

3 September 2008

ERGEG Secretariat
Rue le Titian 28
1000 Brussels
Belgium

Consultation: CESR and ERGEG advice to the European Commission in the context of the Third Energy Package

Merrill Lynch Commodities (Europe) Trading (MLCE) is pleased to have the opportunity to respond to the above consultation. MLCE is an active energy trader across all European electricity & gas markets and active generally across most of Europe. The company has a strong interest in the development of markets in a way that allows participants to assess fundamental physical conditions, along with confidence that the markets operate in an orderly fashion.

In some respects the broader debate about market abuse may be a little early in the development of tradable markets in Europe, as there are still a number of fundamental hurdles (including political intransigence) that are preventing liquid markets emerging at all. It is obvious from both the Commission's findings after their sector inquiry (Ref: SEC (2006) 1724) and your own conclusions reached after the monitoring exercise in 2007, that most of the distortions and perceived "ills" of European energy markets (high concentration, vertically-integrated incumbents, entry barriers, etc) are due to the structural problems of the sector itself rather than market abuse activities by market participants. As such the measures proposed which undoubtedly would incur increased costs of compliance to the majority of participants may constitute an asymmetrical corrective action, in the absence of other more fundamental prerequisites for the development of liquid and competitive markets.

Based on the evidence of the Sector Inquiry, an increase in market transparency on derivatives, wholesale markets and supply contracts would not contribute to reduce market concentration. Furthermore the problem of vertical foreclosure (no proper unbundling between network, supply and generation interests) is not related to transparency on wholesale markets, supply contracts and derivatives. Finally the Commission in its sector inquiry did not refer to transparency of wholesale markets supply contracts and derivatives as an issue or a remedy to the lack of market integration.

That said, we are supportive of the broader push to improve market order, and to improve confidence in price outcomes as this should act to reduce political interference, enable the development of more liquid spot and curve markets, and allow product innovation to thrive. We are therefore in general very supportive of increasing transparency of fundamental physical data

We recognise that the consultation is pitched at a high level and our responses seek to reflect this rather than delving into specific detailed solutions.

Merrill Lynch Commodities
(Europe) Limited

Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

Tel 020 7628 1000

Global Markets & Investment Banking Group

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.

MLCE agrees that information asymmetry can impact on market integrity and that broad access is the main area to concentrate on.

We have seen some third party innovation with data transparency where providers have sought to get around the lack of publication, but while this has proven useful, it is no substitute for a strong transparency regime.

We also consider it important that information is made available in a way that suits market participants. Many will be satisfied with seeing a general picture, but active traders will require information in a raw downloadable format as the questions we want to answer will differ from those that an information provider will consider important. MLCE would advise against allowing network operators to dictate the information types and levels as this will only result in a dragged out process of justification of every minute detail and further delay in implementation.

The consultation also notes the example of a facility operator seeking to balance before informing the market. This kind of practice has, and continues to be, acceptable in some markets. The question that should be addressed when developing a bespoke energy solution is whether some elements of this behaviour are valid and not abusive. When dealing with physical energy assets there may be little opportunity to wait until the market is informed of an event before taking action. Given this, it is difficult to conclude that asymmetric information itself will lead to market abuse when events are related to physical operations that could have been caused by issues such as unplanned outages.

Voluntary disclosure of information is welcome as this can reduce the legislative lags in putting information transparency measures in place. In our experience, the voluntary provision of information has been useful, but it has also raised risks when the data set is incomplete and/or highly unreliable. It should not be discounted that providing misleading information is just as valuable for undertaking abusive activities.

MLCE also agrees that the level of market concentration, and hence market power, is an important catalyst to allow the ability of market abuse to occur. The continuing poor performance of many Member States to support and implement market liberalisation makes them as culpable when it comes to examining abusive price setting and non-market based price outcomes, principally because the market development is weak and illiquid.

Q2 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?

The consultation conclusions on the scope of MAD appear correct. MLCE is pleased to see that the assessment notes that MAD was specifically designed for the financial markets. In our opinion, the extension to physical energy may not be a simple job of applying the same principles in a different sector as the physical impacts of market actions could be detrimental to safety and security of supply.

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?

We agree with the discussion in the consultation that transparency and trade reporting do not change the scope of the existing MAD provisions.

Under the current rules, a focus on trade information alone will be insufficient to reduce the risk of market abuse. The shortcomings on physical information are a far greater issue that needs to be solved.

Trade information itself becomes more important when there is an active tradable market. In gas for example, the development of such markets has been slow and only two markets exhibit any level of liquidity. Trading in liquid markets is obviously far more important for price formation that has an impact on end users. In non-functioning markets, prices are set either by reference to neighbouring markets, or related commodities.

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?

MLCE has always supported a broad level of transparency for physical information. Through direct lobbying and work within trade organisations such as EFET we have been involved in creating specific information requests.

A harmonised list would be a good starting point, but we would want this to be developed quickly and there is already sufficient work to indicate what should be on this list. Consistency will be important, particularly in the context of a market abuse regime where the disclosure of information is such an important trigger. Having information released in an inconsistent manner or at different rates across Member States may increase market abuse opportunities. The harmonised list of fundamental data must coincide, time-horizon wise, with the commodity markets in relevance, i.e. with a contractual forward horizon of 5 years.

