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## **Shell Response to public consultation by the DG Energy on measures to ensure transparency and integrity of wholesale markets in electricity and gas**

Shell has been a leading producer of gas in Europe for decades with production in the UK, the Netherlands, Norway, Denmark, Germany and Italy, which – combined with third party supplies and a global LNG position – gives us an unrivalled position amongst private energy companies. In 2009, Shell produced 915,000 barrels of oil equivalent per day for the European market.

Headquartered in London, Shell Energy Europe Limited coordinates Shell's European gas, power and CO2 marketing and trading business across 14 offices around Europe.

### **General Remarks**

Shell welcomes this opportunity to respond to the European Commission's Public Consultation on measures to ensure transparency and integrity of wholesale markets in electricity & gas. We support the Commission's initiatives in these areas, namely through the work undertaken by DG Energy, DG Market and Services and DG Environment.

Changes in the regulation of financial markets, development of a respective regime for energy (gas and power) markets and adoptions in the carbon market will have a direct impact on Shell's business activities. Consequently, we would like to take this opportunity set out core principles that we consider crucial for the further development of the market:

- All approaches should be co-ordinated.
- Overlapping regulations or responsibilities should be avoided.
- A thorough Cost/Benefit Analysis should accompany proposed changes in regulations. In doing so, the specific nature of each market should be taken into account.
- The implementation of any regulatory framework should be standardized and harmonized across Member States (MSs).

## Responses to Questions Requesting Comments

### 1 **Are there particular developments in relation to oversight of energy markets at a national, European or global level that we have not properly considered?**

We agree with the overall description of the legal situation in the European Community. However, to get both a more accurate assessment of the current situation in the markets and foster implementation, developments on national level should also be acknowledged and considered.

By way of example:

- Role of National Competition Authorities (but also DG Comp), which are monitoring the markets in order to detect possible situations of market abuse or market manipulation.
- Delays in implementation of 2nd Gas and Electricity Directives in a consistent manner across all MSs.

Given the multiplicity of different regulatory initiatives in mind, it is important to ensure effective coordination to help guard against overlapping or duplication of regulation. The danger otherwise would be additional (potentially significant) costs for market participants that would also damage the further development of the European gas and power market.

### 2 **Do you agree that the current Regulatory Framework should be updated to include clear rules governing energy market oversight? Please justify your reply.**

We support the approach to introduce a Regulatory Framework for the energy markets, namely gas, power and potentially elements of the carbon market.

From our point of view the reasons are purely clarity and efficiency related - eliminating regulatory gaps and overlaps, less fragmentation and fewer rules. This would help to reduce costs and legal uncertainties for parties involved.

### 3 **Do you agree that this update should ensure integrated/coordinated oversight between financial and commodity markets and across borders.**

We consider a cross-border approach is crucial. A pan-European energy market with oversight “regimes” ending at the borders of the MSs would not be appropriate, although we would ask for clarity regarding the exact nature of the envisaged “*integration/coordination*”.

Another issue is the alignment of regulatory oversight measures for physical commodity (energy) and for the derivative markets. While there are some similarities between both markets, the fundamental differences between financial and commodity markets should not be ignored.

Finally, with regards to regulatory authorities involved, it is absolutely crucial that the responsibilities for the respective markets (physical and derivative) are clearly defined and the respective regulatory authorities are closely working together. The respective bodies should have a sound understanding of the underlying markets and mechanism.

**4 Do you agree that the overlap of physical, and financial (derivative) markets, and the cross border nature of the market currently leads to sub-optimal oversight of energy markets?**

Broadly speaking, we agree with this view. An overarching cross-border, cross-market approach will help to foster the future market development. However, in attempting to correct a sub-optimal oversight of markets, the costs need to be weighed against the perceived benefits.

A costly, inefficient and inappropriate “one-size-fits-all” approach would be counterproductive for the market. The new oversight regime should be tailor-made for the (at least) physical energy market, with the aim to define minimum requirements to assure appropriate oversight, transparency and integrity.

Harmonization of the regimes, elimination of overlaps and improved co-operation of regulatory authorities involved in oversight could significantly improve the situation – faster and better than the development of a centralised regime.

