

Joint paper of RWE Trading GmbH (“RWET”), EDF Trading Ltd. (“EdFT”) and ICAP plc (“ICAP”)

Response to the Call for Evidence on the second set of mandates from the European Commission on the legislative measures to implement the Markets in Financial Instruments Directive (DIRECTIVE 2004/39/EC – “MiFID”)

Introduction

RWET, EdFT and ICAP acknowledge the expiry of the official response period but would very much appreciate the opportunity to make the following comments on the Call for Evidence. Collectively we consider that the views of two of the principal players in wholesale power and gas trading (and one of the leading brokerage houses) need to be represented directly rather than through the papers submitted by organisations such as the International Swaps and Derivatives Association and the Futures and Options Association, which also represent the interests of the financial services community rather than the direct interests of organisations whose main business is power generation and supply. The points to be considered by CESR are fundamental to the implementation of the MiFID, which we believe will have a major impact on the liberalisation of the European gas and electricity markets.

About the respondents:

RWE Trading is the managing company within the RWE Group for all energy trading activities associated with electricity, gas, coal, oil and environmental products. RWE’s main core business is electricity, gas and water and it ranks among Europe’s largest utilities.

EdFT is the principal trading arm of the Électricité de France (“EdF”) Group. EdF is wholly owned by the French Republic and owns and operates in excess of 100,000 MW of power generation. EdFT is an active participant in the European electricity, natural gas and coal wholesale markets.

ICAP is the world’s largest inter-dealer broker and is very active in the European energy and hard commodities arena, providing specialist intermediary services to wholesale market participants throughout Europe. ICAP therefore does not trade in energy related products, but acts to introduce buyers and sellers.

The European Energy Market

The extension of the scope of Financial Instruments to commodity derivatives has a significant impact on the financial community in Europe and will also affect the further development of the German and European power and gas markets. With the liberalisation of the power and gas markets commodity trading has emerged as a new business area that provides the urgently needed products and mechanisms to manage the risks that coincide with competitive markets, such as price and quantity risks.

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In principal, the respondents support an appropriate body of rules and regulations to harmonise the European financial markets and support the main goals of the Directive. This will foster investor protection, strengthen the confidence in the markets and promote market liquidity. Given the liberalisation of EU energy markets, it is vital that the basic requirements that lead to an authorisation under the MiFID are clearly defined and not subject to interpretation in different jurisdictions.

However, we also believe that these regulations should provide sufficient flexibility for commercial users of commodities and commodity derivatives to have choice as to whether to be financially regulated based on the actual activities they undertake. These commercial entities should also have the ability to participate in trading markets as professionals where it is adjunctive or ancillary to their main commercial activities. Effective regulation should aim to ensure that the innovation potential of "young" and still maturing markets (such as those in power and gas trading) is not hampered.

Executive Summary

- 1) Commodities are tangible assets or products having a trading value and for which a consumer market in the underlying commodity does exist, e.g. electricity, natural gas, crude oil and coal (see p. 4).
- 2) A forward contract related to commodities is concluded for a commercial (as opposed to an investment) purpose if at the time of conclusion physical delivery is intended, whereby certain criteria indicate a physical settlement, or an intention of physical settlement (see p. 5 et seq.).
- 3) A forward contract related to commodities does not exhibit the characteristics of a derivative financial instrument. Further consideration of what constitutes a derivative financial instrument and how it may be differentiated is set out in the following pages (see p. 8 et seq.).
- 4) Against this background the following list of transactions should in general not be qualified as transactions with financial instruments (see p. 13):
 - spot transactions at regulated and OTC markets; and
 - OTC forward physical transactions in commodities, which are entered into for commercial purposes or, if they are not entered into for such purposes, do not nevertheless exhibit the “characteristics” of a financial instrument.
- 5) Investment Advice is a valuable customised recommendation for a certain action or behaviour (see p. 15).
- 6) Companies such as RWET and EdFT currently participate in trading energy and commodity derivatives on an equal footing as the investment banks, often via brokers. If such companies are regarded as trading in financial instruments and are forced to be treated as customers of the financial institutions it will oblige them to either (i) become financially regulated firms, with the associated infrastructure and capital costs, or (ii) accept that they cannot participate in the wholesale trading market at the most favourable price, and accept higher prices for their own commercial risk management which will be passed through to consumers.

