WHEN TRUST MATTERS

CACM 2.0 review: ACER proposal for new governance for Market Coupling Operator (MCO) functions

Introduction to webinar, Scandinavian Institute of Maritime Law

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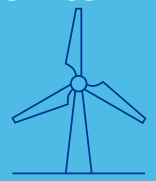

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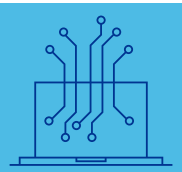

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Outline

CACM and the process towards CACM 2.0

- ACER’s analysis and conclusions – an overview

Reflections on the organisation of the MCO tasks

- What are the MCO tasks
- Why has DNV recommended a fundamental change in the organisation?

The process

- CACM - binding rules for implementing and operating an EU-wide **single market coupling** and **capacity calculation** in the **day-ahead** and **intraday** timeframes
  - Commission Regulation 2015/1222 – 24 July 2015
    - Effectively streamlining, harmonising and regulating 20 years of efforts to integrate European electricity markets, replacing some previous regulations and introducing regulation of topics previously hardly regulated at all
- January 2020: The EC requests ACER to provide a recommendation on reasoned amendments to the CACM Regulation
  - Scoping and drafting
  - Public consultation May/June 2021
  - Final recommendations 17 December 2021
- The proposals are now being reviewed by the EC
  - Two sets of recommendations; i) **MCO governance and organisation**, ii) MCO operations
  - Considerable scepticism and critique from NEMOs, TSOs, market participants – with some exceptions

Suggested amendments related to market coupling governance and operations

- ACER noted the following concerns
  - Slow, complex and delayed implementation
  - Dependency on availability of at least one NEMO per bidding zone
  - Algorithm's ownership hinders level playing field, transparency and innovation
  - Complexity; unnecessarily high amount of human and financial resources
  - Competitive NEMOs' conflict of interest obstruct cooperation for market coupling
  - Difficult regulatory oversight and cost regulation
- And hence suggested the following changes
  - I intend to focus on the one in a solid green frame

- Introducing a **joint decision making body** for all TSOs and NEMOs and qualified majority voting for decisions on market coupling.
- Establishing a European **single legal entity** to perform the market coupling operator's tasks within five years after entry into force.
- Establishing a **permanent forum** to involve **stakeholders and market participants** in market operations.
- The inclusion of **intraday auctions** as target model
- Fostering **competition** between NEMOs and ensure **shared order books** in the intraday market until close to real time.
- A new methodology developed by all NEMOs and TSOs on the **publishing of information** on the day-ahead and intraday coupling.

At risk: Hundreds of million EUR (daily)

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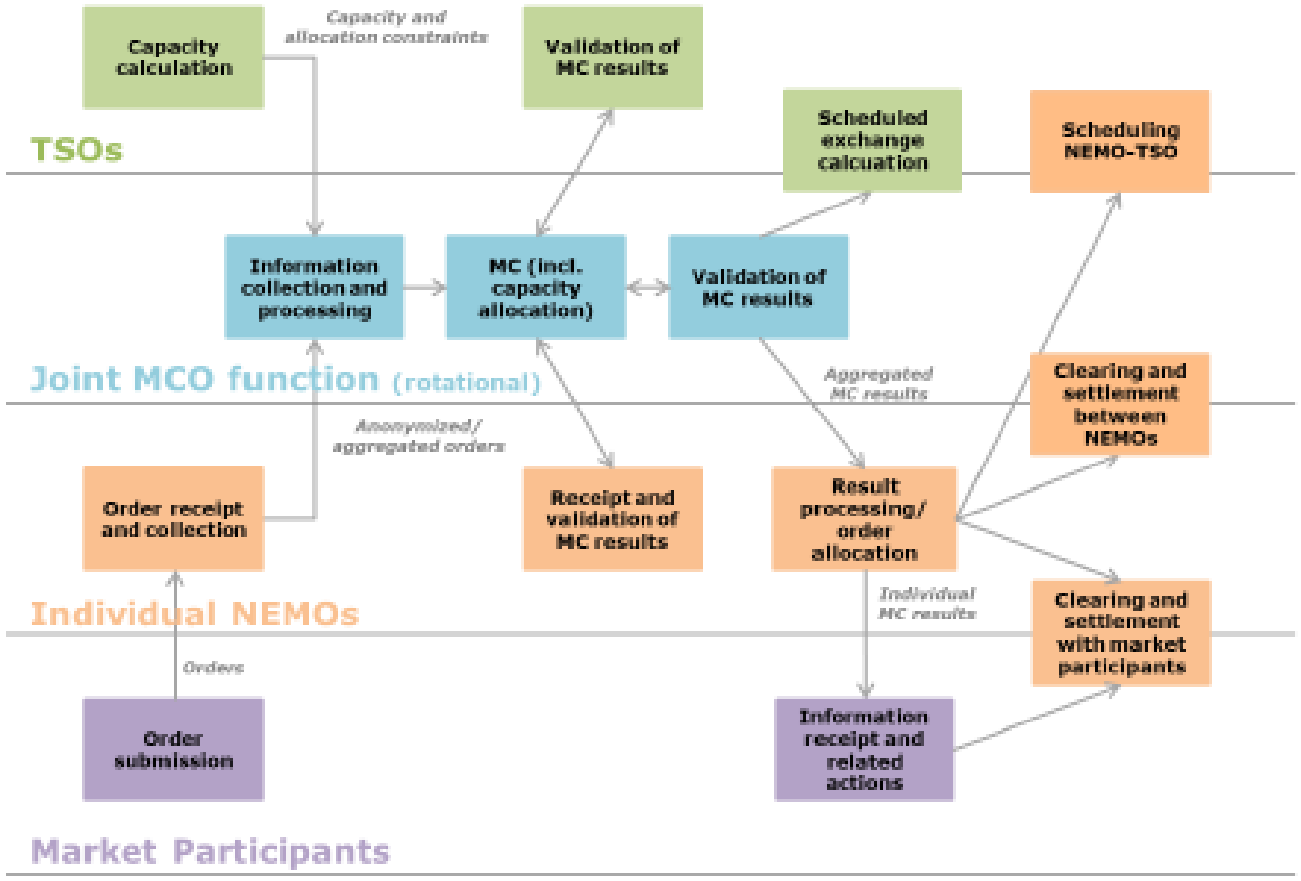
The market coupling operation – a complex set of tasks



