QUARTERLY NEWSLETTER
from Nord Pool Market Surveillance

Q2 2020

Welcome to the latest quarterly newsletter from Nord Pool's Market Surveillance team. We are delighted to share this new update on surveillance, regulations and other topics we have been working on. In this edition you will find our considerations on the recurring ad-hoc intraday auctions that are triggered by additional transmission capacity release in the direction NO1>SE3.

Ad-hoc intraday auctions

Over the summer, we have observed that significant additional transmission capacity in the direction NO1>SE3, often around 300 MWh/h, has been provided to the intraday market. This capacity is valuable since there are typically significant price differences between Norway and the rest of the European wholesale electricity market. Consequently, the regular provision of additional transmission capacity has attracted considerable attention and impacted intraday trading behaviour[1].

Over the course of the last weeks, several market participants have addressed to us how they can trade in order to be able to utilise this additional transmission capacity. It is not possible for us to give a definite answer on this, since it is ultimately the relevant national regulators who decide whether such a trading behaviour fits under REMIT[2] or NEM[3]. We are aware that regulators are looking into this topic and we will continue our discussion with them in order to provide more clarity to the market. In the meantime, we would like to share some preliminary considerations.

Background

The background for this capacity allocation is planned maintenance work on the grid in Sweden, persisting until 30th September this year[4].

The additional capacity is typically provided in the evening hours for the next day, i.e. after the intraday market gate opening. Based on our understanding, market participants are not informed about whether additional capacity will be provided or the exact timing of such an event. In the past, it has, however, happened on such a regular basis that the market seems to be able to prepare for it.

When a TSO provides additional capacity during the intraday trading window, it may lead to a crossed orderbook and the default matching principles of continuous trading (e.g. which order was placed first in the orderbook) cannot be used to determine a fair price. As a result, an ad-hoc intraday auction is automatically triggered, and the matching of orders is suspended for the duration of the auction phase. The auction results in a uniform price for all matched orders which, simplified, is the arithmetic mean between the buy and the sell side. The auction is a feature of the SIDC (former XBID) market design.

This can be illustrated with an example: if there are sell bids at 10 EUR/MWh in NO1 and buy bids at 20 EUR/MWh in SE3 when the additional capacity is provided, then the auction will clear at 15 EUR/MWh.

[1] See for example the news story "Norway day-ahead traders slam TSO over intraday capacity" on Montel (link)
[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011R1227&from=EN
[3] https://lovdata.no/dokument/SF/forskrift/2019-10-24-1413
[4] https://umm.nordpoolgroup.com/#/messages/ba80109c-9ff8-4cbd-8b5b-4b6bace83dde/16

Due to significant price differences between the areas, it is favourable for market participants to participate in those intraday auctions. On the Norwegian side, they have an incentive to compete for the best ask price ahead of the auction in expectation of a considerably higher auction-clearing price. This competition may drive the ask prices below the corresponding day-ahead price and thus, also below the water value of the Norwegian asset-backed hydro producers. Since the exact timing of the capacity release to the intraday market is not known, the orders may be visible for some time in the orderbook and there is a risk that low-priced offers are matched by another market participant in Norway outside the auction. The opposite is the case on the other side of the border with regards to the bid price.

Assessment under REMIT and NEM

Is such bidding behaviour in line with applicable regulation, most notably the definition of market manipulation in REMIT Article 2 (2) (a) and NEM § 5-1?

Based on our experience, market participants need to assess their trading behaviour against the legal definition of market manipulation, which states that "entering into any transaction or issuing any order to trade in wholesale energy products which:

(i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of wholesale energy products;
(ii) 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 [...]"

To what extent can order prices below the day-ahead price and/or the water value of the participant give false or misleading signals? It is relevant to consider if the market is aware of the recurring intraday auctions and the trading opportunities they create. It is also relevant to consider whether there is a price difference between the order price and the actual price that the market participant is willing to trade at.

To what extent can it be argued that such order prices are non-genuine, i.e. false or misleading, since the participant is expecting to trade at a higher price? Even though the participant is possibly willing to accept the financial risk that another trader matches the sell order before the intraday auction starts, it is relevant to consider if the order is designed to prevent other market participants from using the released capacity. Here, it is relevant to consider the recommendation in the REMIT Best Practice Report[5], which states that "There should be a real desire to trade behind all orders – never place an order designed not to be executed".

