

**Governance framework on the European day-ahead market
coupling¹**
(EC public consultation: 28.11.2011 – 29.02.2012)

EFET² Response

(1) Is the problem definition correct? (section 1 and 2 of the consultation)

Subject of the EC public consultation is the need of a governance framework for the successful implementation of a day-ahead market coupling across the entire EU. Achieving a single market coupling in Europe represents a challenge, because of the distinct regional jurisdictions and frameworks, different levels and types of regulation of power exchanges in the Member States, different views among stakeholders on the priority of market coupling aspects and the lack of a regulatory guidance which will contribute, together with the network codes, to a better allocation of roles and responsibilities in market coupling. The aim of this consultation is to study the need of a legally binding guideline that will enable the efficient implementation of single market coupling system across EU Member States.

The definition of the problem is generally correct but there are some preconceptions in the way the problem is described. This EFET response therefore seeks to clarify a number of points where we think the governance guidelines could point the way to a customer-oriented market coupling based on an “open market infrastructure”. With this in mind, it is important that the binding requirements only seek to address what is absolutely necessary and to not introduce limitations on market participants, which could prove to be unnecessary or even harmful in terms of market integration or market development.

Overall, EFET recognises and welcomes the role of market coupling at the day-ahead stage as a central element of the framework guidelines for Capacity Allocation and Congestion Management (CACM). We encourage the Commission to, in due course, adopt binding obligations through Network Codes which require day-ahead market

¹ http://ec.europa.eu/energy/gas_electricity/consultations/20120229_market_coupling_en.htm

² The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

coupling (DAMC) based on the CACM Framework Guidelines. The most attractive feature of DAMC is that it should be the most efficient process for determining coupled day-ahead electricity prices and provide a robust price reference.

Market coupling allows for the implicit use of the Available Transfer Capacity (ATC) or Power Transfer Distribution Factor (PTDF) of power interconnections at the Day-Ahead stage. It is performed through the participation (in each price zone) of market participants in specific, centrally cleared day-ahead auctions of power which takes place at a dedicated point in time. A key feature of market coupling is that, at that point in time, the involved power exchange(s) enjoy exclusive access to the ATC (or to a PTDF profile). If MC still accompanied with PTRs auctioned for forward timeframes, then at prior da gate closure, mc needs to be accompanied with a system to be nominated or given back to TSO for a price reflecting actual M spread. If accompanied by schemes whereby tso allocate just FTR in forward timeframes, they cannot be physically nominated but automatically given up to TSO in the MC. The existence of market coupling is likely to affect the compensation price paid when the holder of Physical Transmission Rights (PTRs) or the person entitled to Financial Transmission Rights (FTRs) is giving it up, as the calculation of capacity combined with the algorithm may permit adverse flows between two zones for the purpose of optimising flows within a wider region.

The CACM network code will be the first Community legislation that contains an exclusivity element and, in doing so, gives a particular role to power exchanges. The Commission, regulators and market participants therefore need to have confidence that it will function efficiently and give the expected efficiency benefits. Prices emerging from market coupling must be credible and understandable by market participants in terms of the supply-demand fundamentals. This is particularly important, since the resulting day-ahead market is likely to furnish the reference price for forward products, which – in turn - must provide appropriate signals for efficient investment in generation, transmission, and demand response capabilities.

Consideration of how the relationship between system operators, power exchanges, and market participants should be governed is therefore of particular importance and a natural outcome of the market coupling initiative.

It should naturally not be the objective of the “governance framework for the European day-ahead market coupling” to define the entire wholesale power market model. While the guidelines may largely be limited in scope to the day-ahead auction, however, they should not ignore the reality and value of the other trading timeframes, or the local continuous day-ahead and intraday trading (OTC trading). **Liquidity and competition will be promoted not only by a day-ahead coupled auction of power, but also by continuous trading within and between bidding zones in varying time periods up to and after the gate closure for that auction.**

(2) Do you agree that governance of market coupling shall be addressed in a legally binding guideline? (section 2 and 3 of the consultation)

Yes, we agree that governance of market coupling should be addressed in a legally binding guideline. In all discussions – starting with the CWE and NWE project, during PCG, AHAG and now while drafting the network code on day-ahead markets – governance was always seen as an important topic to be tackled. It is an important element to achieve efficient price coupling throughout Europe. This becomes increasingly true with the extension of market coupling and with the increased maturity of this process.

