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ERGEG/CESR proposed EU market abuse framework for energy markets

energywatch welcomes the opportunity to comment on this development. This response is not confidential and we are happy for it to be published on the ERGEG/CESR websites.

Energywatch strongly supports the thrust of the consultation paper of July 2008 and the key elements of the draft response it proposes to question F.20 on the scope of Directive 2003/6/EC concerning insider dealing and market manipulation (market abuse).

Our views on the issue of the scope for market abuse and the scope of the directive can be summarised as:

- existing EU securities legislation **does not** (as opposed to **may not** as per the draft response to F.20 Q1) properly address potential market integrity issues in the electricity and gas markets. This is because MAD does not apply to physical market products and, as intermediaries, players in these markets would often not be caught by the disclosure obligations that apply to issuers;
- we agree with the proposed ERGEG and CESR advice to the European Commission that it needs to explore a **tailor-made** EU market abuse framework for the electricity and gas sector given the complexities and unique attributes of trading within them. An extension of the scope of the MAD market abuse regulations would, in our view, be greatly inferior than the development of a bespoke solution;
- enhanced information disclosure should be at the heart of the reworked regime, and deliver disclosure obligations in bespoke energy sector regulations comparable to Article 6 of the MAD. These requirements should be legally binding and oblige all relevant entities to disclose all price sensitive information likely to influence physical and/or derivatives markets prices in a timely manner. This information should also be available in a single accessible place;
- the Nordic Exchange market rules **would** provide a suitable starting point for such a regime provided they were translated into a legally binding framework;
- effective sanction mechanisms to combat market abuse should also be designed and applied. Existing *Guidelines of good practice on information management and transparency* are not legally binding and do not provide for sanctions. The effectiveness of new sanctions should be proportionate to the considerable consumer detriment that can occur when physical players are

able to manipulate the market and carry out abusive practices; and

- the costs of developing such a framework are likely to be minimal given current industry reporting while the benefits are likely to be considerable, not just in terms of providing a mechanism to help tackle market abuse but also helping to increase market confidence and the conditions for new entry.

The sectoral regulators represented by ERGEG should jointly and individually advocate a position based on these points.

One area where the consultation is silent is on trades in related commodity markets outside the electricity and gas sectors. The working group needs to consider the interaction with wider energy commodity prices, especially (i) the relationship between oil and gas prices and (ii) the relationship between carbon and coal on the one hand and electricity prices on the other.

There are real interdependencies in both cases, which the consultation acknowledges but does not explore. We would suggest that these interactions can have as malign an impact on consumer prices as market abuse and insider trading, and require specific consideration. As a starting point we would suggest that all free allocations of carbon allowances should be included in the definition of fundamental data within the proposed regulations. At this late stage as a minimum we would expect the working group to highlight these issues to the Commission and recommend their further, urgent exploration.

Answers to the specific questions posed in the consultation are set out below.

I. Do you agree with the analysis of the market failures in the electricity and gas markets? If not, please provide reasons for your disagreement.

Yes. Energywatch fully agrees with market failures identified, most of which arise from the highly concentrated nature of energy markets. It is essential to robustly tackle the cause, not just the symptoms usually identified as poor levels of transparency, particularly within integrated corporate structures. We think the consultation document is right to highlight that asymmetric information is as important a cause as market power.

Indeed we would argue that they are much more deeply ingrained than suggested by the Commission in its sector report, and that these failures will increase as vertical integration deepens if the regulatory authorities do not make an appropriate response. It follows that the abusive practices highlighted—gaming of outages and other forms of withdrawal of capacity, taking advantage of balancing requirements by raising prices to distressed purchasers in physical markets, manipulating trades and prices through for instance “window dressing”, and using spot trades to influence forward prices—must be addressed specifically by the Commission.

Further, as the consultation indicates, market power will remain an important issue even as and when markets integrate. This situation will be reinforced by the high investment costs and remaining significant barriers to the energy sector flowing from

its inherent complexity.

2. 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?

We think it correctly identifies significant gaps and provides robust justification of the need for targeted measures specific to the energy sector.

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

Yes, it would be a start. Energy markets, especially in electricity, are prone to both spatial and temporal dominance and its abuse, which can be hard to detect. Often those well-placed to identify and publicise instances of such abuse have the weakest incentives to act. As noted, the existing *Guidelines of good practice on information management and transparency* and the transparency rules under the *Congestion management guidelines* do not go far enough, and are not legally binding. There needs to be an “improvement of regulatory framework with regard to the disclosure of information on fundamental data ... to increase public confidence and prevent misuse of such information” (para 58), and we agree with the Commission that “an absence of publicly available fundamental data is leading to distrust in the pricing mechanisms”.

4. Do you agree with the analysis 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?

Yes we do, and it is essential to proceed as proposed. Fundamental data is a basic building block and requires broad definition to capture all price sensitive information. However, once identified this data can and should be supplemented over time, should be readily comparable and produced under common guidelines. Consequently, we think the three shortcomings highlighted at para 74 should be included in the draft response to Q2 as preconditions for disclosure of fundamental data (i.e, it should be made available on an equal and timely manner, on a single information platform, with standardised “quality”).

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?

The principle should be that all price sensitive information should be routinely disclosed. A comprehensive template should be developed drawing on the Guidelines referenced in the consultation document and based on the Nordic model.

5. What is your opinion on the proposals of SESR and ERGEG in the three

different areas: disclosure obligations, insider trading and market manipulation?

We wholeheartedly support the proposal to implement disclosure obligations comparable to Article 6 MAD in energy sector regulations and tailor-made frameworks for insider trading and market manipulation for all electricity and gas products not covered by MAD (option 3 in all cases). A sector specific framework is the only robust response to the abusive practices identified in the consultation. There may need to be an alignment of regulatory powers in some jurisdictions where necessary.

If you do wish to discuss our response further please do not hesitate to contact me on 0044 191 221 2072.

Yours sincerely

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Head of Regulatory Affairs