UNION OF THE ELECTRICITY INDUSTRY
eurelectric

Consultation Paper on CESR and ERGEG advice to the European Commission in the context of the Third Energy Package –Response to Question F.20 – Market Abuse

Annex to EURELECTRIC letter of 1 September 2008

In relation to ERGEG/CESR response to Q1[1]:

1) 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.

We agree with the general analysis carried out by CESR/ERGEG in that it would be **inappropriate to expand the scope of MAD to the physical markets**, given the differences between the physical markets and the financial markets that the MAD regulates.

We also agree with CESR/ERGEG that disclosure of 'fundamental' physical market information needs to be considerably improved. Therefore, **we support the proposal for energy-specific harmonised, mandatory transparency obligations at EU level.** In terms of building pan-European market transparency framework, we believe that the current, on-going transparency work taking place under the ERGEG regional initiatives should provide a good basis for provisions in this area.

One shortcoming of the paper is that it does not detail what information should be disclosed (i.e. what constitutes commercial information) and how this information should be disclosed (i.e. should certain information be released to the regulator alone or should it be released to the public)? These are fundamental questions. Therefore, in the remainder of our response we refer to 'transparency' and 'monitoring[2]' and not specifically to 'disclosure'.

We also disagree with CESR/ERGEG's line of argumentation which claims that a market abuse framework is needed to stop vertically-integrated companies from sharing information with their affiliates. In EURELECTRIC's view this is an unbundling issue, which will be dealt with by the Third Package.

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

As noted above, EURELECTRIC agrees that the scope of the MAD does not cover physical markets in electricity and gas nor does it cover trade in electricity and gas derivatives not conducted in regulated markets. We also agree that the MAD is not designed for the specificities of electricity and gas markets. Therefore, **with regard to information disclosure EURELECTRIC supports a harmonised mandatory pan-European approach to transparency.** Such requirements would improve trust in the market.

[1] Q1: Is the scope of Directive 2003/6/EC on insider dealing and market manipulation (market abuse) such as to properly address market integrity issues in the electricity and gas markets?

[2] Our understanding is proposals for monitoring arrangements will be subject to separate consultation by CESR/ERGEG later this year.

Furthermore, we believe that any such legally binding European framework should be combined with consistent monitoring across the EU in accordance with the third energy legislative package, in particular Article 22 c and 22 f of the Electricity Directive.

However, and with regard to suspected insider trading and market manipulation, EURELECTRIC is concerned about the lack of clarity on:

- what exact information needs to be disclosed and in what form: as there are legitimate reasons for limiting the release of commercially-sensitive information, there is a need to spell this out; and
- what process will be used in investigating whether a company to be in contravention of sector-specific rules: it should be clarified in our view who will be responsible for monitoring this area and which rules will be outlined up-front.

Further comments on these issues are outlined in our response to question 6 below.

In relation to Q2[3]:

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

With regard to commodity derivatives markets, the level of pre- and post-trade transparency is adequate as acknowledged by CESR/CEBS in their recent analysis. Indeed we have previously commented that there is no need for further pre and post trade transparency. Finally, as far as we are aware we are in line with the findings of the sector inquiry which has not identified any need for further action in this area.

4) (a) Do you agree with the analysis above on the importance of the transparency/ disclosure of fundamental data? (b) If yes, would you consider it useful to set up at the European level a harmonised list of fundamental data required to be published? (c) 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?

(a) Yes, **we see that there is indeed a need for a mandatory harmonised European framework on disclosure of market information, whether this is 'transparency data' or 'monitoring data'**.

On the one hand there is a need for a level-playing field in transparency, and particularly in a market where non-storability is a factor in price determination. On the other hand, as in any competitive market, due attention should be paid to the need to protect the commercial confidentiality of market participants. As a general rule, market participants should be free to arrange their individual production and purchasing decisions without having to reveal their individual strategies or commercially confidential data to the market (as is recognised by CESR and ERGEG in paragraph 82).

Therefore, in developing transparency requirements, a proper equilibrium must be found between the benefits of releasing information to the wider market and protecting the legitimate commercial interests of individual market participants.

[3] Q2: Would the assessment be different if greater transparency obligations in line with the analysis above were adopted (This refers to questions 11 to 19 on Trade Transparency in the Commission's CFE)?

In this respect, one important area is the release of information on unplanned outages at power stations. In terms of practical steps, we believe that precise well-balanced criteria on the use and publication of information during and after an outage should be laid down, aimed at ensuring that no undue impediment is faced by wholesale market participants, who trade during periods prior to and just after the announcement of unplanned (or unexpectedly terminated or prolonged) outages. The criteria should take into account the reality of the market designs across Europe (eg. balancing and scheduling arrangements) and should include the following issues[4]:

- the time when actual plant-by-plant production data should be available to market participants;
- the level of aggregation of the data to be published;
- the information to be provided to TSOs, PX (and regulators);
- the criteria to introduce restrictions to trade affecting generators experiencing an unexpected outage;
- when and how specific information should be released to the market.

In terms of next steps, EURELECTRIC is willing to contribute to the development of these criteria, and will make more detailed proposals in this regard in the coming months.

(b) In terms of how the information provided for in these reports could be made available, we agree that this data should be disclosed in:

(i) an equal and timely manner and
(ii) on a standardised basis.

In addition, while transparency information could be published on a single information platform (if practical!), it could also be delivered via a more market-driven solution, whereby information services are developed to meet market needs.

