

## NordREGs perspective on the development of competition among NEMOs

With reference to CACM article 5 (3) and the report that the Commission shall submit to the European Parliament and the Council, NordREG considers this as an opportunity to highlight what we see as challenges to achieve the objectives of CACM GL, in particular effective competition and creating a level playing field among NEMOs.

### About NordREG

NordREG is an organization for the Nordic energy regulators. Our mission is to actively promote legal and institutional framework and conditions necessary for developing the Nordic and European electricity markets.

### Background and problem description

Based on experiences from the implementation of CACM GL, NordREG sees a need for a clearer division between natural monopoly functions and functions/tasks that can be provided by competitive companies. The lack of separation results in costly and complex regulation in addition to reduced competitive pressure on NEMOs.

### Avoid distortion of competition

One consequence of CACM GL is that NEMOs are required to work very close to their competitors. NEMOs are responsible for drafting several terms and conditions and submit them for regulatory approval. They are also operating and developing the MCO function together. Such close cooperation between NEMOs is not a sound environment for competitive companies. The mere fact that competitive firms are setting up platforms for cooperation has a negative effect on competition and should be avoided.

CACM GL and its subsequent terms and conditions sets up a model were NEMOs are obliged to either own, license or be serviced by another NEMO. The terms for these three roles will be set by the existing NEMOs through the NEMO DA operational agreement. This basically means that new entrants must approach their competitors and negotiate on terms to enter the market even though they have been designated as NEMOs. NordREG is worried that this setup creates a barrier for new entrants and a situation where incumbents could choose not to be exposed to competition. For instance by valuing the MCO function itself, or services related to the MCO function, very high. NEMOs are in a position where they can deny current and potential competitors access to services, products and thus potentially abuse their dominant position against other NEMOs and potential new entrants. Furthermore, it creates constant problems for approval processes as there is an inherent conflict of interest in this framework.

In NordREG's view the arrangements that are now being implemented under the CACM GL are not sufficient to ensure sound competition.

### Inefficient rotating responsibility

NordREG believes costs can be reduced by moving the responsibility for operating the MCO function to an MCO entity instead of rotating the operation of the MCO function between NEMOs. Several NEMOs must invest in identical software, hardware and personnel to operate the MCO function. Consequently, the set-up leads to a duplication of resources and increases costs for market operations.

Since the additional cost of a rotating responsibility eventually is paid for by the consumers, we as regulatory authorities are reluctant to see this continue. Both consumers and market participants would benefit from keeping the trading fees and tariffs at a minimum.

### Cost sharing is turning into a bureaucratic nightmare

Managing articles 75-80 in CACM GL has proven difficult. The main reason for this is that monopoly functions are preserved within the NEMOs own operations. Separating the NEMOs own cost from common costs incurred by the MCO function is quite a challenge. NordREG believes that this management would be significantly improved with a clear separation between monopoly functions and tasks taking place in a competitive environment. It would also enable clear regulatory oversight of the MCO functions.

NordREG is also concerned that NEMOs operating in many member states could use a contribution made by a TSO/NRA in one country to cross-subsidize their operations in other member states. Such cross-subsidization if not identified by the NRAs would create a non-level playing field in contravention of Article 3 of CACM GL.

### Way forward

NordREG has developed four proposals for establishing a market structure with a clearer division between commercial interests on the one hand, and the market coupling function aimed at optimizing consumer welfare on the other hand.

#### More effective monitoring and governance

According to article 82 in CACM GL, NRAs are responsible for monitoring entities performing the MCO function. However, with NEMOs being active in several member states and with different regimes for cost sharing and contribution, this task is challenging for individual NRAs. In NordREG's view, separating monopoly functions from competitive activities would strengthen the governance and monitoring of the MCO function and facilitate the oversight of the NEMOs in general.

- *The responsibility of monitoring and supervising the MCO functions should be moved from NRAs to ACER.*

To ensure a level playing field between NEMOs, regulated service fees for operating the MCO functions should be considered together with the unbundling requirements described below. NEMOs who own and operate the MCO functions should not be allowed to discriminate other NEMOs by differentiated service fees between their own competitive branch and other NEMOs that want to purchase this service.