MLCE would support a very broad list of information with ‘ad hoc’ information only relating to new and/or unexpected sources. Allowing competent authorities some discretion to direct disclosure may provide more flexibility if ‘missing’ information is later considered to be price sensitive. However there is a need to agree a core level of information and agree a phased and harmonised program of implementation.

The information we would expect to be released consistently across European markets are outlined in the table below.

Power	Frequency	Comments
Networks		
Transmission capacity	Daily	Constant calculation is necessary
Allocated capacity	Daily	
Available capacity Total Capacity	Daily	TTC – ATC = TRM Reserved for Transmission Reserve Margin
Use of Allocated Capacity = ATC/Actual Flow		
Planned outages	Annual	Updated as necessary
Unplanned outages	Immediate	Instant notification
Investment plans	Annually	Should be part of annual multi-year outlooks
Price for ancillary services per product	Daily through to annual	Depending on the product
Generation		Not aggregated per HV node but per plant
Nominated generation	Daily	Day ahead nomination
Delivered generation	Live	
Planned outages	Annual	Updates as necessary
Unplanned outages	Immediate	Instant notification could have standard reason codes, and there should be consideration of estimates for return.
Gas		
Network		
Total capacity	Daily	Firm capacity
Sold capacity	Daily	Firm and interruptible allows a better assessment of any remaining capacity and would help secondary market
Available capacity	Daily	Firm and interruptible
System input	Sub daily	Aim for near live flow
System offtake	Sub daily	Periodic demand calculations
Linepack	Sub daily	Periodic linepack updates provide an understanding on how the pipeline is being used, and how balancing actions might emerge. Should also include forecasts for the next day.
Balancing	Ex-post	Report on actions and price implications
Planned outages	Daily	But based around a longer term annual plan that is updated
Storage	Daily	Information aggregated by storage type and to include net inflows, outflows and inventory and notifications of outages and maintenance
Gas quality	One off/daily	Full specification, plus procedures for dealing with issues. Daily report of CV.
Operations	Daily/Sub-daily	Notification of constraints, interruptions and aggregate day ahead nominations
Balancing	Daily	Publication of imbalance charges based around market prices

Global Markets & Investment Banking Group

The quality of the information is important, as is the delivery mechanism. While we do not think a single platform is completely necessary (and in fact may be more restrictive than helpful), it is essential that the information is made available through web based systems and as raw data downloads.

A final point to note is that speed is more crucial here than perfection of the final product. In many ways an initial pan-European platform could be initiated fairly soon rather than waiting for a full suite of information.

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?

As noted above, 'ad hoc' information is difficult to define. If information is considered price sensitive then it should be released as part of a broader program. Only where new sources or types of information are identified should they be considered for inclusion. In such cases, a mechanism for assessment and inclusion could be part of any regime.

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

Overall MLCE supports a tailor made solution is best for physical energy markets. As mentioned above, the nature of the energy space requires regulatory solutions to ensure that the basic operation of energy delivery is not put at risk by the compliance rules.

Improved disclosure obligations on physical infrastructure applied in a consistent manner are essential for the market to develop where greater liquidity will lower abuse opportunities. We agree that greater disclosure will reduce the perception of market abuse opportunities which itself will provide more confidence in pricing and longer dated market activity. Improved disclosure on physical infrastructure is the easiest part of the solution, but care should be taken to ensure that different Member State legal systems do not result in a patchwork approach in terms of scope and timeliness of implementation.

MLCE views that insider trading elements as the most difficult to quantify. This mainly arises because of the requirements in energy (in particular power) to take immediate steps to rectify issues and this will often happen before disclosed information has been absorbed by the market. The rules may need to have some safe harbour provisions that prevent any risk of system disruption because of compliance concerns. However, such provisions should allow for post event analysis by Regulators to demonstrate that actions were not abusive as this will improve confidence in the market.

Given that the disclosure and insider trading rules are best suited to a tailor made solution, it is sensible that market manipulation also be considered within this framework. As for the reasons outlined in the response on insider dealing, the physical nature of the system and the requirement to deliver an essential service means that the rules will have to work effectively.

In terms of the options put forward, we would support Option 3 for the transparency/disclosure obligations (subject to our concerns about the single platform limitation). For Insider Trading, we prefer Option 3 as this could be developed to better reflect the different nature of physical energy activities. Similarly, we support Option 3 for Market Manipulation.



Global Markets & Investment Banking Group

Thank you again for the opportunity to comment on the consultation. Should you have any questions about this response I can be contacted on +44 2079959021 or my e-mail at adam_cooper@ml.com.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Adam Cooper", written in a fluid, cursive style.

Adam Cooper
Director, Regulatory Affairs
Merrill Lynch Commodities (Europe) Limited

Merrill Lynch Commodities
(Europe) Limited

Merrill Lynch Financial Centre
2 King Edward Street
London EC1A 1HQ

Tel 020 7628 1000