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Baltic TSOs' Market Participant webinar

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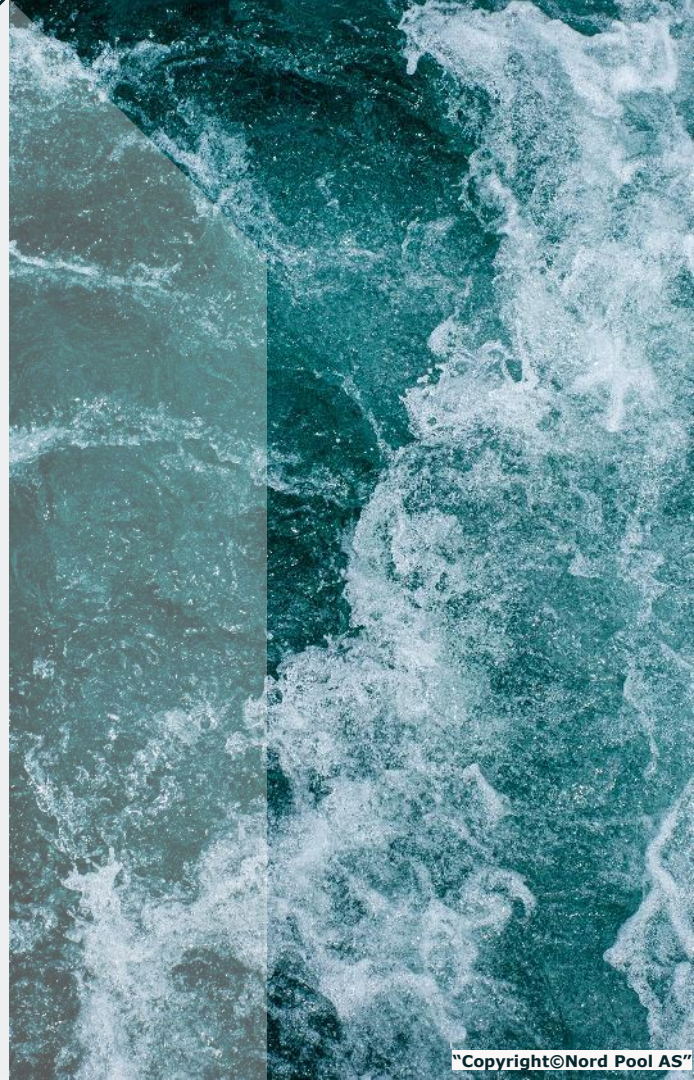

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AGENDA

- Introduction
- Market Surveillance performed by the TSOs
- Prohibition of Insider Trading
- Obligation to Publish Inside Information
- Prohibition of Market Manipulation
- Key take-aways
- Q&A

