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Joanna Strzelec-Łobodzińska
Wiceminister Gospodarki
Podsekretarz Stanu w Ministerstwie Gospodarki
Ministerstwo Gospodarki
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17 December 2008

Dear Mrs. Strzelec-Łobodzińska,

The European Federation of Energy Traders ("EFET"), www.efet.org, is an industry association for wholesale energy market participants that promotes and facilitates energy trading in open, transparent and liquid wholesale markets unhindered by national borders or other undue obstacles.

We are writing to you in response to the publication of the proposed change in the Polish Energy Law, which would obligate energy producers to sell their production through a licensed commodity exchange.

We understand that the main arguments used by the proponents of such a move are the expected increase in transparency and liquidity of the Polish energy market and an assumed decrease in the market power of large vertically integrated companies thus resulting in lower energy prices. In fact, the example of Spain is cited as proving the validity of these arguments.

EFET strongly believes that not only are these arguments mistaken, but that the proposed introduction of an obligation to trade through a power exchange may result in adverse consequences. A healthy trading environment should offer participants the option to trade with a large number of other market participants through a variety of means, including directly negotiated bilateral deals, broker platforms and exchanges.

The lack of detail about the broader policy implications of the change, along with insufficient consultation with market participants, will undoubtedly result in poor policy outcomes and unintended consequences. EFET is very supportive of positive market developments, however in this case we wish to outline some of the immediate risks we envisage given our level of understanding of the policy.

In the first instance, creating a monopoly service is not in the best interest of the market or consumers as there will be a lack of product innovation and high costs. In our members' experience, well functioning markets follow a development path based on competitive intermediation services and active bilateral transactions. While exchanges have become a far stronger influence in recent years, they tend to be successful when they offer competitive pricing and services such as clearing.

Secondly, such an obligation would prohibit, or at least seriously complicate, negotiations of long-term power purchase agreements by new power plant developers, and would thus limit the number and size of new build projects. It is EFET's view that efficient investment decisions require, amongst other things, access to a variety of contract lengths and structures. This is particularly the case for new market entrants, so there is a substantial risk that limiting choice will leave the incumbent market players as the only source of new investment, further limiting competition improvements.

Thirdly, the obligation to sell all production through an exchange may create huge cash-flow problems for the participants, who are required to post margining deposits resulting from market price movements. These problems affect both producers and buyers, depending on whether the price rises or falls. For instance a moderate price movement of 10PLN/MWh within a short time would generate a margin call of 500 million PLN if 50 TWh of forward products were sold via the exchange. The possible severity of these problems was very recently demonstrated in the Czech Republic, where despite the fact that exchange trading is not compulsory, a number of companies active on the exchange forward power market ran out of liquidity as a result of margin calls. Emergency non-standard solutions were called for to avoid bankruptcy of these companies.

Fourthly, the obligation would increase the costs of power trading through the necessity to pay exchange fees and incur financial costs associated with the deposit mechanism. However, we would like to make clear that well functioning power exchanges are important for the market, particularly when they compete for business with efficient terms and services.

Moreover, we understand that the proponents of the obligatory power exchange option claim that in Spain in 1998 when the power exchange obligation was introduced, power prices fell as a direct consequence of the introduction of the obligation. EFET does not believe this analysis to be correct, as power prices fell throughout Europe in these periods and the strongest driver of these falls was the fundamental factor of decreasing fuel price.

We believe that obligatory exchange trading is not a solution to decrease general price levels. Indeed, EFET is wary of any claims about price levels, and believes it is better to focus on creating an environment that delivers efficient price levels as this properly encourages better investment decisions. To that end, it would be more advisable to encourage the large market players to act as a market maker, constantly offering to buy and sell power from the market, akin to a situation observed in the Czech Republic, or to force them to sell significant proportion of their total output through a transparent system of capacity or virtual power plant auctions similar to the one currently employed with good effect in France.

We would appreciate your written response to the observations we have set out in this letter. Should you need further clarification and/or information, we would be happy to provide it in a personal meeting or in another way convenient to you.

We enclose the Polish translation of this letter.

Yours sincerely,
On behalf of the European Federation of Energy Traders

Sandra Milardović

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