As noted in sections 2 and 3 of the consultation, there are several issues across the EU that legislators must address for market coupling to function effectively. If this does not happen, or if the implementation of the market coupling process is of insufficient quality, or if the coupling algorithm is unduly constrained, then the day-ahead allocation process may not necessarily reach the expected superior results or market integration objectives compared to other forms of cross border trading.

Given the current workload of ENTSOE, and the potential conflicts of interest between commercial network flows and TSOs’ operational duties, it is suitable for the Commission to adopt a governance guideline under Article 18(3)(b) of the Regulation rather than it being part of the Article 8(6) procedure involving elaboration of network codes. Another argument in favour of this route emanates from the complexity, variety and opacity of respective roles, responsibilities, contractual relations and corporate/ ownership links between some power exchanges and some TSOs.

(3) Which is your preferred option? Why? (section 3 of the consultation)

Policy options:

<i>Option 1</i>	<i>Continuing the current voluntary approach (no additional EU action).</i>
<i>Option 2</i>	<i>Creating a European governance framework through a legally binding guideline which supports maintaining the diversity of local market coupling governance arrangements including the relation between TSOs and Power exchanges.</i>
<i>Option 3</i>	<i>Creating a European governance framework through a legally binding guideline which strives for a high level of harmonisation of local market coupling governance arrangements including the relation between TSOs and Power exchanges....</i>
<i>Option 3.1</i>	<i>... based on a contractual framework</i>
<i>Option 3.2</i>	<i>...based on a directly regulated framework</i>

Option 3.3	<i>...based on a choice between a contractual or a directly regulated framework</i>
Option 4	<i>Creating a European governance framework through a legally binding guideline including creating a new regulated entity to perform the tasks of market coupling.</i>

Our preferred option in the foreseeable future is Option 2, provided that a harmonised, clear distinction between the respective roles of TSOs and power exchanges will be made. Option 3.3 may be considered as an interesting medium term model (with the same proviso). Option 3.3 seems to be rather similar to option 2, the main difference being the extent of harmonisation that needs to be imposed. However they both imply that some overarching principles with regard to market coupling – but as well cross-border intraday (see our answer under 10) – should be laid down in a legally binding guideline. However, we are of the opinion that, at this stage, TSOs and PXs should decide and negotiate among themselves how to best organise their contractual arrangements. Too much prescription of the legal nature of the relationship between TSOs and PXs might introduce a substantial risk of delays to the implementation of market coupling.

The next best immediate solution, with the best long term enduring outcome, would be Option 3.1: which is based on the successful experiences in the CWE region. This gives less leeway for local cooperation arrangements between TSOs and PXs than either option 2 or 3.3. In this model, system operators are primarily responsible for capacity allocation. They then contract with power exchanges to provide the market coupling service. This avoids counter-productive vertical integration between monopoly (TSO) and competitive (PX) functions. We believe that TSOs should adopt an open-architecture arrangement that allows contracts to be signed with any trading platform that meets the requirement for efficient day-ahead market coupling (including the commercial and governance arrangements to join the market coupling process).

Option 1 is unlikely to deliver an enduring, well-functioning market coupling solution as it would keep the status quo meaning that too many crucial questions remain unanswered.

We consider options 3.2 and 4 to be unacceptable: EFET considers it as counter-productive proposal for exchanges to be fully regulated entities. In general exchanges should be commercial customer-focused businesses, aiming at understanding the evolutions of the market and at providing new solutions to adapt to these evolutions. Maintaining or transforming power exchanges in a purely regulated function at either national or European level risks undermining this continuous improvement process. Similarly, the establishment of a regulated European entity to perform the task of market coupling risks overlapping with the existing obligations on TSOs in this respect.

The consultation document also mentions additional options which are:

1. Allowing or excluding local competition and
2. Mandatory or voluntary participation in market coupling.

As a general point, power exchange services should not be viewed as a monopoly business or considered as part of a system operator's functions. Our practical experience is that PXs who are not nationally licensed/regulated and given a local monopoly for organising the day-ahead trading platform provide the better customer service with regard to the access to their trading and financial settlement systems. In addition they provide more flexibility to correct inefficiencies and to innovate and provide new solutions/ products for the market, thus enabling both market efficiency and real market integration.

EFET therefore considers that the central orientation of power exchanges should be as service providers. Such customer orientation should not be undermined by excluding local competition per se. The eventual legislation should not prejudge or substitute for normal market processes, especially since power exchanges are not a natural monopoly and should not need to become such. Not only would that raise anti-trust problems, it would undermine their ability to evolve.

