According to Peter Styles, board member of EFET, regular monitoring of wholesale energy markets is an important aspect of market liberalisation but too much regulation would be costly and could reduce market liquidity.

Limiting the Burden of Market Monitoring

INTRODUCTION

One of the main functions of the European Federation of Energy Traders (EFET) is to improve the conditions for conducting wholesale transactions in the European energy markets. This in turn means our members want to facilitate the efficient operation of those markets. In order to improve market efficiency, energy traders promote transparency regarding market volumes and prices, for example by means of passing their own data to exchanges, showing their bids and offers on broker screens and disclosing transaction information to trade publishers.

Beyond the release of data by these means, which allow exchanges, brokers and publishers to pass onto the whole market accurate aggregate statistics, some regulators have started to call for the reporting of individual transactions for the purpose of market monitoring. Indeed DG TREN and DG COMP apparently advocated such reporting as an integral obligation in early drafts of proposed amendments to the internal electricity and gas market directives. In the final versions of the European Commission's proposed amendments (published in September 2007) reporting obligations were replaced by obligations to keep records of transactions.

WHO NEEDS INFORMATION ABOUT TRANSACTIONS?

Currently power and gas traders in Europe make no claim to financial information or any other commercial details about other traders' individual transactions as such. If they do become concerned about another market participant's deals, their concern usually revolves around whether TSOs are allowing completely non-discriminatory market access or whether an incumbent producer (or wholesale importer in the case of gas) is giving enough information about its planned or actual output (imports). Abuses of this type are not intrinsic to the operation of the mainstream traded markets, rather they are linked to the surviving traditional structure of parts of the energy sector in Europe.

Of particular concern to traders in the electricity and gas sectors is the marked lack of cross border co-operation between transmission system operators (TSOs). Their failure to harmonise extends in electricity markets, for example, to their methods of congestion management, their assessment of available transmission capacity at borders and their isolated organization of national intra-day and balancing markets. These important aspects of market integration have not yet been resolved on a pan European scale, nor even within most regions. On the gas side, whilst policymakers and regulators increasingly emphasize the need for fully transparent, simple and cost-reflective third party access regimes, there remain formidable barriers to entry. The gas side impediments rest partly on foundations of artificial complexity and opacity in long term legacy contracts, the survival of which continues to deter new entrants.

THE EXPECTATIONS OF REGULATORS

We continue to face proposals for greater disclosure of details of individual wholesale energy transactions to regulators. The CRE in France has recently consulted on a plan to require national reporting. ERGEG and CESR are conducting an investigation at the behest of the European Commission into how energy and financial regulators should monitor the operation of wholesale markets in power and gas as commodities and of markets in related derivative contracts. EFET does not believe that any of these bodies has yet carried out a thorough impact assessment and cost-benefit analysis in relation to extended transaction transparency and reporting requirements.

The imposition of compulsory disclosure to national regulators (or indeed compulsory publication) of details of market participants' OTC wholesale power and gas transactions would cause considerable surprise among the energy trading community across Europe. Banks and investment and commodity firms share the major concerns of physical traders about any precipitate 1:1 roll-out of reporting arrangements - as laid down in the Markets in Financial Instruments Directive (MiFID), in relation to just the power and gas sectors, without apparent regard for the comparable regulatory burdens affecting other commodity derivatives markets. EFET has outlined in consultative exercises a fear that the imposition of significant new obligations could lead to a reduction of the number of market participants, thereby in turn producing a negative effect on wholesale power and gas liquidity and competition.

WHAT IS OPTIMAL REGULATION?

EFET has asked Regulators to take account of the following factors, as they formulate plans as to how they may discharge their monitoring duties:

(1) Duplication of effort and non-harmonisation

The European Commission requested on 21/12/07 jointly from CESR and ERGEG advice regarding collection of data about power and gas wholesale transactions, in connection with its review of the content of Article 5 of EU Regulation 1228/2003 and the equivalent provision in the EU Gas Regulation. It would be unfortunate if in advance of the advice being finalised any national authority were to launch its own data gathering exercise. Indeed a national scheme would in a way pre-judge the outcome of the mandate given to CESR and ERGEG by the Commission.

(2) Undue administrative burden

Trading data requests from any one national authority may lead other national bodies to take their own initiatives, again without waiting for the advice that the Commission has sought. This would lead to administrative confusion for international suppliers, faced with multiple data requests in different formats. International suppliers are not convinced that all European countries and regulators apply sufficiently rigorous confidentiality standards to staff, who would see commercially sensitive transaction data. Furthermore, many companies fear that, after they have submitted raw data, they may face additional, time consuming questions from less sophisticated national regulators, some of whom might not be fully conversant with the operation of cross-border wholesale power and gas markets.

(3) Less liquidity

In addition to the potential barrier that would be erected to new entrants, existing traders may well vote with their feet and just trade less in a national market subject to stringent reporting requirements. Some market parties might even exit such a market. This could lead in turn to less liquidity, more price volatility and potentially higher wholesale prices due to higher risk. By analogy, a recent study performed by the British Financial Services Authority (FSA) contains very clear remarks concerning the potential negative impact of reporting requirements on the liquidity and depth of markets in financial instruments.

A BETTER WAY FORWARD?

Regulatory monitoring of wholesale markets is an important activity within the context of liberalization of the European electricity and gas sectors. But the first steps should not comprise a jump to burdensome transaction reporting. Rather they should practically involve sourcing basic information from the operators of transmission networks and of wholesale market platforms, such as exchanges and brokers, in the view of EFET. An ad hoc EFET working group is presently investigating what traders might do to facilitate access by Regulators or other surveillance agencies to the OTC market data visible to subscribers on broker screens. We are also exploring whether EFET will be able to play a role in formatting or transferring data.

EFET promotes increased transparency on the physical side of the power and gas markets (use of the transmission and production infrastructure, demand/supply balance) as these factors determine the price formation to a large extent. Turning to the role of TSOs, careful tracking and analysis of the flows on high voltage networks and high pressure gas pipelines can, in our experience, yield very interesting indications of how the pan-European market is functioning. A corresponding careful review of the manner in which TSOs then calculate available transmission capacity and actually allocate capacity, especially across national borders, will potentially also tell Regulators a lot about competitive conditions. Analysis of the precise patterns of availability and utilisation of generating plant inside national markets will add to the completeness of the wholesale competitive picture, in the case of the power sector.

> “We are also exploring whether EFET will be able to play a role in formatting or transferring data.”

If a Regulator on top of this makes careful use of an analysis of all suppliers' or shippers' nominations received by TSOs and of transaction volumes and prices in the OTC market as published by the industry press, probably a much more efficient market review can be achieved, than by starting from raw transaction data gathered from scores of individual market actors.

If there are reasonable grounds to suspect abuse of a dominant position or collusion or market abuse, then EFET naturally recognises the responsible authorities (be they energy regulators, competition authorities or financial regulators) must be able to request individual transaction data from individual companies.