
<p>ENEL Response to the Consultation Paper by CESR and ERGEG on Market abuse August 2008</p>

Brussels, 29th August 2008.

Introduction

Enel is the largest Italian power company and the second largest European utility for installed capacity. It produces, distributes and sells electricity and gas across Europe, North and Latin America. The company has c. 60.000 employees and operates a wide range of hydroelectric, thermoelectric, nuclear, geothermal, wind, and photovoltaic power plants. Enel is present in 21 countries with c. 80.000 MW of generating capacity. It serves c. 50 million electricity and gas customers. Listed on the Milan (I) stock exchange since 1999, it has the largest number of shareholders of any Italian company, specifically c. 1.7 million retail and institutional investors. Its shares are part of the MIB30 index.

The Italian Economic Ministry holds 21.1% of the company directly, with another 10.1% indirectly held through the state-run lender *Cassa Depositi e Prestiti*, leaving a free-float of c. 68.8%. Thanks to its Code of Ethics, Sustainability Report, environmental protection policy and the adoption of international best practices for transparency and corporate governance, Enel's shareholders include leading international investment funds, insurance companies and pension funds and ethical funds along with Italian retail investors (for further details please see www.enel.com/).

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General observations

Enel acknowledges the need to address market failures in the electricity and gas markets, in particular with respect to asymmetric information and potential for abuse of dominant position. However, Enel estimates that these issues should not be dealt with within the scope of financial services regulation, as the purpose of this regulation is significantly different from the issues and objectives related to energy markets, as stressed by CESR and ERGEG.

The main purpose of financial markets regulation, including MAD directive, is to ensure stability of these markets and investors protection. However, its aim should not be to correct imperfections in underlying markets, since this would lead to improper and undesirable application - and to potentially unlimited scope - of financial markets requirements, raising doubts about its ultimate effectiveness. In particular, the following should be noted:

- Subjects participating in energy derivatives trading are professional operators, whose main purpose is to hedge exposure of their “physical” activities against commodities price volatility. This means that concerns about public confidence, investor protection and possible destabilizing effects on financial markets are limited;
- On the other hand, financial regulation, as currently designed, cannot tackle the main imperfections in physical markets, as it mainly addresses information-based market manipulation which does not seem the main issue;
- Flaws in the underlying market can also easily be found for commodities other than electricity and gas. For these commodities, in particular, price formation in underlying markets responds to global dynamics. Extending MAD application to physical electricity and gas markets would then require to adopt the same approach for all commodity derivatives (e.g. oil derivatives), even when their fundamentals largely fall outside EU jurisdiction.

Therefore, an extension of financial markets regulation would not be the correct instrument to pursue efficient functioning of electricity and gas markets. On the other hand, sector regulation already provides (or should provide) for a framework aimed at ensuring fair competition in the electricity and gas markets. Competition law and supervision by Antitrust authorities, in order to prevent abuse of dominant position and other anticompetitive behaviour, can also play a crucial role in ensuring well functioning electricity and gas markets.

In fact, many of the issues raised by CESR/ERGEG with regard to integrity of electricity and gas markets can be attributed to flaws in current sector regulation. For instance:

- The lack of transparency issue, as stressed by CESR/ERGEG does not appear to be a problem *per se*, provided that the same degree of information is available for all participants. It is rather related to the fact that some operators (e.g. vertically integrated undertakings) can benefit from asymmetric information. Transparency issues would probably be less relevant if effective unbundling were in place.
- Similarly, lack of competition in the market and possible abuse of dominant position generally arise from market concentration. Some Member States (e.g. UK, Italy) have addressed these issues by imposing structural measures as well as by active monitoring and promotion of competition, thereby limiting the possibility of market abuse. Other countries, however, still suffer from concentrated markets.

Therefore, a harmonised and improved sector regulation, in line with European best practices, would significantly reduce market integrity issues in the physical market. If this precondition is met, then the focus of MAD – and the purpose of financial service authorities – should just be to ensure transparent trades and financial stability in regulated markets of energy derivatives.