Call for Evidence – Detailed Provisions

In the context of the CESR Mandate the issues stated under 3.1 (no. 1 – 4) and 3.2. are of particular relevance for the commodity trading firms and the energy industry as a whole and we like to propose the following comments regarding these issues.

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

(1) Definition of commodities

The relevant literature and jurisdiction provide adequate definitions of commodities. According to the European Court's of Justice understanding, commodities are physical objects of market value and may be subject-matter of commercial transactions.¹ There are certain criteria that are analogous throughout. Accordingly, a commodity is considered a homogeneous product, which is physically interchangeable with other products of the same type (of uniform quality – standardised product) and is therefore fungible, and which is produced in large quantities by many producers. Further, a commodity can be bought and sold at a price that is the result of a pricing mechanism which is subject to supply and demand.

On the basis of this argument and the notion that the scope of application of financial supervision should not be extended disproportionately, only those commodities for which there is a commercial market – which might develop a market price for this product - should be also considered as base values for financial instruments. This is based on the assumption that standardized products may be traded in large volumes with a certain trade frequency and that this market knows different providers. As a matter of principle this applies only to national markets. Commodities are tangible assets or products that are by their nature intended to be or are in fact consumed (by industrial process, domestic use or otherwise).

Accordingly, electricity, natural gas, crude oil, and coal are considered commodities. However, other intangible rights or assets as mentioned in Annex I, Section C, no.10 (e.g. emission allowances, freight rates) do not fall under the definition of commodities.

Furthermore, besides the definition for commodities, a specification of commodity derivatives in this context seems also important (see: section 3 below).

¹ European Court of Justice (EuGH) Rs. C-393/92, Slg. 1994 I 1477 Rdnr. 228 = DVBl 1994, 852.

(2) The conditions under which an option, future, swap, forward rate agreement or other derivative 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.

a) Physical delivery as commercial purpose

We believe that it is essential to define the conditions under which a contract may be considered to be made for a commercial purpose in contrast to an investment purpose. In order to determine whether a contract listed under (2) should be determined not to be for a commercial purpose, one has to consider the intention of the parties to the contract at the time of its conclusion, i.e. the 'subjective criteria'. Accordingly, a contract may be regarded as made for commercial purposes if, under the terms of the contract, physical delivery is to be made within a specified time. Thus a main criteria is whether at the time of conclusion of the contract physical delivery is intended or not. Consequently, the existence of a balancing group, scheduling or the status of the enterprise as general supplier may indicate that the physical delivery is intended.

b) Justification of commercial purpose through special situation of energy markets

Physically settled forward transactions may not be classified as a financial instrument, because - in contrast to the financial sector - energy markets have their own special situation: Due to the fact that on the one hand electricity cannot be stored and gas is only storable to a certain extent and the necessity of security of supply on the other hand, there is with regard to electricity supply contracts a higher economic demand of forward transactions, i.e. supply contracts with a deferred maturity date. Even if electricity or gas trading enterprises conclude forward supply contracts with the intention to sell the purchased commodity at a profit, the subject-matter is comparable with the subject-matter of ordinary cash transactions with regard to the delivery of goods: a "real" profit (arbitrage) shall be drawn. The conclusion of forward transactions is considerably based on the fact that electricity and gas cannot or only to a limited extent be stored. The very fact that a trader would assume an obligation to deliver short thereby exposing himself to the risk of higher replacement costs, could not justify the assumption of a commodity derivative, even if one or more of the mentioned typological criteria (see (3) below) might apply. Therefore the following applies:

If trading transactions stipulate a physical settlement and thus the buyer's obligation to accept, these transactions should not be regarded as financial investment. In fact, such transactions are considered as cash transactions without speculative purposes by the buyer. The buyer must assume (and also wants to do so) that in case of doubt he has to provide the capital necessary for the settlement of the purchase price or to accept the previously agreed

amount of electricity. Therefore such delivery transactions concluded e.g. by municipal utilities to satisfy their end-users' needs should not require a banking license (since derivatives are not involved). A delivery action with deferred settlement is not reduced to a cash settlement and therefore it can be assumed that from a potential investor's point of view such a transaction is not regarded an investment or speculative transaction and also not used as such. Here a leverage effect does not seem to be possible. If there is no intention to profit from price differences ("no difference intention"), because as pointed out especially physical settlement is intended, it is an ordinary deferred transaction.

