

**EDF SA and EDF Trading response to ESMA Consultation Paper  
“Guidelines on the application of C6 and C7 of Annex I of MiFID”**

5 January 2014

**Q1. Do you agree with ESMA’s approach on specifying that C6 includes commodity derivative contracts that “must” be physically settled and contracts that “can” be physically settled?**

We agree, although we do not see the need to address the concept of contracts that “must” be physically settled as this concept is not included in MiFID I.

In our view, it goes without saying that contracts that “must” be physically settled are a subset of contracts that “can” be physically settled. We therefore think that the differentiation in the context of these guidelines may create confusion given the upcoming clarifications that will have to be made under MiFID II.

**Q2. Do you consider there are any alternatives for or additions to the proposed examples of “physically settled” that ESMA should consider within the definition of C6? If you do, what are these?**

We agree with the proposed examples. We believe that the definition of physical settlement should incorporate a broad range of delivery methods and the examples provided in any legal text or guidelines should not be exhaustive.

EDF SA and EDF Trading would like to reiterate the view that the definition of physical settlement should take into account the specifics of wholesale markets and that nomination or scheduling of physical energy trades at specified nominal points of the network with the network operator may take place on a net basis depending on the rules of each individual network operator. This, however, does not undermine the physical nature of these trades as contractual obligations between the counterparties are discharged on gross terms (execution and recording, confirmation, invoicing, accounting). It is worth noting that quantities delivered under each trade are invoiced separately and VAT paid to such amounts.

ESMA has appreciated this introducing the concept of operational netting in the Technical Advice to the Commission on MiFID II published on 19 December 2014 and we would welcome a similar clarification in these guidelines by adding the following points:

*21.b.iii. [...] entitles the recipient to the relevant quantity of the goods, where this quantity can be proved by invoices and the VAT treatment of the contracts.*

*22/bis. Operational netting in power and gas markets shall not be considered as offsetting of obligations and will therefore not prejudice the nature of physically settled contracts in these markets.*

**Q3. Do you agree with ESMA's discussion of the relationship between definitions C5, C6 and C7 and that there is no conflict between these definitions? If you do not, please provide reasons to support your response. In particular, ESMA is interested in views regarding whether the proposed boundaries would result in "gaps" into which some instruments would fall and not be covered by any of the definitions of financial instrument. ESMA also seeks views on whether there are any adverse consequences from the fact that some instruments could fall into different definitions depending upon the inherent characteristics of the contract e.g. those with "take or pay" clauses that may be either cash or physically settled.**

We agree with ESMA and believe that there is no conflict, overlap or gap in the flow of the definitions. This is also clearly indicated by the wording found for example in C7, which applies to contracts "not otherwise mentioned in C6". The practice under MiFID has worked very well in this respect and the objective characteristics of the contracts make it very clear which section of Annex I the contract would fall into.

Nonetheless, EDF SA and EDF Trading are concerned about the statement in footnote 8 at page 10 of the ESMA consultation paper, which reads: "ESMA notes it has not been able to identify any instrument which can accurately be described as 'must be physically settled', as all instruments appear to contain force majeure provisions that would prevent physical delivery."

We believe ESMA may be confusing the concepts of default, early termination and force majeure with settlement. It is our strong conviction that such events do not constitute settlement. When cash compensation for damages takes place due to force majeure, default or "other termination events", the compensation is a secondary obligation which replaces the primary obligation but does not alter the original intention to deliver physically the underlying commodity.

We would like to point out that, in its Technical Advice to the Commission on MiFID II, ESMA stated that "the existence of force majeure or bona fide inability to settle provisions do not prevent a contract from being characterised as 'must be physically settled'" and "the existence of default clauses providing that a party is entitled to financial compensation in the case of non- or defective performance of the contract should not prevent the contract from being characterised as 'must be physically settled'" (p. 407 of Final Report published on 19 December 2014). We consider this as the correct approach and would welcome consistency in the method for applying legal concepts and definitions between MiFID I and MiFID II.

**Q4. What further comments do you have on ESMA's proposed guidance on application of C6?**

We believe that it is beneficial for ESMA to clarify that spot contracts are out of scope of the definition of derivatives, including C6. The definition of spot contracts in Regulation 1287/2006 refers explicitly only to C7, although it is common understanding that spot contracts are not in scope of the definition of a financial instrument or derivative, regardless the place of execution.

We note that also the European Commission has confirmed in the FAQ on EMIR that "Energy spot transactions are not financial instruments under MiFID and are therefore not within the scope of EMIR". By including such clarification in the guidelines for any commodity, ESMA would definitely remove any potential misunderstanding.

<b>Q5. Do you have any comments on ESMA's proposed guidance on the specification of C7?</b>
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We have observed, and we believe, that article 38 of Regulation No 1287/2006 has worked well in identifying the objective characteristics of contracts falling under C7 of Annex I, Section C of MiFID.

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