Having a requirement for a single platform in each nation would imply a degree of limitation on the transacting choices of market participants going beyond what is strictly necessary for market coupling to work. In principle market participants must be permitted to continue to choose competing or alternative trading venues. As a consequence, even if cross border or cross-zone day-ahead transactions are routed through a particular centralised and anonymous exchange, it should be possible for alternative trading platforms to be used for purely national or intra-zone transactions, or for transactions other than day-ahead.

We do not see the need for a mandatory participation by power exchanges in market coupling. It should be in the power exchange's own interest to participate in market coupling as it guarantees reliable day-ahead reference prices which is important for any forward products the power exchanges might offer besides the day-ahead market. This facilitates liquidity in forward products as does market coupling itself. As power exchange fees are volume based it creates higher income for them. Market participants will make use of exchanges which provide the most efficient services to meet their needs.

(4) What are in your view the main impacts of different options? Can you provide elements for assessment of impacts of the different options?

Option 1

Option 1 is unlikely to deliver an enduring, well-functioning market coupling solution. Keeping the status quo means that crucial questions remain unanswered and keep on delaying the implementation of market coupling projects. Important topics like robustness of the algorithm and liability in case of failure, financing among project partners, involvement of stakeholders and how to bring projects together will

not be tackled. There are already stresses emerging in the purely voluntary approach and maintaining this situation will have a negative impact on progress.

Option 2

Option 2 is desirable in that it would allow defining binding European principles and allowing TSOs and PXs to choose the most suitable arrangement. The main risk of this approach is that a minimal degree of harmonisation risks missing an element that is, in the end, necessary. We would also consider it an advantage to have a more European-wide concept of the division of roles between power exchanges and system operators. A more commercially driven trading model for power exchanges, separate from system operation, would better promote liquidity and competition and we therefore do not support this option as an enduring solution.

Option 3

From an outsider's perspective (not taking part in the market coupling projects) it seems to us that the contractual relationship and eligibility of new partners does not seem to be a core problem between the power exchanges and TSOs. We have the impression that most power exchanges and TSOs are willing to implement market coupling. Thus we do not regard it as necessary to tackle these aspects in detail by a binding framework guideline or through regulation. What is missing are binding principles on robustness of the algorithm (avoiding operational decoupling at any point in time) and liability in case of exceptional failure, as well as potentially financing and cost sharing among project partners. (We do recognise it might prove difficult to draft enduring principles.) Also missing is regulatory oversight of the quality of the operational service and of price signals.

Option 4

Establishing a common entity goes beyond what is needed to facilitate market coupling. This is time consuming and costly as it will be difficult to make use of already existing solutions and systems. Further it would delay any new projects as soon as it would be defined as part of the "Target Model" and would give rise to many political difficulties. For market participants this option does not provide any add-on with regard to harmonisation and thereby reducing the amount of different trading and clearing solutions to be maintained as local power exchanges with diverging systems will remain in place.

(5) Are the criteria for a good solution as presented in the list right? Do you have other criteria to add?

The criteria presented in Section 4 are suitable although there will clearly be trade-offs and interference with national rules may not always be negative, on the contrary. The Commission will, for example, need to decide on the balance between a number of these criteria. As "*this public consultation seeks additionally advice whether these criteria are the correct ones and how they should be weighted for choosing the final option*", we suggest applying the following weighting:

Quality of the market coupling	V. High
Efficient change management	High
Speed, ease and cost of implementation	Medium
Tools for regulatory oversight of the involved entities	High
Interference with national rules	Low
Operating cost efficiency	Medium
Extendibility	High

For market participants the quality of market coupling is paramount. As already noted, participating in the day-ahead spot auction is an important commercial and organisational involvement. A large scale price coupling can induce significant risks if badly operated and it is therefore absolutely important that the market coupling process is reliable and credible. Appropriate regulatory oversight of the process is therefore also important, as is proper stakeholder engagement.

We also consider extendibility to be an important criterion as we need a European solution for market coupling (which is in fact the target model).

The issue of cost allocation and efficiency is of lower importance compared to the expected welfare optimisation and should be something that regulators can deal with in terms of their relationship with system operators. Likewise power exchanges should be answerable to their clients in terms of justifying their charging structure. We believe that competition with other potential power exchanges or with brokers will remain the most efficient driver for efficiency.

Meanwhile the issue of change management is common to many of the guidelines and network codes. The Commission could address this by setting out an indicative timetable and process for network code and guidelines modifications, once the initial texts have been adopted.