c) Circumstances indicating investment purpose

On the other hand, the intention not to fulfil physically may be a specific subject matter of the contract, i.e. the parties involved agree (at the date of conclusion of the contract) on net cash settlement at maturity of the contract (no physical delivery). Alternatively, the intention not to fulfil may be noticeable from the circumstances of the contract such as the inability to actually deliver / receive the quantity agreed upon or the absence of some sort of license to deliver to end-customers. Thus derivative contracts that serve speculative purposes can be determined not to be for a commercial purpose.²

d) Risk and asset management indicates commercial purpose

An important fact in this context seems to be that financial instruments may also be entered into for non-investment purposes. This is particularly the case when taking transactions for risk management purposes into account, as these transactions can be subject to both physical and financial instruments. The main purpose for the parties to enter into such a risk management transaction is that of limiting the extent to which their business will be affected by any identifiable risk arising. With the opening of the European energy markets, companies are subject to the risk of frequently volatile markets due to the specific characteristics of especially electricity; mainly non-storability. Hence it seems vital to ensure that the conclusion of derivative contracts for risk management activities are not subject to licence requirements. This is particularly important, as a large proportion of such trades are done for risk management purposes. Furthermore, energy companies typically use physically settled commodity transactions for the purpose of an effective asset management in relation to its power plants only for the purpose of a risk management and not for investment purposes. A limitation of these activities, due to licence requirements, would not only hamper the liquidity of such markets but also may drive companies to reduce their risk management activities

² In addition, derivative contracts may be subject to an investment purpose only if it is concluded on a professional basis as part of the regular occupation or business of the firm. This is particularly not the case if it represents only an ancillary activity to the main activity of the firm (i.e. it is concluded on an exceptional basis and produces any profit or small turnover for the firm).

and consequently would in fact reduce investor protection against the general thrust of the MiFID.

e) Motivation of business indicates commercial purpose

Moreover and primarily, the classification for “non-commercial purposes” requires a corresponding motivation relating to the business. The enterprise’s market appearance must be constituted in such a way that the provision of financial services takes priority in the enterprise’s business activities. An indication that a forward contract is made for commercial purposes is that either or each of the parties is a licensed energy supply company, a producer or commercial user (when considered on a consolidated basis). An enterprise e.g., which delivers electricity/gas to third parties and at this opportunity sells or buys forward contracts relating to electricity/gas from its portfolios, does not act for investment purposes. The enterprise’s primary motivation to act is the delivery with e. g. electricity. The producer’s intentions in relation with the conclusion of forward contracts is primarily an effective asset management. The commercial user needs forward contracts as a solid basis for its production, e.g. of aluminium, and cost calculation and not for speculative purposes.

f) Cumulative test of criteria

In response to the question raised in the „Call for Evidence”, whether the characteristic “for non-commercial purposes” shall be treated cumulatively or separately, it is suggested to consider the characteristic as independent criteria and to examine it combined with criteria “otherwise have the characteristics of financial instruments” (for characteristics of other derivative financial instruments see 4.) and not keep it separately. The consequence of a separate examination, which certainly does not correspond to the aim of the directive, could be that transactions in commodities – which being for non-commercial purposes, but do not have any characteristics of other derivative financial instruments (as listed under 3.) – are regarded as financial instruments within the meaning of the MiFID.

Consequently, the assessment cannot be based solely on the above-mentioned commercial purpose test. Rather, an additional test should be conducted taking the characteristics of other financial instruments into account. Hence, both the subjective criteria of the commercial purpose test and the objective criteria of the test for characteristics of other financial instruments need to be satisfied (see following comments under 3). In other words, the “non-commercial-purpose-test” is not a conclusive criteria.

