Regulators want tougher transparency rules

Europe's energy regulators and financial regulators have jointly backed calls for binding transparency obligations in EU gas and power laws. Why aren't existing rules enough and what does this mean for Europe's utilities? **Paul Whitehead** finds out more.

In December 2007, the European Commission asked the European Regulators Group for Electricity and Gas and the financial regulators group, Committee of European Securities Regulators to jointly provide "technical advice" on including mandatory requirements on disclosure of market information in measures proposed to boost competition in the power and gas markets.

The EC had proposed detailed trade reporting requirements in early drafts of the third package directives adopted in September 2007 but dropped them after EU internal market commissioner, Charles McCreevy, objected and insisted on more research.

The regulators published their formal advice, after conducting a consultation, on October 1. It could form the basis of formal binding technical guidelines on transparency. The regulators advocate introducing mandatory obligations to stamp out potential market abuse, on the grounds that provisions in the EU's existing Market Abuse Directive are not specific enough to the energy sector.

"The current [EU market abuse directive] only covers the energy markets in part given that it is designed for financial markets," said Ergeg chairman John Mogg as the findings were published. "A more appropriate [separate] framework is needed to prohibit market abuse in energy markets. Market abuse can take many forms such as market manipulation or insider trading and regulators and market participants are hampered by the lack of transparency. We call on the commission to commit to address this," Mogg said.

Yet information can be crucial to successful trading in the electricity and gas markets – players risk making poor trading decisions if they do not have equal access to market information.

The regulators' findings are the fruit of a joint working group chaired by Ergeg vice president Johannes Kindler. The group considered whether the existing market abuse directive properly addressed "market integrity" issues in and whether this would change if greater transparency rules were adopted. Finally the EC asked them to suggest ways to address any shortcomings.

Market abuse possible, but not proved

The regulators' report acknowledged that there was a "perception" amongst market participants that market abuse is possible in the electricity sector, but the regulators said they were unable to find conclusive evidence of any market abuse.

The European Commission's energy sector Inquiry carried out in 2006 found there was a "perception that generation data of vertically integrated incumbents is first shared with affiliates and not necessarily at all with other market participants, which undermines confidence in the wholesale markets."

In their report, the regulators say this sort of scenario could lead to market abuse and that "given the current degree of concentration in many member states, physical markets for electricity and gas are also vulnerable to manipulation based on market power," as generators could influence prices by withdrawing capacity or by charging high prices for production which they know is essential to ensuring security of supply.

But the report stresses that because of the absence of a "full and in-depth market monitoring exercise" and the "unavailability of the required information for regulators" they could not determine whether there had been any market abuse.

"As long as the necessary information is not available to regulators actual abusive behavior is difficult to detect," the report said, calling for more data to be available.

While the EU's 2003 Market Abuse Directive sets out common rules on the disclosure of market information and aims to prevent insider trading and market abuse, it applies "almost exclusively to financial instruments admitted to trading on a regulated market," the report notes, pointing out that physical products like electricity and gas traded on spot markets are not covered and derivatives (futures, options and swaps) are only covered if they are traded on a regulated marke. This is not the case with energy derivatives as the issuer is usually the market operator, " which is not an issuer within the meaning of MAD," the report points out.

"In addition, the commodity derivative specific definition of insider information in MAD is difficult for securities regulators to apply, in the absence of a clear definition of the information that users of commodity markets can expect to receive in accordance with accepted market practices on those markets" it concludes.

Industry-specific measures needed

The regulators said they believed industry-specific measures were needed for electricity and gas because a "mere extension of the scope of market abuse regulations in MAD to physical products is not recommended, particularly because it would not reflect the needs of the electricity and gas markets."

Even in the case that regulators were given more information under existing guidelines, energy and financial regulators said this would still be insufficient as current requirements on data in the EC's Congestion Management Guidelines had "shortcomings" as they do not require sufficient detail, are not legally binding and have no power to impose sanctions in the case of non compliance. Ergeg has also drawn up Guidelines of Good Practice on Information Management and Transparency, but like the CMG, these are not binding (*EUE 189/8*)

"Greater transparency/disclosure obligations on price sensitive fundamental data (e.g. generation, transmission, transportation, storage and capacity levels) could enhance the supply of information for both physical and derivatives markets and promote market integrity," Ergeg and CESR said. Their report advocates specific energy sector disclosure obligations to boost transparency by forcing market players to disclose information that would likely influence physical and derivatives prices "in a timely manner and on a single platform," like an exchange or through information providers, like Platts. And they call for sanctions against those companies that fail to comply.

Nord Pool as a model

They say the EC should "consider developing and evaluating proposals for a basic, tailor-made market abuse framework in the energy sector legislation for all electricity and gas products not covered by MAD".

"The aim of new legislation would be to ensure that all trades are covered by appropriate market abuse legislation. This would ensure that over-the-counter contracts do not escape coverage due to the fact that they are not admitted to trading on a regulated market," the regulators said in their joint advice.

Rather than reinvent the wheel, the regulators recommended using the market conduct rules of Nordic power exchange Nord Pool as a model for anti-market abuse measures.

These rules "prohibit insider trading and define in an annex what is considered as inside information – eg planned outages or limitations of plants with more than 100 MW in the next six week period, [plus] unplanned outages or failures of plants with more than 100 MW," they said. "Market participants are not allowed to place trading orders in the Nord Pool system as long as they hold these types of insider information exclusively."

But they warned that any new legal framework would have to take into account the specificities of the electricity and gas markets with regard to any misuse of information, and support cooperation appropriate for regional markets, in the light of the EU's push to create regional electricity and gas markets.

CESR and Ergeg recognized that imposing such requirements across Europe would result in compliance costs, but they felt the benefits and increased confidence in the way markets operate would be beneficial, and this greater confidence could in turn lead to greater liquidity

Market players welcome urgent action

Indeed in a separate survey of wholesale energy market players by UK-based consultants Moffat Associates prepared for the European Commission, most players said they would welcome "urgent action improve supply and demand data transparency."

Moffat Associates were asked by the EC to evaluate key factors impacting on the liquidity and efficiency of EU wholesale electricity and gas markets. They submitted their findings to the EC in July, but the report was only made publicly available in September.

But in an interview with Platts just prior to the release of the regulators' report, Moffatt Associates' managing partner Clive Moffatt said that he was not convinced of the need for new legislation to enforce transparency.

"Physical data transparency is fundamental. It's a no-brainer in terms of getting data out there. But this requirement is all in existing legislation. What they (the EU) need to do is enforce it. They need to say to the generators that they must provide the information".

Moffatt said the Agency for the Cooperation of Energy Regulators, which the EC proposed in its third package, needs to have "physical data at the top of its agenda."

And as well as the need to ensure physical data is available, Moffatt said there were two other priority areas for market transparency

"We need clear guidelines on market design – market rules and market structure – to allow trading, especially in greenhouse gases. And finally we need effort to ensure the independence of regulators....There is a strong view among market players that some regulators are not independent. ACER needs to underpin their independence and ACER itself needs to be independent.

Moffatt's report found that there was strong support in the market for "strengthening the independence and power of national regulator" and "providing a legal basis to underpin the Ergeg regional integration program and creating some form of regulatory oversight at the EU level to ensure consistency and delivery of common market rules".

The Moffat report also underpins the need to ensure that any new market transparency rules extend beyond trading on regulated exchanges and in derivatives to phyiscal spot markets. It found that only half of market participants trade derivatives frequently compared with over two thirds for physical spot, and that most used bilateral contracts in the over the counter market rather than exchange for most of their trading.