EURELECTRIC does see the need for a European-level harmonised list of 'fundamental' data. As energy wholesale markets are becoming increasingly European in nature, we feel that purely individual approaches on the national-level would not provide for a level-playing field, would increase costs and encourage regulatory arbitrage. Indeed, regional and European wide market integration will be hampered if a fair level-playing field in transparency and monitoring is not put in place.

Overall, the level of detail should be sufficient to ensure consistent implementation among Member States. Disclosure of transparency and monitoring information should encompass generation, network and load, balancing and reserves and relevant wholesale data while specific deadlines should be included.

(c) In terms of whether a list should be exhaustive or not, we would argue that **any harmonised list should in itself be complete and transparent, and should not be '*ad hoc*'**. This would provide regulatory certainty. Therefore, a transparency (and monitoring) list should be exhaustive.

[4] These criteria should develop what is currently established in Regulation 1228/2003, requiring publication of "*ex-ante information on planned outages and ex-post information for the previous day on planned and unplanned outages of generation units larger than 100 MW*".

5) 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?

None; as all relevant data should be covered in the list mentioned above, there should be no scope for *ad hoc* measures. In any case, we are unclear as to what is meant by the term 'published on an *ad-hoc* basis'. While all information could conceivably have an impact on prices, this, however, does not mean it should be made public in any case, especially if it is commercially sensitive. Again this issue relates to the difference between what is disclosed for transparency purposes and what is for monitoring.

In relation to Q3[5]:
6) What is your opinion on the proposals of CESR and ERGEG in the three different areas: disclosure obligations, insider trading and market manipulation?

Disclosure Obligations

Option 3 would be preferred. See answer to question 4 above.

In respect of applying the text of Article 6 of MAD to the energy sector, the regulators and the Commission need to identify what information needs to be disclosed before identifying and determining whether the rules have been breached.

Insider Trading/ Manipulation

We have not identified a preferred option as we feel that more work is needed here::

(i) establish whether a new market abuse framework is required when harmonised mandatory transparency and monitoring arrangements are already in place (as supported by clear evidence with impact assessment);

(ii) define what constitutes breach of market rules under such a regime (clear issue-by-issue); and

(iii) allocate specific roles and responsibilities for monitoring & enforcement to relevant authorities (who monitors, what is the process?)

(i) Given our view that the MAD should not be directly applied to the physical energy sector, we recognise that there is a need to identify whether or not alternative physical market rules are sufficient. However with a harmonised mandatory European transparency framework in place, the wealth of competition case law currently in existence and the depth of energy market rules in place (soon to be updated through the Third Package), **EURELECTRIC does not believe that a case has been made, or practical evidence has been presented, for an energy-specific European framework covering 'market abuse'.**

The first and main tool to control and prevent market abuse should be competition law. Indeed, any market abuse which occurs in the energy sector can be dealt with effectively by a combination of EU competition law, national regulation and national or regional market rules. If certain behaviour is not covered in competition law, then it could potentially be handled via changes in the energy market rules, dealt with either by market surveillance committees inside existing power exchanges or by energy/financial regulators themselves where trade is conducted outside the exchanges.

[5] Q3: What suggestions do regulators have to mitigate any shortcomings?

Conversely, both the regulators and the Commission should be very wary of proposing market abuse legislation that is independent of competition legislation. Indeed for participants, competition law – which is well-established – offers more guarantees of due process. For market participants, without further clarity[6] as to how such a regime would work, an energy-sector market abuse framework would bring the risk of duplicate regulation, introducing uncertainty about which route regulators would pursue. This uncertainty would be likely to deter new investment, new entry and competition.

(ii) Likewise **the consultation paper has not identified what constitutes abuse/ insider trading/ manipulation.** It is very difficult for market players to endorse or support an 'abuse' regime where the ground rules are not in place. Much work has been done within the ERGEG regions (and within EURELECTRIC) to define and specify the content of these rules. This work is not outlined in any great detail in the consultation paper. While there are some selected references to what ***might*** constitute abuse (e.g. physical withholding etc), the consultation paper does not refer to a comprehensive set of rules nor does it attempt to document other work on transparency and monitoring completed to date.

(iii) Finally, as referred to above in (i), **the Commission and regulators need to be clear as to who does what and under what regime. A clear designation of duties – across the European Union - would reduce regulatory uncertainty**.

Clarity on all these vital issues is lacking in the CESR/ERGEG proposals. Trading volumes and liquidity are increasing across the European market and an extensive body of new legislation (the Third Package) is about to be adopted with a view to strengthening competition. In this context, regulators and the Commission should consider very carefully whether a further regulatory framework is required.

The lack of an energy-specific market abuse framework does not mean that the regulators/authorities should not have the means/powers to enforce market disclosure rules effectively. On the contrary, **EURELECTRIC believes that regulators/ authorities should have the necessary powers to enforce those rules which are within their remit.** In order to better link oversight of the physical market with competition law and the financial markets, close cooperation between energy, competition and financial regulators should be promoted. Such cooperation should not only be established on a Member State basis; it should take place on a regional and European-wide level, whereby the proposed ACER should be allocated the necessary remit (at least with regard to cooperation between energy regulators).

[6] While the paper notes that rules similar to those existing Nordpool could be replicated at European level, the text also notes that these do not constitute a legal framework, which is exactly what is being proposed!