- *NordREG propose that ACER should be given a mandate to determine the regulated service fee for operating the MCO-function.*

The regulated service fees should cover all the costs needed to operate the MCO functions. The development costs of the MCO functions should be assessed as reasonable, efficient and proportionate by the national regulatory authorities and then be divided between each Member State proportionally to their consumption.

The development costs should be recovered through the network tariffs. ACERs can be responsible for monitoring also the development costs.

#### Harmonize shipping arrangements and create a central shipper

Today, decisions on shipping arrangements is a national competence. Shipping arrangements are part of the national decisions to approve arrangements for multiple NEMOs in bidding zones (articles 45, 57 and 68.6 in CACM GL). Nordic TSOs and NRAs have on a voluntary basis chosen to create regional arrangements which cover all 12 Nordic bidding zones and Nordic bidding zone borders. However, neither the shipping solution between the Nordics and neighboring countries nor the arrangements between other member states and bidding zones are harmonized.

- *NordREG propose that ACER should be given a mandate to appoint a central shipper between all European bidding zones and NEMOs.*

A central European shipper would increase transparency and most likely be the most cost-efficient shipping solution. A central European shipper would also reduce the barrier to entry for new entrants and create more level of playing field between operational NEMOs. The shipping responsibility should be moved from individual NEMOs to a separate entity.

#### Full ownership unbundling by creating a MCO entity

From recital 15 in CACM GL, the Commission (in cooperation with ACER) have the competence to create or appoint a single regulated entity to perform common MCO functions relating to the market operation of single day-ahead and intraday coupling.

- *NordREG encourages the Commission to use its competence to create or appoint an entity to perform monopoly functions such as managing, running and developing the MCO function.*

By structuring the market in line with these principles, monopoly functions could be handled in a more efficient manner by a regulated monopolistic entity. NordREG believes that full ownership unbundling, together with our proposals for more effective monitoring and governance and the European central shipper are important steps towards a true competitive market for NEMOs. A MCO entity would also make the day-to-day management more cost efficient.

A full divestment of the MCO-functions could be seen as an invasive measure (for instance the question of property rights need to be addressed). Although NEMOs do own the MCO function today, the historic development costs have been paid for by the TSOs so it is not unreasonable to argue for full ownership unbundling.

Even though creating a single MCO entity would lead to improved transparency and oversight, some regulatory issues still needs to be addressed, for example: Ownership of the regulated entity, how to ensure security of supply and back-up solutions, appropriate governance structure and decision-making processes. As the NEMOs still will need to enter all orders into the same algorithm and offer the same standardized products, a governance structure for how NEMOs can interact developing the algorithm, agree on products etc in coordination with the MCO-function will have to be developed anyway.

In our view, it is important to maintain the same level of security and robustness in the price setting also after an unbundling. A rotating responsibility between NEMOs is however, as far as NordREG can see, not a prerequisite for a robust price setting, given that best practice IT security and back-up measures are in place to ensure safe operation of this crucial function.

### Consider legal and functional unbundling

An alternative to full ownership unbundling would be to require functional and legal unbundling, in addition to the requirement of separate accounts that exists already today. Although monopolistic functions would still be a part of a vertically integrated undertaking, it would be legally separated and independently operated from the NEMOs competitive branch.

This does not entail a full structural separation, and there will still be a duplication of costs due to multiple MCO operators. However, in combination with the existing requirement of keeping separate accounts, more harmonized rules on cost recovery and regulated service fees, legal and functional unbundling will provide more transparency compared to today's set-up.

If its not possible to initiate a full ownership unbundling, the Commission should consider adding effective unbundling as one of the designation criteria's under article 4 or 6, in NEMO tasks in article 7 in CACM GL or in other appropriate legislation.

### Final words

Structuring the market in line with these principles would be important to solve the conflict of interest inherent in the existing CACM framework. NordREG believes that these proposals would reduce entry barriers for new entrants and strengthen competition between existing NEMOs.

NordREG is happy to provide clarifications and more in-depth explanations to the points above.

