

## Position Paper

# Measures to ensure transparency and integrity of wholesale markets in electricity and gas

July 23, 2010

## **General Remarks**

The German Association of Energy and Water Industries (BDEW) represents 1,800 members of the electricity, gas and water industry. In the energy sector, we represent companies active in generation, trading, transmission, distribution and retail.

We welcome the opportunity to comment on the Directorate General for Energy Public Consultation Paper.

The BDEW fully supports initiatives to ensure transparency and integrity of wholesale markets in electricity and gas. Any measure should be harmonised on a European level and should be based on the existing legislation and initiatives. The need for further legislative action, however, has to be carefully assessed with regards to the principle of proportionality, in particular whether further duties are necessary to mitigate shortcomings and whether additional burdens for the industry are proportionate to the benefits achieved.

We would also like to highlight, that there are currently initiatives in the financial market regulation, which can potentially lead to overlapping regulation. We would urge regulators and the European commission to coordinate these approaches as much as possible and pick up the work, which was started by the CESR/ERGEG recommendations in 2008.

## Questions

**1. Are there particular developments in relation to oversight of energy markets at a national, European or global level that we have not properly considered?**

### **BDEW comments to the analysis**

We agree with the summary and would like to confirm the importance of the 3<sup>rd</sup> energy package and the revised Emissions Trading Directive for wholesale energy markets. In reference to these legal foundations a harmonised approach of implementation and supervision is vital to avoid distortions for cross-border energy wholesale trading.

In our view, energy markets shall predominantly be governed by a set of energy regulations (and the respective energy regulators) and not in addition by financial market regulation. Consequently, the most important challenge of the current EU legislative framework is to define the appropriate borderline between financial market regulation and the regulation of energy markets and – if there is an interface – to find appropriate measures to deal with it.

### **Further developments to consider in relation to oversight of energy markets**

BDEW would like to point out that also European and National Competition Authorities are analysing the behaviour of energy markets in order to detect possible situations of market abuse. Especially, in the context of considerations to extend regulatory influences of the national regulatory authorities (NRAs) it is important to take note, that most functions envisaged may already be performed by these competition authorities.

Therefore, we would like to urge the Commission to avoid overlapping oversight, which would only tend to increase the administrative burden of market participants.

Furthermore, we see a number of national initiatives, which are detached from the work on the European level. This has a high risk of creating further burdens for market participants and slows down the developments towards one set of harmonised rules across Europe.

Coordinated regulation of energy markets must be the primary objective, especially because there are several different activities going on, which are currently running in parallel.

**2. Do you agree that the current Regulatory Framework should be updated to include clear rules governing energy market oversight? Please justify your reply.**

**Energy markets already have an adequate regulatory framework**

There already are adequate oversight rules in place, which govern the energy markets. The problem is much more of overlapping regulatory frameworks. We would welcome a tailor-made regime, which sets clear and concise rules for energy markets across Europe.

In particular, it is important to reduce the level of fragmentation and overlap in the market oversight. Market participants should be subject to a clear set of rules in terms of transparency, insider dealing and market manipulation, which should cover both physical and financial energy markets.

**3. Do you agree that this update should ensure integrated/ coordinated oversight between financial and commodity markets and across borders.**

**One clear and harmonised regulation across Europe**

BDEW would welcome a harmonised and clear set of rules which is applicable for all energy markets across Europe. In principle, this could best be achieved by only one regulatory framework.

Whereas coordination certainly plays an important role both on national and European levels, we do think that the national energy regulator should be the single point of contact for all points concerning oversight. Such a “home regulator” would be in the best position to assess markets, to maintain communication with market participants, especially SMEs, and would help market participants in reducing regulatory efforts.

We see an important role of ACER in the development of the framework guidelines and network codes, which are likely to have major impacts on the energy regime as well. ACER’s function will then mean that it will have to ensure harmonised implementation across Europe.

