ISSN 1977-3919

POLICY brief

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ISSUE 2011/03 • JUNE 2011

Transparency in the European Wholesale Energy Markets: Filling the Regulatory Gaps

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Highlights

- Wholesale transparency promotes competition and market well-functioning, and positively reflects on the performance of the entire energy sector. Transparency can be improved through the disclosure of ex-ante and ex-post information, as well as through record keeping

- The governance of transparency in the European wholesale energy markets can be analysed from three different points of view: levels of governance (national/supranational), policy domains (sector-specific, financial, carbon), nature of enforcer (private/public)

- While several pro-transparency initiatives were undertaken by market actors, the public governance of transparency is still a work in progress. The current regulation exhibits significant regulatory gaps which the EU is willing to fill through a new tailor-made market transparency framework

- The main challenge in this respect is represented by the need for coordination. Overlaps and inconsistencies with the existing national and supranational rules shall be avoided and the three different policy domains involved in energy trading shall develop more integrated implementation paths

[1] Michetti E. 2011. 'European Energy Markets Transparency Report 2010'. http://www.florence-school.eu/portal/page/portal/FSR_HOME/ENERGY/Energy_Market_Transparency_Award/2010_Edition/Transparency_Report_2010.pdf

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Florence School of Regulation

The Florence School of Regulation (FSR) was founded in 2004 as a partnership between the Council of the European Energy Regulators (CEER) and the European University Institute (EUI), and it works closely with the European Commission. The Florence School of Regulation, dealing with the main network industries, has developed a strong core of general regulatory topics and concepts as well as inter-sectoral discussion of regulatory practices and policies.

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Background

Wholesale energy markets in Europe involve a few hundred companies, including producers, large energy users, pure traders, investment banks and funds. Energy is typically traded either at exchanges or through over-the-counter (OTC) agreements. At the moment around 15 energy exchanges provide trading platforms for electricity, natural gas and carbon emissions. Nevertheless, the majority of energy in the EU is traded via OTC.
Well-functioning wholesale markets reflect on the overall performance of the energy sector, since wholesale prices work as a benchmark for the retail prices paid by household and industrial consumers, and send signals for future investments. Accordingly, there is a regulatory interest in ensuring that wholesale prices are not distorted by abusive market practices or lack of transparent rules.

The role of transparency

Transparency promotes markets well-functioning by ensuring that operators have an adequate understanding of the market and that the available data (prices and quantities) provide them the right signals. Moreover, transparency enhances competition. Operators holding greater market power enjoy an information advantage which they can use to deter entry and limit fair competition. Thus, information disclosure represents a useful instrument to create a level playing field for market participants, favour market oversight and detect abusive behaviours.

Types of transparency and examples of advanced practices

Pre-trade transparency allows for the disclosure of information on the physical data which operator shall gather as a prerequisite for efficient trading choices.

> ERGEG Comitology Guidelines (2010) on fundamental data transparency require electricity generators to provide ex-ante information on the generation capacity installed and on the planned unavailability of generation units (non-binding).

Post-trade transparency allows access to information on previous transactions, such as prices, quantities and bid curves.

> Regulation (EC) 715/2009 on conditions for access to gas transmission networks requires TSOs to publish information concerning effective records of all their capacity contracts (binding).

Record keeping obligations provide for a certain amount of information to be available in the medium-long term.

> The 3rd Energy Legislation Package in force since March 2011 codifies a 5-year record keeping obligation for (gas/electricity) supply undertakings on their trading records (binding).

The governance of market transparency

Governance consists of setting rules and enforcement mechanisms. The governance of transparency in the European wholesale energy markets can be analysed from a three-dimensional point of view.

First dimension: levels of governance. Governance of transparency combines at least two fundamental “layers” of governance: national and supranational. In practice, transparency governance in the EU functions in a multi-level frame in which the different levels interplay and compete in creating or implementing rules. In order to avoid overlaps and heterogeneity among the different governance levels, a higher level of coordination is needed.

Second dimension: policy domains. Wholesale energy markets are highly hybrid and involve three different policy domains: sector-specific (energy) regulation, financial regulation and carbon market regulation.
Coordination is required among implementing policies and action lines which have developed separately so far.