(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) Unambiguous and clear-cut criteria

Generally, we like to state that a financial instrument relating to Annex I, section C, no. 7 is given, if and only if all conditions stated under no. 7 are satisfied on a cumulative basis. In addition, “the characteristics of other derivative financial forward transactions“, which are to be developed with regard to the definition of financial instruments (Annex I Section C.7), shall be preferably unambiguous and clear-cut and ascertainable on the basis of objective circumstances.” These criteria should give consideration to all interests of commodity firms. Their application should prevent the classification of every forward transaction relating to an exchange of commodities as derivative financial forward transaction and the coming under supervision of the parties involved. The license requirement involves a couple of consequences (e.g. higher capital adequacy requirements and obligations with regard to company organization), which lead to considerable difficulties for commodity traders and the energy industry as a whole. In respect of selecting criteria it has to be taken into account that real exchange transactions do not come under the application of the MiFID on the basis of a too broad interpretation of the criterion “derivative financial forward transaction” – particularly against the background that especially transactions relating to electricity must always be concluded “forward” since the commodity electricity cannot be stored.

b) General definition of derivative contracts

The definition of the characteristics of derivative financial instruments is closely linked with issue (2) above as this sets out the 'objective criteria' when a contract is to be considered to be subject to derivative financial instruments. In this context, we like to note that the Directive does not provide for a general definition for derivatives / commodity derivatives. Such a definition would be very useful in differentiating between futures contracts and contracts traded on the spot market.

We propose the following definition and understanding of derivatives contracts as financial instruments:

"Derivatives are outright forward transactions or option contracts whose price depends directly or indirectly on for example the stock exchange price, index price or market price of traded commodities".

Essential characteristics pursuant to this definition of financial instruments are:

- Contractual fulfilment is to be made at a future date (while the price is agreed upon when the contract is made)
- The contractual price depends directly or indirectly on the stock exchange or market price of e.g. commodities. The contractual price of a derivative contract depends directly or indirectly on the price of the underlying commodity only if the price of the underlying commodity is not fixed, but calculated on a variable basis either through a link to a published stock exchange or market price or through a separate calculation.

c) Concept of forward transaction does not provide appropriate solutions for energy industry

The above mentioned definition of derivatives includes the concept of forward transactions. A forward transaction is a transaction pending between conclusion and maturity, and which has not been settled by both parties. One characteristic of buying forward e.g. is the fact that the object of purchase is to be delivered and paid at a deferred point of time. An option contract in its typical form is a contract which entitles a party, the buyer of options, against premium payment to conclude a transaction on the basis of predetermined conditions by issuing a unilateral declaration of intent at or up to a specific future date. Until exercising the option right the buyer of options is only entitled, but not obliged to conclude such a transaction.

However, the above mentioned description of forward or option transactions does not include appropriate criteria to classify forward transactions as financial instruments. In addition, European and national legislators, jurisdiction and literature have not succeeded in developing an adequate definition which considers all manifestations of forward transactions. Assuming, however, that a forward transaction is merely characterized by the fact that the time of delivery differs from the conclusion of the contract, for commodity traders dealing with non-storable commodities such as e.g. electricity this would lead to the unintentional consequence that the conduction of trade transactions would require a banking license. A nearly complete supervision of electricity/gas supplying companies, including their classical business of supplying e.g. end-consumers with electricity/gas without ever needing a banking license for decades, would thus be the consequence. This interpretation does certainly not correspond with the MiFID.

d) Typical characteristics of financial instruments

The impossibility of defining the term „forward transaction“ with regard to all kinds of cases, suggests to regard this term as a type which is determined by a number of characteristics, where the existence of all characteristics is not always mandatory, but which determine the appearance of the transaction as a whole. Such typical features include:

- a) The possibility to participate disproportionately in price changes with a relatively low initial investment (**leverage effect**);
- b) The **risk of total loss** of initial investment that exceeds the regular insolvency risk;
- c) The **risk** of having to provide **additional funds** to cover liabilities, against what has been originally intended.
- d) Physical settlement of the transaction is legally and/or de facto not possible;
- e) Speculative interest of the acting party (= no interest in acquiring the base value).

Furthermore, a special supervision of the commodity trading firms and of the energy industry as a whole is only justified for reasons of investors' protection. If the idea of protecting investors is the central reason for supervising services in connection with commodity futures, also the typology of transactions must take into consideration the point of view of potential investors as well as the risks of possible financial investments. In view of the Financial Supervisory Authority's of the Member States safeguard function it seems to be justified that only those transactions are typologically regarded as forward transactions within the meaning of the standard,

- which are deemed an offer of financial investment by a **potential investor**, i.e. a possibility to draw profits speculatively.

