

Attn.: konsultation-leitfaden-missbrauchaufsichtstrom@bundeskartellamt.bund.de
remit@bnetza.de

Our date: 20.05.2019

Our ref.: [REDACTED]

File no.:

Your date:

Your ref.:

Enquiries to:

[REDACTED]

Konsultation zur Missbrauchaufsicht im Bereich Stromerzeugung/-großhandel

We are referring to the consultation ‘Missbrauchaufsicht im Bereich Stromerzeugung/-großhandel’. Wholesale energy markets are increasingly interlinked across the European Union. Market abuse in one Member State may affect wholesale prices for electricity across national borders. REMIT is a common European regulation, and we find it important that NRAs have a harmonized interpretation, especially when it comes to the most essential rules of the regulation. We would therefore like to use the opportunity to present our understanding of the prohibition of market manipulation in the wholesale energy market.

General comments

In Norway, nearly 90 % of wholesale energy trade takes place in the auction-based day-ahead market, where consumers and generators within the same price area meets the same price. We thus consider efficient price formation that reflects the resource situation as crucial.

REMIT states the importance to ensure that prices in wholesale energy markets reflect a fair and competitive interplay between supply and demand. In economic theory, in an auction based market, the principle of offering capacity at marginal cost will ensure that the distribution of rents i.e. consumer surplus and producer surplus, is fairly allocated, and maximize total economic surplus. The cost of the last unit produced then equals the willingness to pay for the last unit produced. The market price will then clear at the industry’s marginal cost, which equals the marginal cost of the most expensive power plant cleared in the market, and ensure the optimal utilization of production capacity (merit order). Prices above the industry’s marginal cost will decrease consumer surplus more than producer surplus increases. Hence, the net effect on welfare is negative.

In a well-functioning, highly competitive market, a rational producer will always be willing to produce at or above its marginal cost of production. The market price then equals the cost of bringing the last (marginal) unit of capacity into production in any given hour. All power plants with accepted bids in a market with marginal pricing will earn a premium equal to the market price less the power plant’s

E-mail: nve@nve.no, P.O.Box 5091, Majorstuen, N-0301 OSLO NORWAY, Telephone: +47 09575 / +47 22 95 95 95, Web site: www.nve.no

Org.nr.: NO 970 205 039 MVA, Bank account: 7694 05 08971, Den norske bank ASA 0021 Oslo NORWAY, Swift: DNBANOKK

Main Office

Middelthunsgate 29
P.O.Box 5091, Majorstuen
N-0301 OSLO

Central Region

Abels gate 9
N-7030 TRONDHEIM

Northern Region

Kongens gate 14 - 18
N-8514 NARVIK

Southern Region

Anton Jenssensgate 7
P.O.Box 2124
N-3103 TØNSBERG

Western Region

Naustdalsvegen. 1B
N-6800 FØRDE

Eastern Region

Vangsveien 73
P.O.Box 4223
N-2307 HAMAR

marginal cost, except for the last power plant on the margin, which sets the price. The premium will cover irreversible investment costs and return potential total profits to the market participant.

We agree that the price signal must be allowed to work also in a strained situation. In our opinion, this means that the capacity should be offered at prices that reflect fundamental factors. If a plant has a high cost for running, it shall be bid to the market at an accordingly high marginal cost of production. In an auction-based market, a bidding practice which allows contribution margins, leads to reduced socio economic welfare. Not only will the generator which would not be profitable without the contribution margins get a higher price for its power, but all generators and consumers participating in the auction would get a higher price. As long as the day-ahead market is an auction-based energy only market, the practice of allowing contribution margins should be avoided. Other means than the Energy Only market should therefore be considered to ensure sufficient provision of peak load capacity.

Further, we would like to point out that a supplier normally not found to be dominant, might have a dominant position in a scarcity situation. If the total demand exceeds the supply of all other suppliers, this supplier meets the residual demand, and thus has the possibility to behave independently of its competitors to some extent. In a scarcity situation, the generation, and thus the supply, is close to the capacity limits, and such a situation is more likely to occur.

The draft guideline paragraph 49 states that *'In the Sector Inquiry a dominant position was inferred if a supplier was indispensable to meet power demand in at least 5% of the hours of a year (i. e. at least 438 hours).'*

We would like to point out that even if a supplier is indispensable to meet power demand only in a more limited number of hours, it might also have a significant negative effect on welfare if bidding above prices that reflects a fair and competitive interplay between supply and demand is accepted in those hours.

Assessment in relation to article 5 and article 2 (2) (a) (ii) of REMIT

The draft guideline paragraph 83 states that *'Sales offers that, for instance, exceed the marginal costs of generation costs can, in an Energy Only Market, represent a legitimate bidding practice to earn contribution margins. This is not generally regarded as an abusive practice according to REMIT'*.

In our opinion, pricing above marginal cost or opportunity costs in the auction-based day-ahead market should be defined as market manipulation unless there are legitimate reasons for this behaviour, and the transaction/order conforms to accepted market practices.

Article 5 and article 2 (2) (a) (ii) of REMIT prohibits issuing bids to sell electricity when such bids «secures or attempts to secure, by a person, or persons acting in collaboration, the price of one or several wholesale energy products at an artificial level».

A prerequisite for applying REMIT article 2 (2) (a) (ii) is to determine what the price should have been if the market manipulation had not taken place. Such an assessment cannot be conducted without an understanding of the economic concepts involved. An artificial price level is undoubtedly a legal condition, which has to be fulfilled in order for REMIT article 5 and article 2 (2) (a) (ii) to apply. Nevertheless, in order to determine whether a transaction/order secures a price at an artificial level, we must take into account the economic theory that explains price setting in a market, and thereby conclude on whether the market behaviour leads to an artificial price level.