- CACM introduced formal rules for how NEMOs should cooperate to calculate (and validate) bidding zone prices and scheduled flows between zones
  - This is the MCO function
    - MCO = Market Coupling Operator
- The (new) setup also ‘solved’ how competing NEMOs (PXs) could co-exist for the same bidding zone
  - Member states decide if they allow competing NEMOs

The rotation principle
Explained in the context of day-ahead coupling

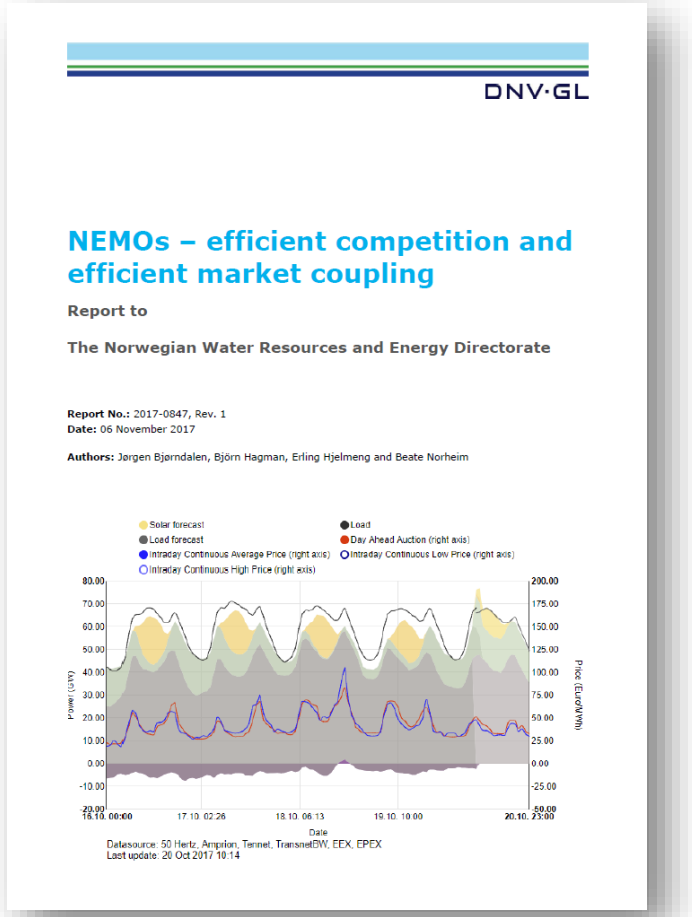
- Three alternative options to become an *Operational NEMO* for SDAC
  - DA MCO Function Asset Co-owner
  - DA MCO Function Asset Licensee
  - Serviced NEMO
- Operational NEMOs must perform one of the following
  - Coordinator
  - Backup Coordinator
    - Monitoring the Coordinator, prepared to take over for the Coordinator if needed (hot backup)
  - Operator
    - Warm backup
- The roles of Coordinator and Backup Coordinator are rotated among Asset Co-owners and Licensees
  - Serviced NEMOs (not Co-owners, not Licensee) cannot take a Coordinator role (?)
- Coordinating NEMOs are compensated by the others for the cooperation costs

The text above is based on the MCO plan of 13 April 2017. Is it still valid?

- ACER notes that there are pros and cons with this setup:
  - Secure operations (N-x, where x > 1)
  - Costs; human, financial and technical resources
  - Illusory benefits of ability to opt out of the role as coordinator?
    - Barrier to entry in the NEMO market?
  - Lack of incentives to improve quality, innovation and efficiency

2017: NVE asked for a short analysis: does CACM provide real and efficient competition between NEMOs?