Furthermore, forward transactions and commodity trading as a whole does not create substantial systemic risks which the MiFID intends to prevent. The energy industry is already heavily regulated through specific European and national laws, which ensure the security of supply and the ordinary function of the energy markets.

Finally, one of the most significant differences between derivative financial instruments and commodity derivatives are due to the fact that "liquidity" (i.e. price availability due to the desire and willingness to trade in such instruments) is driven by those that wish to risk capital in financial markets. Derivative financial instruments can furthermore be characterised as being for two general purposes:

- Interest rate exposure or hedging (such as trading in government bond futures, interest rate swaps, or repurchase agreements),
- Credit/performance exposure or hedging (such as trading in shares, credit default swaps, secondary debt markets, or Eurobonds).

This can be differentiated from commodity derivatives markets where liquidity is driven by the consumers and producers of an underlying commodity, who cause and are most exposed to fluctuations in supply and demand of those limited tangible assets.

Not all criteria of differentiation as mentioned above are necessarily mandatory with regard to a transaction. It is important that the overall assessment is in favour of a financial instrument or against a forward commodity exchange transaction. In other words, one single criteria is not a conclusive criteria for the classification of OTC-commodity derivatives.

e) Explanation of typical characteristics of financial instruments in detail

We suggest to include the typifying characteristics with regard to the clarification of Section C.7 of the MiFID. For the characteristics in detail:

- **Leverage effect**

The so called leverage effect is based on the fact that price fluctuations have a considerably stronger impact on the rate of derivative financial futures than on the rate of the underlying base value.

- **Risk of total loss of initial investment**

In correspondence to the leverage effect, there is the risk that one contractual party – if prices develop against what has been anticipated – is not given value for its performance and thus loses its initial investment completely.

- **Risk of having to provide additional funds**

With regard to derivative financial futures there is also the risk of having to provide additional funds in order to cover future liabilities, if market or stock exchange prices develop against what a party has expected.

- **Financial Settlement**

A typical characteristic of a derivative financial future is the possibility of financial settlement. This means that according to the regulations of the forward transaction there is – either exclusively or at least at the option of one contractual party - only a financial settlement of contractual liabilities. In particular with regard to those commodity forward transactions, where beside a financial settlement there is also the possibility of physical settlement, a differentiation between a commodity exchange transaction with a deferred settlement date and a derivative future transaction proves to be difficult to some extent. Here the decisive condition is that the aforementioned characteristics (a) – (c) and in particular the speculative interest as described under (e) apply to be able to speak of a financial future. The classification of forward transactions as financial instruments in the case of a subsequent close-out (in the event of termination) or in the event of a subsequent concluded cash-out agreement (agreement for the subsequent financial settlement) is not justified because the parties do not intend – at the date of the conclusion of the physically settled contract – a pure financial settlement. This is due to the fact that a subsequent change of the settlement mode

– due to termination of the agreement – or a subsequent change of the intention of the parties do both not affect the status of this contract as being for commercial purposes.

- **Speculative Interest**

Finally, one basic criterion of derivative financial futures is the parties' speculative interest. If one of the transactions listed in number 7 was subjectively concluded with a speculative interest, it can be concluded from the fact that the parties to the transaction objectively do not have any interest in an actual exchange of the base value. A speculative intention e.g. can be assumed if the respective contractual party is not able to collect or provide the base value physically, e.g. if it has not obtained official licenses or the transaction is unusual for the general activities of the contractual party. In contrast to this, the fact that the contractual parties have the legal and effective conditions to settle the transaction physically and transactions above the base value of the contract correspond to subject-matter of their business speaks against the conclusion of a transaction from speculative motives and thus, speaks for an interest in the physical settlement of the transaction.

