



# REVIEW OF MEASURES DEFINED IN POLICY GUIDELINES

JPM

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Therefore readers are urged to seek specialist advice on the individual issues emphasized herein and to verify the presented information before taking any action thereupon.

## **I. Introduction**

In May 2019 Energy Community Secretariat issued the Policy Guidelines on increasing Competition and Liquidity of Wholesale Electricity Markets, including Power Exchanges (hereinafter referred to as: "Policy Guidelines") recommending the measures for increasing competition and liquidity on markets of Member States of European Union as well as on markets of Contracting Parties of the Energy Community Treaty. The main purpose of respective document is to propose necessary legal and regulatory measures to promote competition enable cross-border trade and increase liquidity on organized markets, particularly on day-ahead markets.

Policy Guidelines, as a part of strategic and gradual development of the acquis in force, represents legal and regulatory upgrade of Policy Guidelines 03/2015-ECS on promotion of organised electricity markets in the Contracting Parties, which determined strategies aimed at enabling market integration and establishing electricity markets allowing market coupling. Mentioned strategies, further elaborated in Policy Guidelines, are as follows:

- creating incentives to participate in the markets;
- setting out the obligation to trade certain quotas on the organized markets; and
- putting in place model combining bilateral agreements and spot market.

## **II. Background and Market Coupling**

European Union and Energy Community recognized the need for rearranging the electricity sector which was organized mainly as regulated monopoly. For this purpose, European Union has adopted three energy packages promoting liberalization of markets and the Council of European Energy Regulators in its Discussion Paper states that "electricity will flow among the countries of the region as it was flowing within a single country." However, until now no essential steps toward market coupling and creating pan European electricity market have been made. Moreover, in majority of Contracting Parties organized markets are not in place (apart from Republic of Serbia where SEEPEX is established).

The two above mentioned policy guidelines are adopted by the Energy Community in order to encourage and speed up process of market integration as well as liquidity. Beside them, Energy Community introduced NEMO nomination process in the Recommendation of the Energy Community Regulatory Board on regulatory measures supporting early implementation of day-ahead market coupling in the Energy Community Contracting Parties in April 2019. The purpose of NEMO is to enable the offer of day-ahead and intraday trading services in one EU Member State or Contracting Party with delivery to be performed in the other EU Member State or Contracting Party. Implementing NEMO shall be first crucial step toward market coupling and creating greater regional and pan European electricity market.

In order to fulfil its prescribed goals, Policy Guidelines has recommended to the Contracting Parties several measures which can be divided in the following groups:

- Measures to ensure effective competition on wholesale electricity markets and enhance end-user benefits;
- Measures for vertically integrated undertakings;
- Measures that directly enhance liquidity on organized electricity markets;
- Measures on surveillance of undertakings` conduct on a power exchange and preventing abuse of dominance; and
- Market powers of power exchange operators.

### **III. Proposed Measures**

As already stated, measures proposed in the Policy Guidelines may be divided into several groups and each measures will be in more detail described in the text below.

Measures to ensure effective competition on wholesale electricity markets and enhance end-user benefits

Under this group, the measures recommended to remove structural barriers (such as cost advantages, substantial economy of scale), legal barriers or combination of both are:

#### **1. Regulated access to historic nuclear energy**

Under this measure, the dominant undertaking is obliged to sell certain amount of energy to its competitors upon their request at regulated prices. This measure is applicable in case when electricity is generated from one single source almost exclusively available to dominant undertaking to which no other generator has access. This consequently results in inability to establish and develop competition at retail level.

#### **2. Virtual Power Plant (VPP) auctions**

The aim of this measure is to encourage competition in wholesale market and to limit and diminish market power of dominant undertaking. VPP auctions represent mechanism in which dominant undertaking is obliged to sell certain volumes of electricity through auctions to its competitors, enabling them to be competitive on retail market. Although subject measure is similar to the one previously described, what differentiates them is that in this case electricity is sold to the bidder who offers the highest price and not at regulated price. Additionally, in some cases combination of Regulated access to historic nuclear energy and VPP auctions is in place.