- Does CACM create a level playing field for NEMOs?
- What are the consequences of requiring NEMOs to co-operate for provision of MCO functions?
  - Could alternative arrangements potentially work?
- CACM regulates cross-border exchange, while some intra-day trades are strictly and purely internal in one bidding zone. Some NEMOs only offer services within one bidding zone. How does this impact competition?
- Are the governance rules, from CACM as well as from other regulations, sufficient and efficient?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NEMOs – efficient competition and efficient market coupling

Report to

The Norwegian Water Resources and Energy Directorate

Report No.: 2017-0847, Rev. 1
Date: 06 November 2017

Authors: Jørgen Bjørndalen, Björn Hagman, Erling Hjelmeng and Beate Norheim

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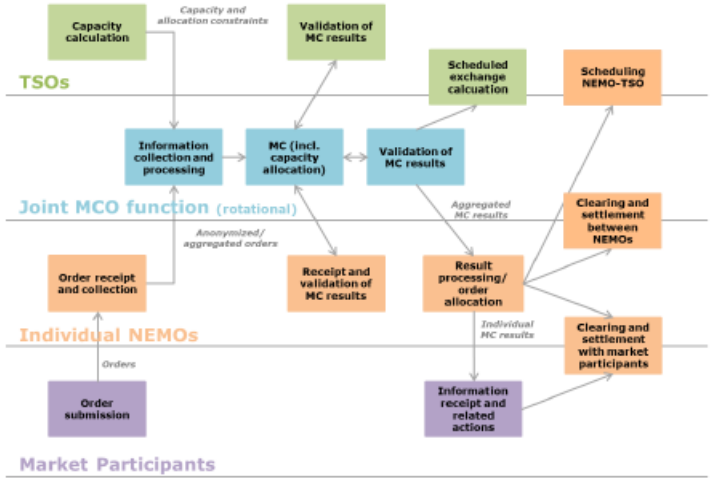
Fundamental difference between MCO function and other NEMO tasks

- Optimal matching of orders subject to grid constraints can only be done in one single process
  - Key result of the matching process
    - Cross-border flows (= utilisation of cross-zonal capacity)
    - Prices
    - Net positions
- Monopolistic attributes – natural monopoly
  - Parallel and competing processes cannot deliver an equally good result
- The MCO cooperation creates a platform not only for necessary exchange of information, but also for potential collusion
  - We are not blessed with a high number of independent providers of NEMO services
    - There is (was) a history of market sharing agreements, reluctance to share order books, challenging clearing and collateral requirements between NEMOs (in their roles as central counter parties/CCPs)



Implications

- Reasons to consider alternatives to the current CACM solution
  - An MCO monopoly must be regulated
    - For the same reasons we have strict regulation of DSOs and TSOs
    - (and in fact revenues are, in CACM: reasonable and proportionate costs recovered)
- The security of supply of capacity allocations and market prices must not be ignored
- An MCO monopoly does not ensure efficient NEMO competition
- Apparently inefficient rules for clearing and settlement (in 2017; today?)

- There are barriers to entry in the ‘NEMO market’
  - Likely entrants are already active providers of exchange services
    - Two dominant groups in Europe: Deutsche Börse and Euronext
  - The price coupling algorithms, its maintenance and further development require unique knowledge and experience
    - Current MCO requirements raise these barriers further
- Limiting innovative pressure and incentives

ACER’s proposed *single legal entity (SLE)* is an answer to these concerns. But is it the best one?

Thank you for your attention!

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Suggested amendments related to market coupling governance **and** operations

- Introducing a **joint decision making body** for all TSOs and NEMOs and qualified majority voting for decisions on market coupling.
- Establishing a European **single legal entity to perform the market coupling operator's tasks** within five years after entry into force.
- Establishing of a **permanent forum to involve stakeholders and market participants** in market operations.
- The **inclusion of intraday auctions as target model**
- Fostering **competition** between NEMOs and ensure **shared order books** in the intraday market until close to real time.
- A new methodology developed by all NEMOs and TSOs on the **publishing of information on the day-ahead and intraday coupling**.
- Further specify the determination of **capacity calculation regions** to deliver maximal cross-zonal capacity (to the physical extent possible).
- Provide more details and regular reviews for **capacity calculation methodologies** to facilitate the achievement of the **70% target**.
- **Align** the capacity calculation **processes** and bidding zone **review** with the Electricity Regulation.
- Improve efficiency by reformulating the **criteria** used in the bidding zone **review**.
- Various amendments to the **SO Regulation** stem out directly from the revisions of the CACM Regulation. In particular:
  - Specific content moved from the CACM Regulation to the SO Regulation will benefit of synergies in the already existing and corresponding framework of the SO Regulation.
  - Amendments mainly relate to data exchange, the common grid model, the operational security analysis and scheduling.