**5 Do you agree that definitions of market misconduct for gas and electricity markets should be consistent across EU? If not, why not?**

We do not consider that there should be any lack of clarity or room for misinterpretation regarding the ultimate goal of a pan-European regime and the penalties for misconduct. However, it is also vital that the structure a regime reflects the fundamental characteristics of the market to which it applies. The disclosure of outage information in the gas production and electricity generation markets respectively is a relevant case in point.

Shell supports measures to improve energy market transparency and reduce any uncertainties which adversely affect future investment in the energy sector. Effective transparency is best ensured through a framework in which information disclosure obligations are established according to the practicalities of market operation and are balanced in the long-term interests of consumers and all other market participants. Furthermore, the degree and nature of the transparency must not be such as to create “artificial transparency” giving rise to competition law concerns.

In this light, a distinction has to be made between gas production and electricity generation markets. Fundamental differences in their operation call for differentiated approaches. It is inappropriate and potentially damaging to implement arrangements that apply to electricity to the upstream gas market – the two markets are fundamentally different in terms of structure, functioning and technical operation.

Gas production and supply is inherently more flexible than electricity generation and therefore less sensitive to outages, mainly due to the use of storage, linepack, etc, thus explaining why gas balancing can take place over longer periods. Of necessity, electricity is balanced instantaneously, but gas is not.

Any attempt to harmonise the gas regime with that in electricity will in effect result in premature disclosure, with unnecessary price volatility based on non-supply/demand fundamentals ultimately damaging the interests of consumers. Moreover, there are

competition law concerns as the exchange of commercially sensitive (i.e. strategically useful) information can lead to the coordination of companies' competitive behaviour.

In accordance with long established practices in recognised commodity markets, gas producers, who sell gas (days, weeks or years) ahead of the supply period, should continue to be able to cover their physical positions, if they suffer an unexpected outage. Restricting such orderly balancing of supply and demand risks causing greater price volatility, with:

- An increase in costs feeding through to consumers;
- Greater uncertainty in supplies during times of high demand or system stress;
- A potential impact on future investment in indigenous production as such a regime could not be enforced in relation to imported gas from countries where such rules could not be enforced; and
- A progressive erosion of security of supply.

Indeed, rather than improve the functioning of the gas market, Shell is concerned that an inappropriately designed, one-size-fits-all obligation for the disclosure of production information is likely to create unintended and adverse consequences; e.g. an increase in volatility of prices across the market that will have impacts for consumers and producers alike.

Furthermore, indigenous production risks being disadvantaged vis-à-vis competing non-EEA sources of supply, particularly in the short term traded markets. This will introduce additional costs of compliance, put major external suppliers at a competitive advantage and could jeopardise EU security of supply because indigenous sources of supply may attract less investment.

While some similarities exist between gas and electricity transmission access and downstream market principles, these similarities do not extend to gas production and electricity generation.

**6 Do you agree that market misconduct should follow the MAD definitions? If not, why not?**

The current MAD definitions do not match all the needs of the energy markets. Nevertheless, the definitions could be used as a starting point and expanded/adopted accordingly, eg. a starting point could be definitions of “insider information” and “market manipulation” as used in Article 1.1 and 1.2 of the Directive 2003/6/EC and respective implementation directive 2003/124/EC.

However, the scope for “misconduct” should be expanded and the definitions should be adopted in a way that (physical and financial) energy markets are appropriately covered, too.

Care should be taken that energy and financial regulation do not unduly overlap. In a similar vein, the currently non- harmonized record-keeping obligations should be consolidated and streamlined between regulatory authorities involved.

As mentioned above, care should be taken to enable commodity specific rules aligned with established practices in energy markets.

- 7 Do you agree that specific account of the specificities of the physical energy markets should be taken of energy markets through guidance rather than in legislation? If not, why not?**

No - if a stringent regulatory oversight regime is developed, it should be clearly stated in the relevant legislation what is expected from market participants. In our experience, non-binding guidance has the potential to leave too much room for interpretation by MSs, platform operators and market participants.

- 8 Do you agree that regular market monitoring is an essential function to detect market misconduct?**

Yes, if an appropriate and effective system is established, monitoring is a pre-condition to detect misconduct. However, this system should be backed-up by an ex-ante notification to all market participants of the consequences of misconduct.

- 9 If yes, given the characteristics of wholesale energy markets, do you agree that market monitoring is best organised on EU level?**

In the context of the organisation and coordination of monitoring processes, we would agree with such an approach.