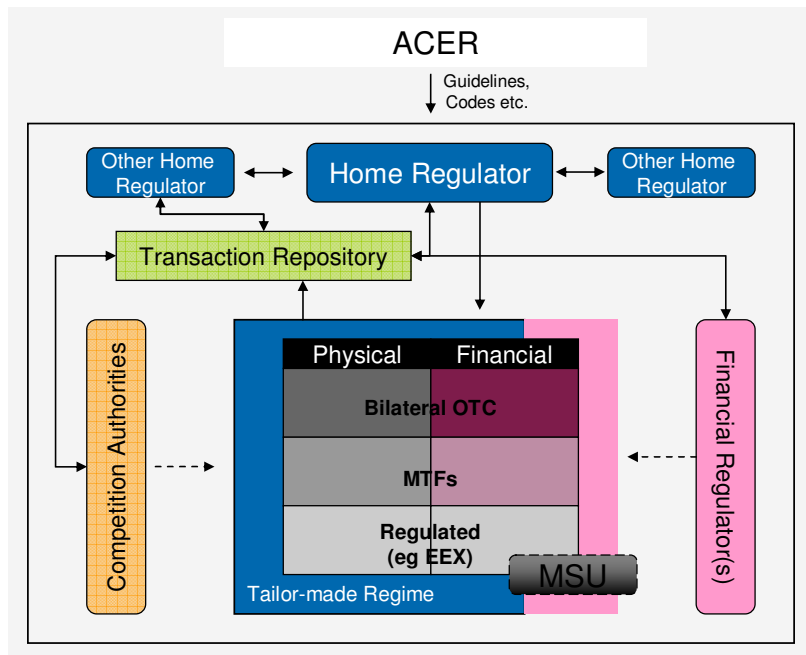
For cross-border regulation, we see the home regulator as the single contact for market participants, which will mean that interagency communication will have to be integrated and coordinated.

At a later stage, we will further address the transaction repository, but it would be sensible to have only one for the market that can be accessed by regulators and competition authorities. This means that it will have to be designed to fulfil all requirements envisaged.

Regulated markets, such as the EEX, will continue to be monitored by institutions like the Market Surveillance Unit (“MSU” / “Handelsüberwachungsstelle”).

We will further detail our views to such an implementation in our answer to question 18.

**Figure 1 "Possible regulatory framework for energy markets"**



There are also areas in energy trading, where products are structured similar to financial instruments, and there are also some market participants which hold licenses for financial institutions. However, we see this as a rather limited section of the energy market and would prefer to keep as much of the energy market as possible under an energy market framework.

**4. Do you agree that the overlap of physical, and financial (derivative) markets, and the cross border nature of the market currently leads to sub-optimal oversight of energy markets?**

We disagree that there is a suboptimal oversight of energy markets. In fact, we feel that the oversight is adequate. However, the burden of market participants to reply to requests from national energy regulators, financial regulators, regional regulators and competition authorities is ever increasing. Therefore, BDEW feels it is urgent to harmonise the oversight of energy markets and provide non-discriminatory access to markets across Europe to foster liquidity.

We would like to point out our fear that the coming future legislation of both energy and financial regulators has the potential to create undue overlaps.

**5. Do you agree that definitions of market misconduct for gas and electricity markets should be consistent across EU? If not, why not?**

Yes, the definitions of market misconduct for gas and electricity markets should be consistent throughout Europe. However, whereas these definitions should be applicable for all markets and participants, we do foresee differences in the between the commodities gas, power and CO<sub>2</sub>.

**6. Do you agree that market misconduct should follow the MAD definitions? If not, why not?**

BDEW firmly believes that the MAD definitions of market misconduct cannot be transferred one to one to the energy markets.

We would like to point out that the energy industry is currently only affected by the MAD in the area of commodity derivatives and not the commodity itself.

Trading of energy (including derivative products) is, most commonly, used to mitigate arising price and volume risks. This is an important difference to the financial and investor markets for which the MAD has been designed.

For example in respect to disclosure obligations, the duties of the “issuer” under Art. 6 MAD cannot be easily transferred to the context of energy markets. The scope of the disclosure obligations does not apply to physical products. Equity and debt securities have issuers who have obligations with regard to precise material price-sensitive information. With regard to energy derivative markets, there is no equivalent of a single issuer with the responsibility of ensuring equality of information for market participants.

MAD defines inside information in the context of commodity derivatives as

*“...information of a precise nature which has not been made public, relating, directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practice on those markets.”*

Regarding the energy derivative markets, it seems difficult to assess what is price-sensitive data that market participants might expect to receive.

Also with regard to insider trading, the MAD provisions cannot be applied to physical markets for electricity and gas. As set out above, the definition of inside information in MAD is generally ill-suited for commodities derivative markets – let alone for commodities markets - where

there is no single issuer. Therefore the definition is not only difficult to handle for the securities regulator but also for market participants.

Art. 1 para 2 MAD defines market manipulation as dissemination of information which gives false or misleading signals as to financial instruments; as transactions or orders which give false or misleading signals to the price of financial instruments, or which employ fictitious devices or any other form of deception or contrivance. The provision covers only market manipulation which has impact on derivative markets.

