

VIK Response

to the CESR and ERGEG Consultation Paper

on Market Abuse

dated July 2008

Essen, August 29, 2008

VIK, the federation of industrial and commercial energy consumers in Germany, welcomes that with CESR and ERGEG both the regulators of the financial as well as the energy markets together have thoroughly investigated the state and the deficiencies with regard to the detection of market abuse in the energy markets. Over the last years especially the electricity market has adapted and incorporated many characteristics and specifics of the traditional financial markets. In these markets we could learn in the past that clear and strict market abuse regulation with regard to both its detection and the appropriate sanctioning have become very prominent. As a result, both issues found proper reflection in legal documents at least for the traditional financial markets.

On the other side, the scope for market abuse in the energy markets is considered to be significant. This is based first on the highly oligopolistic structure of these markets, especially in generation, where market power plays a huge role, and second on a price development, which often does not comply with fundamental price drivers' data. Mistrust in the market development – be it substantiated or just felt – is therefore a general characteristic of the energy markets in the EU. And this is to the detriment of a sound development with attracting an adequate number of new and outside players to it, for the benefit of a more competitive environment. It is therefore, that similar rules as found and established for the financial markets are especially needed for the energy sector – thereby reflecting and covering all its specifics. It is high time, that politicians take up this important exercise. The CESR/ERGEG consultation constitutes a valuable cornerstone to such development.

VIK's comments to special issues of the CESR/ERGEG response paper:

1. The CESR/ERGEG analysis of the elements lacking within the financial markets regulation if applied to the energy markets is absolutely correct. If market abuse regulations for the energy markets can not cover OTC markets as well as physical trades, these are not complete and appropriate. It must be underlined that the regulations for these markets must definitely go beyond what is covered by the Market Abuse Directive (MAD).
2. There is a second issue where MAD is not appropriate for the energy markets: The definition of "issuer" used for determining the application of disclosure obligations according to MAD cannot be brought into fit in order to reflect and cover the roles/players within derivatives markets in general or the energy markets specifically. We cannot see that this problem could be solved within the framework of MAD.
3. Based on these two issues mainly, the clear statement of CESR/ERGEG in favour of a separate, tailor-made market abuse framework for the energy markets is definitely supported by VIK.
4. Beside the doubt for the possibility of a proper fit of the energy markets' needs with the financial markets' ones the urgency of the task is the most important reason for such tailor-made solution. Such urgency must be underlined here! The rules and regulations addressed here are an important feature of the liberalized energy markets which already has been lacking for too long.
5. Transparency is an important element within the package of a market abuse framework. It is however, - as also mentioned by CESR/ERGEG - by far not a sufficient one. VIK welcomes

that the EU Commission in its congestion management guidelines dated Nov. 2006 has already initiated the implementation of such a transparency package. However, it must be criticized that by today – meaning nearly two years later – the appropriate rules are still not in place within all EU members states. The implementation process has been gone much too slow. It must therefore be accelerated as much as possible. Its result must be that disclosure rules similar to the ones as applied to “issuers” in the MAD must be valid and obligatory for any carrier of information, which is of relevance for the market development and price formation within the energy markets. Here we admit that also demand side data might be of relevance for a proper understanding of the market development. However, the important and substantial differences must also be taken into account. As the most prominent feature, it must not be forgotten, that it is not the demand side which is considered to be the source of any potential market abuse. Furthermore, non-aggregated information disclosure for the demand side players can lead to substantial competitiveness disadvantages within their competitive product markets. Therefore, when considering disclosure obligations also for the demand side, the specifics and the important differences as compared to the generation side must be properly considered. Furthermore, it should be safeguarded, that the disclosure rules as implemented within the EU member states build a harmonized basis over the whole EU.

6. CESR/ERGEG considers that there is probably no need to change the specific definition of insider information from the MAD for the application within the energy markets. We can support this in general. However, the consultation paper itself draws the readers’ attention to an unclarity regarding the understanding of this term (see point 29 of the consultation paper). We think that during the implementation of tailor-made energy market rules there is the need to judge, where and when (forbidden) insider trading really starts. It is necessary to thoroughly discuss and determine, whether the behavior not to inform the market about generation outages until the missing position has been closed is to be considered non-forbidden insider trading. Can such behavior be accepted since it is just covering emergency needs? Or can it not? The market abuse framework for the energy market should make that clear upfront in order to establish a fair and clear ground for any actors.
7. The interrelationship between the different energy markets is very complex and tight. As one of the most important examples the impact of the CO₂-market and the electricity market should be mentioned here. Both markets’ price developments are very closely correlated. Thereby, the CO₂-market is a relatively small one as compared to the power market, Nevertheless it can build an effective leverage for impacting the other. Therefore, it would be inappropriate and an important deficiency to leave out this market, when establishing an energy market abuse framework.
8. To conclude on this, VIK is supporting the initiative and findings of CESR/ERGEG and hopes that the EU will very quickly react in order to establish a tailor-made and comprehensive market abuse framework for the energy markets which provides for an information-balance for all players, gives guidance on correct vs. incorrect behavior and foresees the necessary adequate sanctioning mechanisms.