With regard to “speed, ease and cost of implementation” it should be noted that quality should be more important than achieving the ambitious 2014 goal. The market coupling arrangements are likely to become increasingly complicated because of the planned introduction of flow-based market coupling and due to the extension of the markets covered by market coupling but quality should not be left aside during this development process.

We give “Interference with national rules” lowest priority as we think that national rules should be adjusted to allow for integration of the European internal electricity market.

(6) Is the proposed timeline for the network codes and guidelines as presented in Annex 1 sufficient? (Annex 1 from the consultation)

With respect to the CACM network code and a governance guideline we would recommend that these are adopted at the same time, rather than separately in Q2/2012 and Q1/2013. There is a risk that the governance guideline prejudices the text of the network code, or *vice versa*, or that they end up being inconsistent.

Similarly we believe that the framework guideline/network codes on system operation and the framework guideline/network codes on balancing should also be developed in parallel. Coherence between these two codes is absolutely essential.

(7) If you think that governance of market coupling shall be addressed in a legally binding guideline, is the relation between this guideline to the related network code as presented in this paper correct?(Annex 2 of the consultation)

Both the network code and the guidelines will in our view be legally binding and have direct effect. So in one sense it does not matter which elements are in which piece of legislation provided that everything is well designed and adequately dealt with in order to ensure consistency.

However, as already discussed above, it is more appropriate for the Commission to be responsible for preparing any Guidelines that deal with the interactions between TSOs and power exchanges in view of the potential conflicts of interest between power exchanges' and TSOs' roles and activities.

(8) What should be the cost sharing solutions of market coupling, between countries and between TSOs and power exchanges, both regarding the initial investment costs and the operation costs?

We do not have a strong position on how to share costs between countries and between TSOs and power exchanges. In principle it should be a fair mechanism and costs should be shared among all market coupling project partners involved. In any case cost components that can be clearly identified as grid congestion management shall be paid by the TSOs making use of congestion rent. It may, however, be necessary for regulators to have a role in resolving disputes.

(9) Which aspects of market coupling do need specific regulatory oversight? (section 2 of the consultation)

With respect to the issues highlighted in Section 2, we would expect the governance guidelines to deal with them as follows.

Existence/effectiveness of day-ahead spot markets

As already noted, we do not accept the need for regulated or mandatory power exchanges, which is questionable with respect to basic compliance with the Directive and even the EU Treaty. So governance guidelines should clearly note that a regulated mandatory power exchange is not a requirement. However, it may be necessary for regulators to incentivise a certain basic level of volume in centralised day-ahead market(s). At the same time, a poorly functioning or non-existent power exchange is also likely to be a consequence of the size of the price zone being coupled.

National diverging governance frameworks

Clearly, in some countries, power exchanges are considered to be intrinsic parts of the system operator functions and quasi-mandatory and regulated. This is regrettable and potentially dangerous in terms of possible inadequate supervision of the coupling algorithm or undue introduction of system or network constraints (confusion of the respective roles and responsibilities), but this can potentially be avoided through:

- 1) A clear description of the various functions and interface between these functions in the DA network code,
- 2) Clear indications of the best practices in terms of respective roles and responsibilities between TSOs and power exchanges in the framework guidelines, in addition to a convergence process,

Price formation within power exchanges/Maximisation algorithm:

Products and bidding rules may well need to be harmonised in order to deliver an efficient coupling of markets as does, potentially, the nature of the maximisation algorithm. For example the chosen algorithm should not lead to counter-intuitive flows.

Accountability and responsibility/Stakeholder consultation

This is a key area that needs further development. The guidelines should set out how system operators and power exchanges may be held accountable to market participants and the wider world.

Power exchanges and TSOs should set up between them a market coupling committee to keep price coupling under review and to consult wholesale market participants. The guidelines should therefore require a “market coupling Steering Committee” to be established with representatives from both TSOs and power exchanges who will be directly responsible for the functioning of the complete market coupling process, with an internal split of the respective responsibilities of power exchanges (grouped or individually) and TSOs (grouped or individually). This Committee should be required to issue an annual report and be accountable for any problems in operations or in implementation.

There would need to be a clear distinction between market issues (under the leadership of power exchanges) and capacity calculation or network constraint issues (under the natural leadership of TSOs). This Committee would also deal with operational efficiency and efficient functioning of the regular and exceptional back-up mechanisms to price coupling. Power exchanges, through this process, could also seek the input of representatives of wholesale market participants to help safeguard the integrity and effectiveness of the algorithm used for price coupling. This body in turn would be accountable to an advisory body similar to AESAG, involving representatives of market participants.