f) Clearing and regular margin calls are not conclusive criteria

We like to state that the clearing of OTC-commodities derivatives through recognised clearing houses or the inclusion of regular margin calls in OTC-commodities derivatives contracts are in our opinion not conclusive criteria for the classification as financial instruments. It is important that these criteria are not deemed to be conclusive, since bilateral margin calls and/or clearing of trades may be used as valid and credible credit risk management techniques in relation to OTC physical transactions which would not otherwise be "characterised" as derivatives. It would be damaging to the credit risk management imperative, if commodity traders and the energy industry as a whole were, in effect, denied the use of these techniques because of the risk that their physical dealings will be adjudged dealings in financial instruments within the scope of MiFID notwithstanding that the contractual terms and the nature of the transaction evidenced a commercial purpose physical transaction. This is an important point, bearing in mind that such credit risk management techniques are already under consideration for use in relation to non-financial dealings.

g) List of transactions which are no transactions with financial instruments

Against this background the following list of transactions should in general not be qualified as transactions with financial instruments:

- (a) spot transactions. It is appropriate to consider developing a common definition of what is meant by a “spot” transaction, but with input from the industry; and
- (b) forward physical dealings in commodities which are entered into for commercial purposes or, if they are not entered into for such purposes, do not nevertheless exhibit the “characteristics” of a financial instrument.

In this context it seems useful to provide a list of typical transactions in the energy commodity sector that do not satisfy the criteria to be financial instruments (not exhaustive):

- Physically settled electricity and natural gas supply contracts as well as physically settled crude oil and coal supply contracts with end-users: These transactions are de facto physically settled. There is no speculative intention. Consequently, these transactions are – regardless of their deferred settlement date – not financial futures within the meaning of the MiFID.
- Also physically settled electricity and natural gas supply contracts, which partly include energy prices indexed as “embedded derivatives”, are not financial futures. The indexing does not justify the contracts’ characteristic as derivatives within the meaning of the MiFID, since there is no difference between the originally agreed price and a later value of the transaction, which could be used for speculative purposes.
- Physical OTC-spot electricity and natural gas trading transactions. These agreements are physically settled and provide no opportunity for speculation.
- Physical forward electricity and natural gas trading transactions, natural gas trade at the Zeebrügge Hub as well as natural gas trade at the National Balancing Point in the UK or physical forward electricity trading transactions in the UK: These transactions are physically settled and do not have the typifying characteristics which are relevant for the differentiation of commodity derivatives (forward transactions) and mere delivery transactions with a deferred settlement.
- Transactions with exchange traded spot products: Exchange traded spot products are traded as hourly contracts, block contracts of the hourly auction, baseload contracts, peakload contracts and weekend baseload contracts. These spot market transactions are aimed at physical settlement. The physical delivery takes place on the next delivery day after the trading day and on all weekends and public holidays directly succeeding the trading day and the delivery days succeeding these weekends and public holidays.

These transactions are characterized by a timely settlement date after the conclusion of the transaction. This timely settlement date offers limited opportunity for speculation with regard to the conclusion of these transactions.

(4) Definition of emission allowances

Regarding "emission allowances" we propose to apply the definition established in Directive 2003/87/EC on establishing a scheme for greenhouse gas emission allowance trading within the Community. Accordingly, "emission allowances according to this Directive is the allowance to emit a specific amount of carbon dioxide equivalent (e.g. tonne) during a specified period (e.g. year). One tonne of carbon dioxide equivalent means one metric tonne of carbon dioxide (CO₂) or an amount of any other greenhouse gas listed in Directive 2003/87/EC, Annex II".

However, the purchase of emission allowances for the fulfilment of the obligation under Article 12 sub-para. 3 of Directive 2003/87/EC can not be regarded as a transaction in financial instrument as such transactions are not made for investment purposes. This holds even in case that the transfer of emission allowances via the competent registry may take several months or even years, given the nature of the European emissions trading scheme.

Accordingly, the following has to be reckoned: These transactions do not have the typifying characteristic „speculative intention“, which differentiates derivative financial instruments from mere delivery transactions with deferred settlement. The trade in emission allowances is settled physically. Pursuant to the standardised system of registries for emission allowances and a standardized procedure for their transmission throughout Europe these are transferred through mutual consent and record of the transfer on the purchaser's account in a register. To settle a transfer claim it is not necessary to physically deliver the allowance, but it is sufficient to record the emission allowances on the purchaser's account in the register. Thus, this legal transaction is not a financially settled transaction, as it also includes, beside the payment of the price, the transfer of property in allowances. Therefore transactions with regard to the transfer of emission allowances are to be settled physically de facto. This is only consequent, since emission allowances are transferred on the condition that allowances are registered for the purchaser.