However, any market manipulation with regard to physical energy market should in our view be dealt with by competition authorities in the existing legal framework.

In our view, it should be carefully considered whether there is a need for additional market manipulation provisions besides the existing competition provisions regarding the abuse of a dominant position. With regard to disclosure obligations and insider trading, it should be carefully assessed whether the perceived shortcomings of the current legal framework may not be remedied by a sector-specific harmonised European approach to the publication of fundamental data.

Therefore, we support the initiative to define sector-specific rules.

For example electricity spot markets are by nature very volatile due to the non-storability of electricity and an inelastic demand. This volatility is likely to increase further as the share of intermittent sources of energy will continue to grow.

Unexpected and significant price movements are common in energy markets. Hence, the assumption that a market participant had the intention of manipulation must be clearly expressed by the competent authority as well as it would be responsible to prove such an intention.

If a new legal framework were established, it should be a one-stop shop for the market participants with regard to various issues: Concurring jurisdictions of energy and financial regulators have to be avoided. Equally, under a new framework the record-keeping obligations from the 3<sup>rd</sup> energy package should be consolidated, in particular to avoid additional burdens for companies which act on the European level.

**7. Do you agree that specific account of the specificities of the physical energy markets should be taken of energy markets through guidance rather than in legislation? If not, why not?**

BDEW supports a specific account as addressed in the previous question to be taken and does not support a simple extension of MAD to be applied to energy markets. Rather, BDEW believes that a tailor-made regime could further improve the reliability of open and competitive energy trading wholesale markets and the trust participants have in the market and its price

building mechanisms and, hence, foster further market development and liquidity of the markets.

The above mentioned energy specific regime should be tailor-made for the energy trading markets, its products, participants and market places, taking into account the specifics of the energy markets and shall not be a „copy-and-paste“ exercise on the basis of the existing financial market regulations. This tailor-made approach would create a single EU-wide harmonized regime for this market and close any regulatory gaps. Hence, it should cover power, gas and CO<sub>2</sub> products and encompass products traded on regulated markets, MTFs and OTC-markets and products which are physically and financially settled. Thus, the regime would be appropriate to achieve its objectives and would not place disproportionate burdens on the market participants.

Establishing a tailor-made market integrity regime for the energy markets requires to carefully assess the borders between the different areas of existing regulation. In particular, it shall not contradict and overlap with other relevant EU legislation, such as the MAD and antitrust law and the competencies of the respective regulators. Either duplication or even contradiction of regulation will create uncertainty for the market participants (e.g. which legal framework should apply including the appropriate authority to pursue any cases). The interaction between energy, anti-trust and financial regulators will be crucial to making any regime work effectively. Clear obligations and responsibilities must be outlined in any legislation.

We do not feel the distinction between guidance and legislation is very clear. In the end it is crucial to have a level-playing field, which is built on clear and harmonised regulation. Guidance can also achieve this, but we prefer clear rules.



**8. Do you agree that regular market monitoring is an essential function to detect market misconduct?**

Yes, in order to detect market misconduct a competent authority would need to monitor markets on a regular basis. Currently, competition authorities already have the power to monitor power companies for their activities. Even though to date there have been no significant cases of market misconduct, we see that this function should not be divided up between different agencies.

If an additional institution monitors the market it needs the capabilities to interpret the data gathered, it needs the technical capacity to analyse the data and generate reports and have an overview of the market trends.

The BDEW firmly believes, that a national home regulator, which would need to be a competent authority would be best suited to fulfil such a role.

We do not feel that a central superagency should be built up from scratch and be assigned with this duty.

**9. If yes, given the characteristics of wholesale energy markets, do you agree that market monitoring is best organised on EU level?**

Please also see our answer to question 8.

BDEW prefers a single transaction repository, but it does not have to be central or on a EU level. Most importantly we would urge regulators to push for a unique interface for all market participants.

Of utmost importance is ensuring that the data stored will be safe and anonymous. Only with such a guarantee can data collection be successful and build trust in the market place.

As for the process of data collection we believe that regulated markets like the EEX should report transactions. Data on MTFs like broker platforms should also be readily available and should be reported directly by these platforms.

As for the rare case of standardised bilateral deals we can see this best achieved by an industry solution to report this date.

Particularly, the record keeping obligations implemented in the 3rd Energy Liberation Package<sup>1</sup> can be used to provide competent authorities with adequate trading data on non-standardised transactions.

