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Position Paper

Response of the German Association of Energy and Water Industries (BDEW)
on CESR/ERGEG advice to the European Commission in the context of the
Third Energy Package
Draft Response to Question F.20 - Market Abuse Consultation Paper

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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 CESR/ERGEG Consultation Paper. Due to the very tight timeline for the response, we limit our observations to the most pertinent points and would reserve the right to add additional comments in the further consultation process.

Generally, we would like to point out that BDEW in particular supports transparency with regard to fundamental data in a harmonised European approach which should be based on the existing legislation and initiatives. BDEW has taken part in a voluntary initiative in order to facilitate transparency and ensure central publication of fundamental data. The need for further legislative action, however, has to be carefully assessed with regard 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.

Commission Question Q1: Is the scope of Directive 2003/6/EC on insider dealing and market manipulation (market abuse) such as to properly address market integrity issues in the electricity and gas markets?

CESR/ERGEG consultation questions to Commission Question Q1:

1) 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.

CESR and ERGEG base their concerns on market integrity on findings of the Commission's Sector Inquiry. They refer to perceptions of market participants that generation data of vertically integrated undertakings is not necessarily shared with other market participants and the possibility that market power is used for the manipulation of markets, either by withdrawing capacity or by imposing high prices when the production is indispensable to meet demand.

Although we do not want to go into a detailed analysis of the Sector Inquiry's findings, which give rise to several critical remarks, we would like to highlight some issues with regard to the market failures identified in the consultation paper:

- CESR and ERGEG rightly observe that the Sector Inquiry's diagnosis might be outdated to some extent as the electricity and gas markets have undergone substantial changes in the meantime. It has to be noted that the findings of the Sector Inquiry deal with a period of time where in some European countries, as e.g. Germany, regulatory authorities did not yet exist. We would concur with the consultation paper in this respect and point out that in particular with regard to publication and transparency of fundamental information substantial progress has been made in the meantime, e.g. the Congestion Management Guidelines have been introduced in Regulation 1228/2003. In Germany, the implementation of the publication duties with regard to fundamental information has been subject to a joint initiative of the German Ministry of Economy and BDEW and other German associations representing generators.

- With regard to the abuse of market power by withdrawing capacity, recent studies indicate that such behaviour would not be economically feasible for market participants under the current market design (cf. the study of Dr. Axel Ockenfels, Strommarktdesign, May 2008).

Generally, the perceived market failures are already dealt with in the context of the 3rd liberalisation package. In addition, most of the alleged market failures would fall within the scope of the competition law provisions on the abuse of dominant positions and can therefore be addressed by the competent competition authorities, which have sufficient powers under the current legal framework. However, the consultation paper points out that the abusive practices do not necessarily relate to the existence of a dominant position. In our view, it would be inefficient if concurrent and partly diverging jurisdictions of competition authorities and energy regulators with regard to market abuse in the energy markets were established. We therefore endorse the statement at para 113 of the consultation paper that the contemplated legal framework has to be coherent with existing securities and antitrust legislation.

We would like to stress, however, that any new legal framework has to be assessed under the principle of proportionality, i.e. whether there is really a need for further restrictions; and whether the planned restrictions are necessary to achieve the aim.

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?

In general, we agree with the analysis of CESR/ERGEG in that respect.

With regard to **disclosure obligations**, the duties of the “issuer” under the Art. 6 MAD cannot be easily transferred to the context of energy markets. Firstly, the scope of the disclosure obligations does not apply to physical market 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 do not apply 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 where there is no single issuer, but a dispersed market where numerous market participants may have non-public information. 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 or energy regulators in the existing legal framework.

Commission Question Q2: Would the assessment be different if greater transparency obligations in line with the analysis above were adopted?

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

In our view it is essential that a clear distinction is made between the issues of transparency and the issues of market monitoring and supervision. Pre- and post-trade reporting duties mainly serve to facilitate the monitoring of the market by regulators. The information needed for market transparency purposes (understanding of price formation) and information to suit regulators needs (monitoring of the market) are substantially different. While improved market transparency generally increases trust, the publication of commercially-sensitive information would bear the risk of market distortion. Hence, the type of data released to the market should be aggregated data relating to the use of infrastructure (i.e. data on the transmission network and interconnectors) or the status of generating units as these data are important to understand price formation. The publication of such data is subject to several voluntary initiatives of the energy industry, as further set out under 4 below.

As already set out in our response to the CESR/ERGEG call for evidence, we like to stress that the Commission's Sector Inquiry has not provided any argument for additional pre- and post trade transparency. Generally, transparency on exchanges is ensured by the exchange itself, where market players can see e.g. the traded volumes, bid/ask curves, number of players and clearing prices. Regarding OTC-trading the broker screens in use in modern trading rooms allow for market players to see e.g. the bid and ask prices and the traded volumes. Additionally, a range of further detailed ex-post information is provided by brokers and information providers. In this context we also like to point to the ERGEG Guidelines for Good Practice on Information Management and Transparency in Electricity Markets (Ref: E05-EMK-06-10) which clearly concludes that information needed to be released to the public should be aggregated information provided through respective exchanges and brokers platforms.

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?

We support the disclosure of fundamental data which is important for the understanding of price formation in the markets. There is in our view a strong case for a harmonised list of fundamental data at the European level.

The Transparency Reports for the Regional Markets should be the basis for such European approach. CESR/ERGEG observe that these Transparency Reports are not legal acts by themselves; they, however, give the common interpretation of the legally binding Congestion Management Guidelines and represent the common understanding of the regulators involved.

In Germany, the fundamental data listed in the Transparency Reports have been taken as basis for a voluntary initiative of the German Ministry of Economy and BDEW and other German associations representing generators. The data will be published in Germany on a central platform at the EEX ensuring a high level of transparency. The data will also be monitored by the German energy regulator. This initiative is a pilot project ensuring the implementation of the requirements of the Transparency Reports. In our view, any further obligations of disclosure of fundamental data have to be based on the existing instruments, in order to avoid that existing solutions as the platform mentioned above and related IT solutions and processes may have to be redesigned with considerable costs for all market participants concerned.

Equally, any European solution should avoid the necessity to deal with multiple platforms and should ensure that companies are not subject to the jurisdiction of different regulators with conflicting data requirements, processes and formats.

In order to guarantee legal certainty for the undertakings concerned an exhaustive list of data to be published is clearly preferable. The necessity to publish additional data on an ad hoc basis is neither helpful for other

market participants who do not know which disclosure to expect, nor for the undertakings which continuously have to make difficult assessments whether to publish certain additional data or not.

In addition, it should be noted that the disclosure obligations should acknowledge that the withholding of information for a certain period may be legitimate under certain circumstances (cf. para 82 of the consultation paper).

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?

As set out in our answer to question 4, we recommend an exhaustive list of information to be published.

Commission Question Q3: What suggestions do regulators have to mitigate any shortcomings?

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

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.

If, however, the Commission sees the need for additional legal rules, the option of a tailor-made sector specific regime seems to be the preferable approach. In the short timescale for consultation it is, however, not

possible to develop a more detailed framework for such a regime. This approach would therefore necessitate subsequent careful consideration and consultation. In our view, it would be preferable if such regime were established by a directive or regulation and not by Commission guidelines.

In such discussion, the Nord Pool market rules can only serve as a first starting point, as suggested by CESR/ERGEG. They have to be very carefully considered and adapted, taking into account that they are designed for the specific characteristics of the Nordic Market with a high volume of hydro-generated power.

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 various record-keeping obligations should be consolidated, in particular to avoid additional burdens for companies which act on the European level.