#### **3. Direct trading obligation**

Under this measure, the dominant undertaking is obliged to commence negotiations in order to execute agreement with the other usually minor undertakings upon their request, to sell them the electricity. However, the dominant undertaking may refuse to execute the agreement but must provide the justified explanation for rejection. This measure is in force in Great Britain where Ofgem, British national regulatory authority, imposed such measure on six undertakings.

### **Measures for vertically integrated undertakings**

Notwithstanding the fact that the above measures may be imposed on the vertically integrated undertakings, the following measures are designed specifically for them in order to promote competition and open the market to participants, which are not part of vertically integrated undertakings.

#### **1. (Partial) self-supply restrictions**

This measure is designated to impose the restriction on vertically integrated undertaking to purchase part of its wholesale needs for electricity through free market and not to be fully supplied by its integrated part which generates electricity.

## 2. Other measures

Other measures encompass the following: i) non-discrimination obligation, which is one of the fundamental European Union and Energy Community value, meaning that vertically integrated undertakings do not make difference between market participants and its parts, ii) accounting separation, which measure is implemented in the legislation of the Republic of Serbia by Energy law, and iii) termination of bulk supply agreements executed between the dominant generator and supplier.

### **Measures that directly enhance liquidity on organized electricity markets**

#### 1. Obligation to trade or to offer electricity on the power exchange or organised forward market

The obligation of mandatory participation on the day-ahead markets may be introduced either through duty to offer certain volumes on the power exchange or through duty to effectively trade these volumes.

This obligation may be imposed in a form of a general obligation for all market participants (symmetrically) or as obligation targeting only market participants with significant market power (asymmetrically). Each of these obligations may be imposed on the seller's side, buyer's side or on both sides.

#### 2. Market making obligations

Market making obligations assume an obligation to simultaneously submit a bid price as the price at which buyer is willing to buy and an offer price as the price at which the seller is willing to sell the given product based on predetermined spread. When introducing subject measure it is important to address the following three matters:

- (i) who bears the market exposure,
- (ii) the products to be provided by the market maker and
- (iii) the volumes to be made available.

#### 3. Financial Transmission Rights

Financial Transmission Rights (FTRs) are a hedge product designed to help parties manage the risk they face from large, unpredictable differences in wholesale electricity prices. Having this in mind the FTRs are important mechanism to ensure that all physical cross-border exchanges go through market coupling algorithm.

### **Measures on surveillance of undertakings' conduct on a power exchange and preventing abuse of dominance**

In order for all previously described measures to be efficient and implemented in their full extent and having in mind that establishing power exchange itself is no guarantee that dominant market participants will not abuse their market power (e.g. modification of volumes with a view to influence price formation, modification of prices, false transactions, excessive bidding pricing or collusion) set of rules governing participants' conduct and market monitoring must be adopted by general law, competition law, unfair trading rules and criminal law each within its scope.

## **Market powers of power exchange operators**

Undoubtedly establishing power exchange markets is important step in enabling cross border connection and market coupling. However, it is important to understand that power exchange are natural monopolies and that in practice they may abuse their market power (as was the case in several Contracting Parties in the past). Therefore, it is vital to precisely define competencies of national competition authorities and national regulatory agencies in order to empower them to perform monitoring and investigative function efficiently, each within its scope of competencies, but also from the aspect of complementarity of their roles and cooperation.

## **IV. Conclusion**

Despite the fact that to this date several regulatory and legal acts have been adopted on subject matter by European Union and Energy Community, in practice no significant improvement toward market coupling and creating pan European electricity market has been made. Therefore, in order to achieve goals set out in Policy Guidelines it is crucial that each Contracting Party makes an effort to implement above measures and harmonize its domestic legal framework.



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