**10. If yes, do you believe that ACER should be given the role of an EU level monitoring body for wholesale energy markets?**

We do not believe that ACER should be given a monitoring role in regards to market misconduct. This task should be given to the competent authorities, such as the home regulators.

ACER should however monitor the implementation of the specific energy-related regulation and could facilitate the coordination between national authorities.

Generally, ACER's main function will be to design the framework guidelines and network codes and ensure their implementation. We cannot see how ACER could be enabled in any reasonable time to fulfil the tasks of the national regulators today.

**11. Do you agree that the EU level monitoring body for energy markets should have a coordinating role to ensure effective application of EU level rules for energy markets? If not, why not?**

As stated in our answer to question 10. We only see ACER's monitoring role in ensuring the effective application of EU level rules for energy markets.

We do see a need to further define this role to foster harmonisation, which could be part of a further consultation.

**12. In your view, would enforcement of market misconduct rules be best organised on national level or EU level?**

Following our answers 8-11, we believe that home regulators are best suited to fulfil this role of enforcing market misconduct rules and will be able to handle the monitoring better than a super-agency for the whole EU.

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<sup>1</sup> (Art 40 Directive 2009/72/EC of the European Parliament and of the Council of 13 July 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC) and (Art 44 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC)

A European super-agency would take time to be set up and would very likely just build up the competence which is with the home regulators today.

**a. If on national level, would national energy regulators or national financial regulators be better placed to enforce compliance?**

BDEW would welcome a competent authority to be such a home regulator. We do not feel that financial regulators are prepared to enforce compliance with a sector-specific energy regime.

**b. If on European level, which institution would be best placed to enforce compliance?**

Not applicable.

**13. Do you agree that the market monitoring body for energy markets should also be able to monitor EUA transaction?**

Yes, home regulators should also be able to monitor EUA transactions.

The data is available at the trading platforms. In each Member State, the relevant data is already collected by respective registries (e.g. DEHSt for Germany), which should exchange data with the home regulators.

EUAs are not traded on a pure bilateral basis.

**14. Would monitoring of traded carbon markets be best organised on national or on EU level?**

Please check our previous answers for more detail. Also for traded carbon markets we see the home regulator in the best position to monitor the market participants, even though this monitoring needs to be closely coordinated on a European level.

**15. If on EU level, do you believe that ACER could be an appropriate monitoring body?**

We believe that ACER can only have a coordinating role in enforcing the network codes and guidelines. ACER's main function should be to ensure harmonisation of rules.

**16. Do you agree that it is not appropriate, at least at present, to consider coal, oil and other commodities along with wholesale gas and electricity markets? If not, why not?**

The nucleus for the work on an energy specific integrity framework should be electricity, gas and CO<sub>2</sub>. BDEW believes that the focus should be on these three commodities.

We would welcome further transparency in global oil and coal markets. However, in Europe the consumer markets only constitute a minor share of the global market development. As any approach would require complex global coordination, we do not consider it appropriate or even possible at this stage.

**17. Do you agree that it is appropriate to apply exemptions and *de minimis* levels? If not, why not?**

The tailor-made regime should be designed so that there is no need for a *de minimis* rule. All market participants should be obliged to fall under this regime.

However, we can already foresee that not every activity needs to fall under the regime though. For example in electricity, there are already certain thresholds for generators and consumption units.

**18. Do you agree that market data relating energy market transactions should be reported centrally? If not, why not?**

The data repository does not necessarily have to be central, much more important is that there is only one interface for each market party. The needed data repository can be based on several locations as well and naturally it should be lean and just collect and store the data in a safe way. Then national energy regulators as well as competition authorities could access this repository for their investigations. We are especially cautious, when central means that this will also be a European agency.

Data on regulated markets as well as MTFs should be reported directly by the market operators while for standardised bilateral OTC deals an industry solution developed in cooperation with the repository operator seems to be most appropriate.

In any case it must be ensured that data provided is anonymous and does not reveal business strategies. The repository should at best be a neutral public organisation.

As for non-standard transactions, we firmly believe that record keeping obligations as already applicable to the energy industry are fully sufficient.

**19. Do you agree the body with an oversight role requires full access to fundamental data relating to carbon?**

We are not entirely sure what would entail fundamental data relating to carbon. Naturally national competent authorities should have access to the fundamental data which is published and that they require to assess the market.

Data on EUA transactions are collected by the national EUA registries and they should also be accessible for the relevant competent authority.

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