To what extent can it be argued that such orders, or transactions outside the auction, secure prices at an artificial level? And what would constitute an artificial price in the intraday market, which is typically driven by price expectations? It is relevant to consider that regulation does not set a numeric threshold on what prices are considered artificial.

Preliminary considerations

We consider it an important principle that an active order is always reflecting a real and genuine interest to trade. In the case of ad-hoc intraday auctions, there can be an economic rationale for offering sale volumes below the actual willingness in Norway or offering buy volumes above your actual willingness outside Norway. This strategy is particularly profitable in a market with low liquidity where the risk of being hit on prior to the capacity release is low. In our view, there is, however, a risk that such behaviour may be considered market manipulation, as it can potentially be deemed to send false or misleading signals regarding the price of a wholesale energy product, and/or secure the price at an artificial level. It is up to each market participant to assess this risk and make decisions on the strategies they want to implement.

In the past, we have observed a number of market design issues that create incentives to place orders at prices at which the market participant does not wish to trade. This is typically an indication of a non-perfect design, but it does not allow market participants to pursue a profit-maximizing strategy to take

[5] https://www.nordpoolgroup.com/globalassets/download-center/remit/remit-best-practice_second-edition.pdf

advantage of such imperfections. We are always working to address such market design issues in order to create a well-functioning market with low risk for market participants. At the same time, we also have to follow up potential abuse of design imperfections. According to our obligation in REMIT Article 15, we typically investigate incidents where we see that market participants have placed orders at a price that we believe they do not wish to trade at and where we suspect that the trading activity falls under the definition of market manipulation.

We recommend market participants to providing as much as possible of their available flexibility to the market at real and genuine prices. This becomes especially important in periods when it is expected that new capacity may be provided. This will minimize the risk of breaching REMIT Article 5 or NEM § 5-4 and it will allow market participants to compete on equal terms for the additional capacity, i.e. based on their real willingness to trade. It is up to each market participant to decide, and be able to document, what constitutes a real and genuine price for them. The above questions may help in that process, but in the end, it is up to the regulator to decide whether such bidding behaviour is in line with REMIT or NEM.

The challenges related to the auction are also a result of limited liquidity in the market. This has especially been the case on the buy side in Norway. If market participants are active in placing orders on both the buy and sell side, reflecting their real willingness to trade, this will increase liquidity, and reduce the opportunities for others to place aggressively priced orders in order to benefit from the auction. It is recommended that market participants are always able to document their real willingness to trade, e.g. the water value for hydro producers, and act accordingly on both the sell and the buy side. Be aware that layering or a trading strategy with an intention to prevent competition are types of market manipulation, according to REMIT and NEM.

At this point, we would also like to use the opportunity to ask participants who are active on both sides of the auction, e.g. sell in NO1 and buy in SE3, to ensure that they use the acquired transmission capacity effectively. More advice for such a scenario can be found in ACER's guidance on transmission capacity hoarding [6].

On a final note, we would like to point out that not allocating this transmission capacity already in the day-ahead timeframe contributes to the significant price differences between Norwegian and other bidding areas, thus impacting reference prices for the financial market as well as bilateral contracts. The day-ahead market is the main marketplace for trading electricity in terms of volume as well as an important reference for the financial market and bilateral contracts. Based on ACER/CEER's annual monitoring report [7], the efficiency of using cross-border transmission capacity is highest in the day-ahead timeframe.

In our opinion, it would be highly beneficial if the transmission capacity was already allocated in the day-ahead timeframe. We believe that the consistent allocation of significant transmission capacity to the intraday market points to an imperfect transmission capacity management and urge relevant stakeholders to assess alternative options. That assessment should include the market impact of the existing practice (including wholesale and financial markets, as well as market manipulation risks) and losses experienced by market participants.

We will continue to work with this topic.

[6] https://documents.acer-remit.eu/wp-content/uploads/Guidance-Note-Transmission-Capacity-Hoarding.pdf

[7] Report is available on ACER's website.

HOW TO CONTACT MARKET SURVEILLANCE

We hope that you have enjoyed reading our latest quarterly newsletter. Please let us know if you have any comments on the subjects covered here, or if there are any issues you would like us to examine in future editions: market.surveillance@nordpoolgroup.com