For the collection, evaluation and interpretation of the data itself, however, national authorities are usually better placed in terms of resources and market familiarity to carry out these duties.

- 10 If yes, do you believe that ACER should be given the role of an EU level monitoring body for wholesale energy markets?**

Our principle view is that we do not see one body on EU level responsible for the whole monitoring process but consider a reliance on national monitoring authorities to be more appropriate. However, we would advocate a role for a body at EU level to assist in cross-border cases.

This body could be a valuable driver for pan-European harmonization and standardization of monitoring activities.

- 11 Do you agree that the EU level monitoring body for energy markets should have a coordinating role to ensure effective application of EU level rules for energy markets? If not, why not?**

We would refer to our response to Q10 and our support for an approach based on national authorities. However, we would potentially support a pan-European body to coordinate in cross-border cases. In that context, we would urge that the duties and responsibilities of such a body are clearly defined. See our answer to question 10.

**12 In your view, would enforcement of market misconduct rules be best organized on national level or EU level?**

From our experience, the national authorities responsible for the enforcements of market misconduct have the appropriate experience, resources and powers to enforce respective cases.

In cases where more than one authority is responsible for market oversight (e.g. a financial and an energy regulator), there is an obvious requirement for close co-operation between the agencies concerned.

**12a If on national level, would national energy regulators or national financial regulators be better placed to enforce compliance? and**

**12b If on European level, which institution would be best placed to enforce compliance?**

See our answer to question 12. From our point of view, both authorities should get involved if misconduct occurs – as expertise from financial and energy markets will most likely be required when it comes to assessing market misconduct.

Depending on the nature of the legal and regulatory framework in each MS, the competition authority might take over a co-ordination role.

**13 Do you agree that the market monitoring body for energy markets should also be able to monitor EUA transaction?**

We would support this proposal. The issues with transparency and market integrity in the physical carbon market are very similar to those in the gas and electricity markets with respect to market abuse and transaction reporting and transparency.

Moreover, the oversight of carbon markets depends very heavily on an understanding of its interactions with the power and, to a lesser degree, the gas markets.

**14 Would monitoring of traded carbon markets be best organised on national or on EU level?**

See our answer to question 9.

**15 If on EU level, do you believe that ACER could be an appropriate monitoring body?**

See our answer to question 9.

**16 Do you agree that it is not appropriate, at least at present, to consider coal, oil and other commodities along with wholesale gas and electricity markets? If not, why not?**

We do not consider it appropriate to do so. With respect to coal, oil and other commodities, although described as “commodities”, the variety of products and the respective markets are too broad to be easily covered by one set of rules.

Rather, we advocate considering differences between gas, electricity and carbon. Each additional commodity would add complexity, which would not help to improve development of gas, electricity and carbon markets.

**17 Do you agree that it is appropriate to apply exemptions and de minimis levels? If not, why not?**

No, we do not consider it reasonable to restrict the application of the regime if it addresses the special issues of the gas, electricity and carbon market.

This is especially the case when it comes to de-minimis rules and other options which can and will be used to bypass regulation. A better approach would be an approach that relied on a relatively small set of disclosure obligations, which can be managed by all – small, medium and large - market parties.

**18 Do you agree that market data relating energy market transactions should be reported centrally? If not, why not?**

In principle, we support the proposal. However, we urge the Commission to bear in mind that quality rather than quantity of information is key for market transparency: more information not necessarily equates to better information.

Additionally, we would make the following comments:

- Care should be taken that the reporting burdens placed on firms do not become excessive.
- Any proposal should take into account other new/additional reporting requirements for financial markets to help avoid duplication.
- The term “centrally” should not automatically imply a new organisation with large database operations. A decentralised data collection with access to information for relevant authorities might be a more cost-effective solution.
- The transactional data should be reported by exchanges, MTFs (regulated multilateral trading platforms) and broker platforms (OTC). Pure bilateral OTC deals should not be covered.

**19 Do you agree the body with an oversight role requires full access to fundamental data relating to carbon?**

The responsible authorities should have access to all relevant information necessary to fulfil their obligations.

Again, Shell appreciates the opportunity to provide these comments. We would be pleased to provide additional information regarding our views and would welcome the opportunity to work further with the Commission.

Kind regards,



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