(5) Climatic variables

Climatic variables are all variables which refer to measures based on climatic circumstances or processes. Such measures can in particular arise out of temperature, precipitation, air pressure, insolation and wind.

(6) Freight rates

Derivative contracts based on freight rates are those contracts which are related to the average transport costs of commodities. Transport costs are costs for a certain type of freight on a certain transport route and under certain transport conditions. Transport conditions are inter alia transport time, means of transport and capacity of transport. Freight rates are considered to be a financial instrument only if they really serve as underlying for a transaction. In this context it can be referred in particular to the freight rates which are traded on exchanges (e.g. on the Baltic Exchange in London). A contract which is purely an agreement with respect to the transport of commodities if the effective transport is the main subject of the contract is not a financial instrument.

3.2. Definition of Investment Advice (Article 4 para. 1 no. 4)

Generally, following the reasoning described above under issue (2), the question whether investment advice relating to commodities requires an authorisation within the scope of the MiFID is not relevant in case where such investment advice leads to transactions in derivative financial instruments serving risk management purposes (hedging).

The main criteria to differentiate a personal recommendation from the listed items (general recommendations; marketing communications; information given to the clients or from; simple offer; the activities carried out by tied agents) is the fact that a personal recommendation is subject to a valuable customised recommendation/advice in distinction to the general information which approaches a potential abstract number of clients. Hence the purpose of such a recommendation is to provide the customer with an individual recommendation/advice in respect of transactions relating to financial instruments.

A further criterion for the differentiation is the question whether the information has been delivered on basis of a particular expertise of the informing person, his experience and under the availment of a particular clients' trust based or whether the information has been given solely for informational reasons. The latter speaks for a general informational statement. In context with the differentiation between a "personal recommendation" and a simple information of a client regard will have to be made also to the fact whether the informing person connects with the information the advice for a certain action or behaviour, e.g. the conclusion of a transaction or whether the information has been given without suggesting the informed person a certain behaviour or action.

A further criterion is also the existence of a consulting agreement between the consultant and the person seeking consultation. In this respect it is decisive whether the information is for remuneration meaning that the informing person awaits for its information a valuable consideration. Information for remuneration indicates investment consulting (also arg. Article 2 para. 1 lit. (j) MiFID); the information inspires a particular value of the consultation and

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intensive occupation with the information's background. A factor which speaks against the existence of investment consulting is the delivery of statements of a certain generality without knowledge of the personal situation of the client and the special situation.

3.6.2. Eligible Counterparties (Art 24 MiFID) – The criteria, including quantitative thresholds, that would allow considering an undertaking as an eligible counterparty, and the procedures for obtaining their express confirmation to be treated as eligible counterparties.

For those commodity market participants that are demonstrably undertaking trading activity as part of a commercial purpose, the qualitative measure of whether they can elect to be treated as an eligible counterparty should be whether they are a professional in the supply or consumption of the commodities in question (when considered on a consolidated basis).

This qualitative measure would allow firms like EdFT and RWET to continue to participate in the wholesale market in commodity derivatives. As EdFT and RWE both have to manage the different supply and demand balances in their portfolio in not just electricity, but the other hard commodities that fuel their generation (primarily gas and coal), they should properly be able to elect treatment as eligible counterparties when dealing in these products. This logic also applies to other markets which have a material impact on generation costs, including dry bulk freight, emissions allowances and transmission capacity.

Much of the OTC market in commodity derivatives is complex (due to differences in supply and demand, both in general and also based on individual requirements of participant institutions) and is often intermediated via brokers that provide anonymous price discovery prior to trading. If brokers and investment firms are required to apply conduct of business rules to the liquidity providers in commodity markets, but not the investment banks who also participate the effect would be to prevent the commodity producers/consumer institutions from trading at the same speed and on the same basis (and therefore at the same price) as the investment firms. The commodity institutions would therefore deal with investment firms direct, and not participate in the wholesale price formation process anonymously via brokers and MTFs. This would have a negative effect on market transparency and liquidity.

Professional commodity institutions should have the ability to elect treatment as an eligible counterparty on the basis that such trading is ancillary to and informed by, their use or production of the underlying commodity.

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