Third dimension: nature of enforcer. Private and public governance compete to create rules and to enforce them. A number of effective pro-transparency initiatives - shaping the private dimension of governance - were recently undertaken by European market actors.

The private governance of transparency

Nord Pool Spot (NPS) - the largest exchange for electrical energy in Europe and in the world - has had a pioneering role in the development of market transparency and won the Energy Transparency Award in 2010. Already 12 years ago, NPS disclosure requirements were fulfilling most of the provisions of EU Directives and Regulations in place today.
The Gas Regional Initiative North-West (GRI NW) - the largest GRI in terms of both market size and geographical scope - contributed to the improvement of transmission and storage transparency through very high standards for the disclosure of information.
Further noticeable initiatives promoting transparency were undertaken by ERRA, Joint Oil Data Initiative, National Grid Gas, AGGM, ENTSO- G, GRT Gaz, REE, Belpex and EEX.
Full details available from:
www.Florence-school.eu/portal/page/portal/FSR_HOME/ENERGY/Energy_Market_Transparency_Award/2010_Edition/Transparency_Report_2010.pdf

By contrast, public authorities' activity of law-making, regulation and enforcement provides the public dimension of governance.
As for public governance, the current framework exhibits some relevant regulatory gaps which need to be filled.

The current regulatory gaps

Currently, the issue of energy markets transparency is to a different extent affected by three pieces of European legislation:
Markets Abuse Directive (MAD): Directive 2003/6/EC provides a common framework for the disclosure of information to the market and sanctions insider trading and market manipulation.
The MAD is designed for financial markets only: it covers energy derivatives if they are admitted to trading on a regulated market, while it does not apply to spot energy products and to OTC trades.
Markets in Financial Instruments Directive (MiFID): Directive 2004/39/EC provides investor protection and market oversight over investment service activities carried out by investment firms.
The MiFID is designed for financial instruments only: it does not cover energy derivatives unless they are investment products, and it does not cover the spot market and non-standardised physical OTC transactions.

The MAD and the MiFID are designed for financial markets and cover only energy derivatives traded at energy exchanges. In figures this means that a portion equal to 16% of the total traded volumes of electricity is covered by these rules.

3rd Energy Legislation Package: The 3rd package (into force since March 2011) includes some disclosure provisions and codifies a record holding obligation for supply undertakings on all trading transactions for 5 years. Moreover, some broad monitoring duties are identified for National Regulatory Authorities and for ACER.

The 3rd Energy Package does not specifically address transparency in energy wholesale markets and the specificity of carbon market.

QM-AI-11-003-EN-N

Transparency in the carbon market

Carbon market transactions value more than €70b per year. At the moment, only 80-90% of trading in carbon market is covered by financial regulation, while there is a regulatory gap concerning the remaining percentage. The main challenge with carbon market is the specificity of the traded assets: it is controversial whether the allowances shall be considered financial instruments or tradable goods and EU States diverge. The legal status of allowances should be harmonised across Europe and further carbon-specific issues, such as the need of stronger coordination, centralisation of registries and market oversight, should be tackled.

In order to fill the regulatory gaps, the European Commission started considering a new tailor-made market transparency and integrity framework, which would:
(i) Cover all of the transactions taking place in European wholesale energy markets (and not only a portion of them);
(ii) Address energy-specific market abuses.
DG Energy issued a draft Regulation on Energy Market Integrity and Transparency (REMIT) in December 2010. The draft Regulation prohibits the use of inside information and the information manipulation providing misleading signals to the market. The Regulation also assigns to ACER the responsibility to collect transactions records and monitor the market. However, at the moment there is uncertainty about the final content of the regulation which will be eventually adopted, as well as about the time-line of the entire legislation process.

Policy challenges

Besides the pro-transparency initiatives undertaken by market actors, there is a big need of a regulatory framework ensuring the implementation of common and transparent trading practices across the EU. In fact, the definition of such regulation is still a work in progress.
The main challenge in this regard is represented by the need for **coordination**, first of all to avoid overlaps and inconsistencies among the existing rules set at both national and supranational level. Moreover, a serious effort should be directed at coordinating and integrating the transparency interdependencies among the three policy domains involved in energy trading: sector-specific regulation, financial regulation and carbon market regulation.