However, the need for additional transparency requirements or for an *ad hoc* market abuse framework for the energy sector should be carefully assessed. Excessive transparency requirements could in fact create barriers to entry (through over-regulation) and ultimately damage competition (e.g. by making commercially sensitive information public, or by facilitating coordination and collusive behaviour).

Even the need for an *ad hoc* market abuse framework is questionable: in countries where energy regulators actively monitor market functioning, and where cooperation between them and competition authorities is effective, market abusive practices have been successfully prevented or persecuted even in the absence of a specific legal framework. On the other hand, the definition of any disclosure rules should be exhaustive as to what

constitutes “inside information” in order to make aware the Market Participant concerning whether certain information constitutes Inside Information or not. Nevertheless, an exhaustive ex ante definition of all possible abusive practices in the energy market would be a very complex task.

Answers to questions for consultation

Question n. 1: Do you agree with the analysis of market failures in the electricity and gas markets as described above? If not please provide reasons for your disagreement

Enel agrees with the analysis of market failures in the electricity and gas markets. However, as stated in the general observations, Enel believes that these imperfections mainly relate to improper application of sectoral regulation - e.g. insufficient unbundling requirements and persistence of a concentrated market structure – rather than just transparency issues.

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

Enel agrees in principle with CESR/EREG, concerning scope and effectiveness of MAD in electricity and gas markets. However, these should not be considered as “limits” of current financial markets regulation, as they are fully consistent with the main objectives of MAD. Once again, these objectives shall be protection of investors’ confidence and stability of financial markets, which have little to do with physical market dynamics. If the physical markets work well, then current MAD provisions can be considered satisfactory even with respect to electricity and gas markets.

Question n. 3: Do you agree with the conclusion that greater pre- and post transparency would not be sufficient in the context of market abuse?

Enel agrees with CESR- EREG position that a mere extension of the scope of market abuse regulations (insider trading, market manipulation) in MAD to physical products should not be recommended because it would not reflect the needs of the electricity and gas markets and would bear the risk of leading to an inappropriate application of MAD. MAD is designed for financial markets and its purpose is not to address integrity issues of underlying physical markets.

Question n. 4: 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?

Enel agrees in principle with the objective to assure operators access to fundamental data in order to improve competitiveness of the market. However, an European harmonised list of data required to be published shouldn’t be exhaustive, but only stress minimum requirements. Besides the definition of any disclosure rules should be exhaustive as to what constitutes “inside information” in order to make aware the Market Participant concerning whether certain information constitutes Inside Information or not.

Question n. 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?

Actually, the “ad hoc” publication concept remains ambiguous: as we interpreted it, it refers to the possibility of occasionally considering some data as inside information, even if there is no ex ante requirement to make this information available. However, Enel estimates that no other information shall be considered as “inside information”, other than what should be disclosed according to sector specific regulation.

Question n. 6: What is your opinion on the proposals of CESR and ERGEG in the three areas: disclosure obligation, insider trading and market manipulation?

As regards disclosure obligations and transparency requirements, Enel welcomes them, although it estimates that priority should be given to improve electricity market design and reduce market concentration. Any transparency requirements should also take into account the need to protect commercially sensitive information. Also, a balance should be struck between transparency objectives and the need to avoid over-regulation, which increases the costs for market participants (especially smaller ones).

Concerning the proposal of a tailor-made market abuse framework in the energy sector, Enel does not fully agree. Monitoring of physical markets by energy regulators, and effective cooperation between regulators, can already provide for adequate prevention of market abuse. A legislative framework defining market abuse would only bring added value if it was exhaustive. However, as mentioned in the general observations, this would be a very complex task. In the absence of an exhaustive framework, it would only result in over-regulation, without reducing the degree of uncertainty for market operators concerning how compliant their conduct will be.

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ENEL would like to thank CESR, ERGEG and the European Commission for the opportunity of providing comments with the view of helping to develop the debate on market abuse (electricity and gas markets).

We hope that our comments make a useful contribution to the debate and we look forward to future cooperation with CESR, ERGEG and the European Commission.