover, the Competition Commission noted that the MALC amounted to over-regulation that

[1] In 1999 Ofgem sought to introduce a broadly framed market abuse licence condition in the licences of certain GB generators given concerns that the relevant generators had the potential to exercise short-term market power, including with regard to the withdrawal or withholding of capacity and the ability to impose excessive prices. Two generators, including British Energy, refused to accept the condition and the matter was therefore referred to the UK Competition Commission.

could deter new investment and new entry, with harmful effects on consumers in the longer term. In essence, the MALC represented unacceptable and unmanageable regulatory risk.

The Competition Commission has very recently reviewed in detail the findings of its decision it made in 2001 and concluded "The CC's decision not to support the introduction of the MALC in 2001 seems well justified by subsequent market developments in Great Britain[2]". It can therefore be seen that competitive markets like GB can flourish without specific market abuse rules.

We recognise that arguments could be made for a market abuse regime that addresses the problems identified by the UK Competition Commission. Nevertheless the MALC graphically illustrates the difficulties of a broadly framed prohibition and the risks to generators and other market participants of a sector-specific market abuse provision. But in any event, such arguments are academic given existing EU competition law, which is perfectly capable of addressing market abuse concerns in the energy markets.

Competition policy under Articles 81 and 82 of the EC Treaty, which each Member State has been required to implement into domestic law, already provides a comprehensive EU framework for tackling market abuse. In particular, Article 82, which prohibits the abuse of a dominant position, is sufficiently flexible and able to be adapted to different market structures, including with regard to the energy markets.

Whilst the particular characteristics of the energy markets present challenges, these are perfectly capable of being accommodated under existing competition legislation. In the UK for example, the OFT and Ofgem has published guidelines explaining the approach the UK competition authorities will take in applying UK competition law to the energy sector.

A particular concern that has been expressed regarding the application of competition law to the energy markets is the perceived difficulty of bringing cases for abuse of dominance against market participants with relatively small market shares, particularly those that may hold a position of local or temporal dominance as can be the case in the electricity markets. However, EU competition policy is fully able to take account of the temporal dimension when considering the appropriate definition of the market. Moreover, we note that competition policy generally does not set market share thresholds for defining dominance. Whilst the definition of the relevant market (and hence market share) is an important step in identifying the competitive constraints on an undertaking, it is not an end in itself. As a consequence, market shares are only one factor competition authorities take into account in assessing dominance.

Indeed, the ECJ has held that dominance can be inferred from conduct, irrespective of market shares. In this context we note that European competition policy has increasingly moved away from the rigid adherence of form-based measures of concentration to an 'effects-based' assessment of abuse. This largely removes concerns that small undertakings capable of producing an 'effect' would somehow escape the application of competition law.

A further criticism that has been levelled at the use of competition law in the energy markets is that it is too slow to prevent many of the consequences of abuse of market power. However, the same could be said of most other markets to which competition law applies. Arguably, given that competition law almost always operates after the fact, it could be said to have beneficial effects principally through deterrence, rather than redress.

[2] Evaluation of the Competition Commission's past cases: Final report Jan 2008, paragraph 4.82.

In conclusion, we find it alarming that CESR and ERGEG are proposing a sector-specific market abuse regime for the energy markets given the extensive powers that are already available under existing competition law. Not only is the introduction of a competition prohibition unique to the energy markets wrong in principle, it is wholly inappropriate for CESR and ERGEG to seek the introduction of such a prohibition until it has been clearly demonstrated that existing competition law is somehow deficient or inappropriate. Yet there is no analysis of this in the consultation document.

Yours faithfully,

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