The guidelines could also require a market coupling “market council” which could gather from time to time in order to deal with markets and products evolutions, with a representation from market participants trading on all constituent power exchanges and on other platforms in the same areas, from the power exchanges themselves, from brokers, and with TSOs and Regulators sending observer representatives. As a general principle power exchanges, especially those which are owned or otherwise controlled by a TSO or group of TSOs, and/or which enjoy a national statutory monopoly, should not be allowed to decide unilaterally the trading rules for the day-ahead market without putting those rules to the market council fairly reflecting the interests of the market and of participants in the power exchange.

Oversight of power exchanges:

Besides the prompt implementation of European legislation and codes to ensure a level playing field we would like to point out two main aspects for regulatory oversight:

Correctness and robustness of the coupling algorithm

As mentioned earlier, the market coupling arrangements are likely to become increasingly complicated because of complex products (for example block bids), the planned introduction of flow-based market coupling and due to the extension of the markets covered by one single market coupling solution. Even though this is challenging - it needs to be guaranteed that the price calculation solution chosen by the power exchanges and TSOs is correct. Further it must be guaranteed that the coupling solution is robust and there are appropriate and functioning back-up and fall back solutions in place. Given that more and more markets shall be operated by one central coupling algorithm any decoupling can easily outweigh the benefits of market coupling.

Access rules and customer orientation of power exchanges that join market coupling

This is an aspect missing in the current discussions on governance. With the implementation of market coupling as well as implicit intraday trading arrangements the participating power exchanges gain the exclusive use of cross-border capacity for a dedicated timeframe, under a specific service arrangement. As the target model for day ahead and intraday trading will naturally lead to the decrease of OTC-trading or other trading venues if the service provided is efficient and cost effective, the access rules and customer orientation of power exchanges should be subject to some type of cross border regulatory oversight in order to prevent trading barriers or to correct potential abusive situations. Some of the existing and nationally licensed power exchanges have very burdensome access requirements: for example only allowing access to national companies (forcing foreign companies to open an establishment in

the country of the power exchange). Some other power exchanges impose a dedicated licensing procedure taking approximately one year and requiring that the trading company employs staff speaking the local language.

Market integrity and transparency

ACER and national regulators already have responsibility for market integrity. National regulators are also responsible for the enforcement of the network codes and guidelines. There does not need to be any additions to this framework.

Prevention of undue TSOs interference and preservation of market flexibility:

TSOs should not impose system, balancing or grid constraints in the coupling algorithm apart from ATC or PTFD which can be considered as an input to the coupling algorithm and which should be firm and guaranteed during the coupling process. Power exchanges should have the duty to report and publish in a transparent manner any constraint or specific scheme introduced in the coupling algorithm which would interfere with market results or which would introduce some constraints to the normal matching process. Likewise TSOs should not imply any types of transmission fees on export or import volumes otherwise matching algorithm will fall and there will be no flow across respective border in any direction.

The timetables and procedures adopted by power exchanges and TSOs in combination must facilitate trading flexibility and in particular allow for moving UIOSI deadlines as close as practicable to the timing of the day-ahead market coupling process.

Even when the deadline is a matter of minutes from the gate closure for the PX auction, TSOs should publish as transparently as possible the overall capacity available to the market, including a breakdown of the amount being nominated physically and the amount left for allocation through the implicit auction.

(10) What differences do you see between the need of governance arrangements for organising intra-day trade compared to the day-ahead market coupling? Should a legally binding guideline on governance also cover the intraday timeframe?

Yes, the legally binding guideline should cover both, the day-ahead and the intra-day time frame but with some specific focus for each of them. In both the same TSOs and power exchanges are involved and the same core topic “allocating cross-border capacity in the most efficient way” is affected.

One of the additional elements that needs to be covered in intraday governance guidelines is non-discrimination between implicit and explicit allocation during the interim period and the market test before the transition from the interim to the final intraday model. We believe that system operators should have an obligation to make available the OTC option during the transition period as OTC is absolutely needed to develop the intraday market and to avoid partitioning of the market for non standard products.

Development of complex products should take place with the consultation of stakeholders and any removal of the OTC flexibility should only take place after it can be demonstrated operationally that the common implicit solution can provide the full range of flexibility which is needed for the market to operate efficiently and after consultation and agreement of market participants. No unilateral solution should hence be taken in that respect.