In our opinion it is guidance in REMIT on the factors that should be taken into account when the benchmark for legal price-setting is determined for the purpose of REMIT article 2 (2) (a) (ii).

First of all, it is stated in REMIT recital 1 that it is «important to ensure that (...) prices set on wholesale energy markets reflect a fair and competitive interplay between supply and demand (...)».

In recital 13 it is stated that «Manipulation on wholesale energy markets involves actions undertaken by persons that artificially cause prices to be set at a level not justified by market forces of supply and demand, including actual availability of production, storage or transportation capacity, and demand.»

REMIT is intended to enhance competition for the benefit of final consumers. This is stated in REMIT recital 1 which reads that «It is important to ensure that consumers and other market participants can have confidence in the integrity of electricity and gas markets (...)».

Furthermore, it follows from recital 2 that the goal of increased integrity and transparency of wholesale energy markets should be to «foster open and fair competition in wholesale markets for the benefit of final consumers of energy».

It is repeated in recital 7 that «In order to protect final consumers and guarantee affordable energy prices for European citizens, it is essential to prohibit [behaviour which undermines the integrity of the energy market]».

Another point to mention is that the rules in REMIT are designed to take into account the specific characteristics of the wholesale energy markets. This point is mentioned in REMIT article 1 (1), and recital 3.

Therefore, an artificial price level in the auction-based day-ahead market should in our opinion be understood as a price which does not reflect a fair and competitive interplay between supply and demand in that specific context, and reduces the consumer surplus to the detriment of European consumers. Such a price would constitute market manipulation unless there are legitimate reasons for the behaviour, which conforms to accepted market practices.

To assess what is the price level that is justified by market forces of supply and demand, it can be useful to start out with a situation where all MPs behaves like small rational price takers. The optimal strategy for producers in the day-ahead auction will in this case be to nominate according to their marginal cost or opportunity cost. According to economic theory, this situation will optimize social welfare. Such situation would also be considered as a “fair and competitive” (ref. Recital 1).

In an auction based market, only producers who are likely to set the price at the margin have incentives to add a margin to the marginal cost or opportunity cost of their marginal power plant. They are then acting as price makers. By allowing producers to act as price makers by withholding parts of the capacity or adding to their marginal cost/opportunity cost, this would lead to ‘artificial prices’ in the DA market, since these prices are likely to be higher than what the prices would have been if the producers acted as price takers and only nominated their marginal cost or opportunity cost in the day-ahead auction.

By deviating from a situation where producers are acting as price takers in the DA, by allowing producers who are likely to set the price to add a contribution margin to their orders, the price for customers will increase and lead to an increased income for producers.

As pricing at marginal cost or opportunity cost in the auction-based day-ahead markets optimises allocative efficiency and is the best benchmark for ensuring consumer welfare, we believe that marginal cost/opportunity cost should be the starting point when determining what an artificial price level is in the context of REMIT article 2(2) (a) (ii) in the context of the day-ahead market.

Finally, it is worth noting that this would be the starting point for the assessment. In the wording of art. 2(2) (a) (ii) there is provided a defence for situations where the pricing is based on legitimate reasons

and conforms to accepted market practices, and that would have to be considered based on the specific facts of each case.

On the obligation to sell generation capacity in a specific market segment

The draft guideline paragraph 82 states that '*Neither REMIT nor the German market rules or regulatory requirements make any specific specifications regarding the submission of bids in auctions or continuous trading (no obligation to sell generation capacity in a specific market segment)*'.

In our opinion, if day-ahead (DA), intraday (ID) and balancing markets are liquid and competitive markets, a rational producer, being a price taker, would be willing to offer available production at its marginal cost of production or opportunity cost in the day-ahead market, and only offer the remaining capacity after the market clearing of day-ahead in intraday or balancing markets. Withholding of capacity that influences the price in DA can fall under REMIT article 2(2)(a)(i) and (ii), and should be considered as market manipulation, unless there are legitimate reasons for this behaviour. Further, the market participants bidding in the intraday or balancing markets should always reflect fundamental factors such as the cost of production, production capacity and demand.

A legitimately justified behaviour is represented by bidding generation capacity at marginal cost, including opportunity costs. Opportunity costs are especially important when the offered generation capacity is sold in a sequence of related markets in timeframes closer to real-time, e.g. the day-ahead, intraday and balancing markets. Closer to real-time the value of power can increase or decrease compared to DA, reflecting opportunity cost. Examples of opportunity costs is the assessed value of the water level in hydropower reservoirs, or the estimated benefit, based on an objective method subject to a certain risk profile, that an asset owner can obtain from his power plant output in another public market or a bilateral trade.

To take a specific example; if at the day-ahead stage, intraday prices are expected to be high, this would potentially encouraging a shift in power sales to the intraday time frame. These expectations should also therefore be reflected in sellers' offers into the day-ahead market and the day-ahead price should thus react so as to remove any discrepancy between expected day-ahead and intraday prices. More generally, the day-ahead market should always reflect the market's expectations of intraday prices such that it is impossible for a systematic difference in expected prices to open up and encourage the deferral of trading.

Concluding remarks

An important motive for establishing REMIT was to prohibit behaviour, which undermines the integrity of the energy market. In our opinion, specific behaviour like price-setting that exceeds marginal costs of generation (or opportunity costs) or withholding capacity from a specific market segment, may amount to a breach of Article 5 of REMIT.

Yours sincerely

A solid black rectangular redaction box covering the signature.A solid black rectangular redaction box covering the signature.