

## Position paper

### Competition between Power Exchanges within bidding zones

#### Summary

The draft Guideline on Capacity Allocation and Congestion Management includes rules intended to open the day-ahead and intra-day markets to competition between power exchanges.

NordREG welcomes any effort to make markets in general more competitive, given that this also increases overall efficiency and does not entail decreased system security or additional costs. As regards the market structure described in the current draft, NordREG is concerned that it does not present a market structure that will prove to be efficient over the long term, in the sense that it will not lead to efficient competition. The current version proposes a structure that makes it possible for existing Nominated Electricity Market Operators (NEMOs) to enter each other's home markets and thus offer some kind of competition. The current guideline is far from sufficient for providing the necessary means to also open the market to new entrants.

NordREG believes that one of the keys to designing a structure that actually would open the market for NEMO services to real competition is to make a clear distinction between natural monopoly functions and functions/tasks that can be provided by competitive companies. The potential shortcomings that we have identified in the structure currently proposed stem from this basic principle not being applied.

#### 1. Competitive framework between NEMOs in the current version of the draft Guideline on Capacity Allocation and Congestion Management

The draft Guideline on Capacity Allocation and Congestion Management (hereinafter "the Guideline") outlines a structure that can be characterised as a development of the newly-launched NWE market coupling for the day-ahead markets.<sup>1</sup> In order to facilitate competition within this setup, the Guideline allows for more than one NEMO in a specific bidding zone, given that these NEMOs are designated in at least one Member State. In this setup all NEMOs shall also be responsible for developing, implementing and operating the joint MCO (Market Coupling Operator) functions.

When a NEMO has been designated in one Member State, it automatically has the right (although with some possible restrictions) to offer day-ahead and intra-day trading services in other Member States as well. One of the criteria that a NEMO must fulfill is that it can show

---

<sup>1</sup> <http://www.npspot.com/Message-center-container/Exchange-list/2014/02/No-052014---/>

that it has adequate resources to perform a common, coordinated and compliant operation of a single day-ahead and intra-day coupling.

A designated NEMO shall not only receive and submit orders to the MCO function, but together with all NEMOs shall also be responsible for implementing the MCO function and take turns operating the MCO function.

A designated NEMO shall also act as central counterparty for clearing and settling the commercial cross-zonal transactions resulting from single day-ahead and intra-day coupling, and operate backup procedures for local or regional markets.

Common costs for establishing, amending and operating single day-ahead and intra-day coupling shall be shared among the TSOs and NEMOs in the participating Member States and third countries. Regional costs shall be shared among NEMOs upon a common agreement.

## 2. Shortcomings in the proposed structure for competition

One general observation on the proposed Guideline is that several aspects related to costs and arrangements, necessary to open up the market to competition between existing NEMOs, are due to the fact that monopoly functions are preserved within the NEMOs. This setup entails many potential difficulties and risks.

- While introducing the possibility for existing NEMOs to offer services outside their home market, the setup raises substantial entry barriers for new entrants.
  - In order to be designated a NEMO, new participants have to be prepared to operate the MCO function. This will require large investments in IT systems and hardware; these investments will increase costs but not contribute to or give any added value to the market functioning as a whole.
  - A participant must also maintain “system critical” know-how of power system operation in order to participate in the continued development of the MCO function etc. This task is only about duplicating resources that the existing NEMOs already have, driving costs for market operation while there is no added value to market functioning or competition.
  - Given the current wording, there will still be opportunities for Member States to protect national NEMOs from competition, which will also affect willingness among potential new entrants to invest.
- Extensive regulation would be needed.
  - This adds costs and challenges to the national regulatory authorities when determining whether the NEMO:s are well-suited to operate on the market. Being best suited to stay in the market is normally something that competition guarantees provided a level playing field.
  - The application of vague designation criteria puts the “level playing field” into question.
- System security might be compromised.

- In NWE, substantial progress has been made in arranging the daily operation of market coupling, including TSO/NEMO cooperation and cooperation between NEMOs. With the current Guideline, more than one NEMO within each bidding area will increase the possibility of errors in data management or other vital procedures, which may in turn lead to decoupling. In order to maintain a secure management, proper back-up procedures that can handle several NEMOs within one bidding zone will have to be established.
- Unclear financing and regulation of NEMOs
  - The current proposal leaves some ambiguity about the TSO's obligation and opportunities for reimbursing and recovering a portion of the NEMO cost.
  - The current draft does not explicitly cover regulation of NEMO capitalization to ensure financially robust NEMOs, the level of securities/collateral for settlement between a NEMO and their customers, and the settlement of imbalances between NEMOs within a bidding zone. It is questionable whether the current wording allows for the establishment of a level playing field for competing NEMOs.

Despite the ambitious drafting concerning competition between NEMOs, NordREG finds it unlikely that the structure outlined in the Guideline will bring any substantial benefit to market participants. In order to reap the benefits of competition, NordREG believes that there needs to be a sharper distinction between natural monopoly functions and areas that could be opened for competition among entities that are replaceable.

### 3. To achieve real competition - monopoly tasks need to be separated from areas suitable for competition

NordREG welcomes any effort to make markets in general more competitive, given that it also increases overall efficiency and does not entail decreased system security. However, NordREG is convinced that the structure in the current version of the Guidelines does not present a market structure that will prove to be efficient over the long term and raises considerable barriers to entry. NordREG's major concern is that there is no clear distinction between natural monopoly functions and functions/tasks that can be provided by competitive companies that should, in practice, be replaceable. This lack of separation results in costly and complex regulation.

One possible step towards achieving a clear distinction is to have the MCO functions become a European MCO entity, or alternatively to leave the system critical responsibilities to regional regulated MCO entities, separated from the NEMOs that are supposed to compete. The MCO could bear the system critical responsibilities together with the TSO and could be the TSOs only point of contact concerning the clearing of the day-ahead and intra-day markets. It could also be the place to turn to for the TSO if there is a need for regional or national de-coupling. Moreover, the NEMOs should only interact with the MCO and not have to co-operate directly with the TSO.

Additionally, regulation of the MCO function would be more straightforward if it were performed by the MCO. The costs of the NEMOs would subsequently be charged as service fees to their clients in a competitive fashion, thus creating a level playing field.

By structuring the market in line with these principles, monopoly functions could be handled in an efficient manner by regulated monopolistic entities. These should be well suited to build secure functionality in the market while maintaining cost efficiency together with TSOs. The competing NEMOs should be left with the tasks that carry no system critical significance. Thus, the benefits of real competition should be brought to market participants without any risk of jeopardizing system security.

NordREG encourages Member States to suggest to the Commission to issue an impact assessment on alternative governance structures required when introducing competition between NEMOs. Similarly one should make an assessment and define, which functions should be included under the MCO and which functions would naturally be suited for competitive NEMOs.