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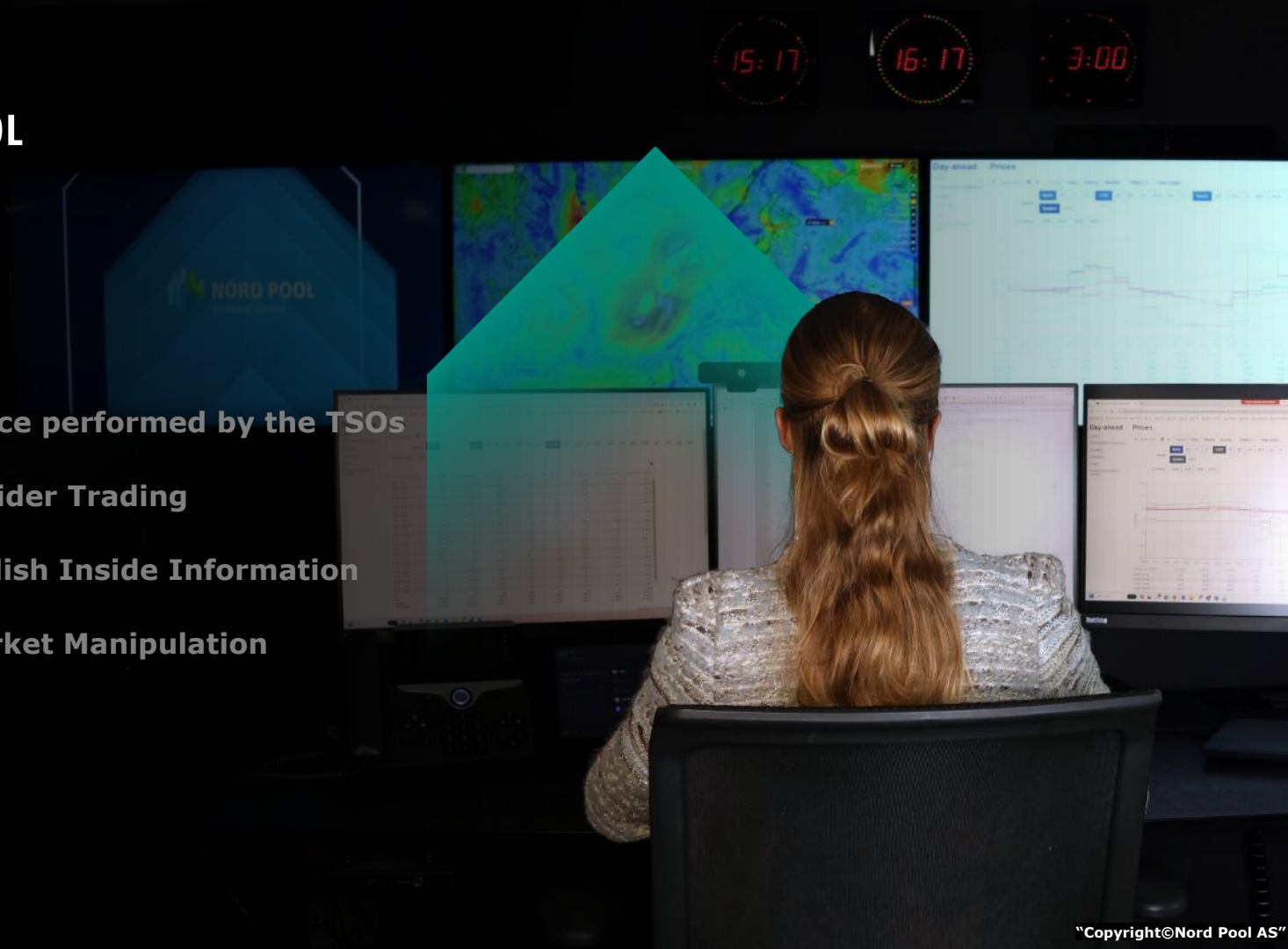

Introduction

- Nord Pool Market Surveillance is consultants to the Baltic TSOs, and are assisting the TSOs in creating a Best Practice Guidance document for the Baltic Balancing markets. The Best Practice Guidance document will eventually be made available to the market participants in the Baltics.
- This presentation is based on the Best Practice Guidance document, and the content of the final document may be adjusted at a later stage based on input received during this webinar.
- Therefore, we urge you to ask questions or suggest topics related to REMIT compliance in the balancing markets, where you believe there is a need for additional clarification. This can be done in the chat, orally, or through an email.

The Baltic TSOs and the Baltic Balancing Markets

- The Baltic TSOs organize the balancing markets in all three Baltic countries
  - mFRR and aFRR energy markets
  - Baltic Balancing Capacity markets (mFRR, aFRR, FCR)
- As market operators, the Baltic TSOs seek to ensure:
  - The well-functioning of the markets
  - That resources are used as efficiently as possible
- According to REMIT, the TSOs are obliged to:
  - Monitor the markets for possible market manipulation, insider trading, and breaches of the obligation to publish inside information
  - Report possible breaches to the authorities

Baltic TSOs:

- Elering (Estonia)
- AST (Latvia)
- Litgrid (Lithuania)

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Best Practice Guidance

BALTIC BALANCING MARKETS

- Detecting possible breaches – important to ensure well-functioning of the markets
- Also important to prevent breaches from occurring
- The TSOs will publish a Best Practice Guidance document
  - Highlights important principles to keep in mind when trading in the Baltic balancing markets
  - Not comprehensive guide on all balancing market trading requirements
  - Highlights issues where there may be a need for additional clarification

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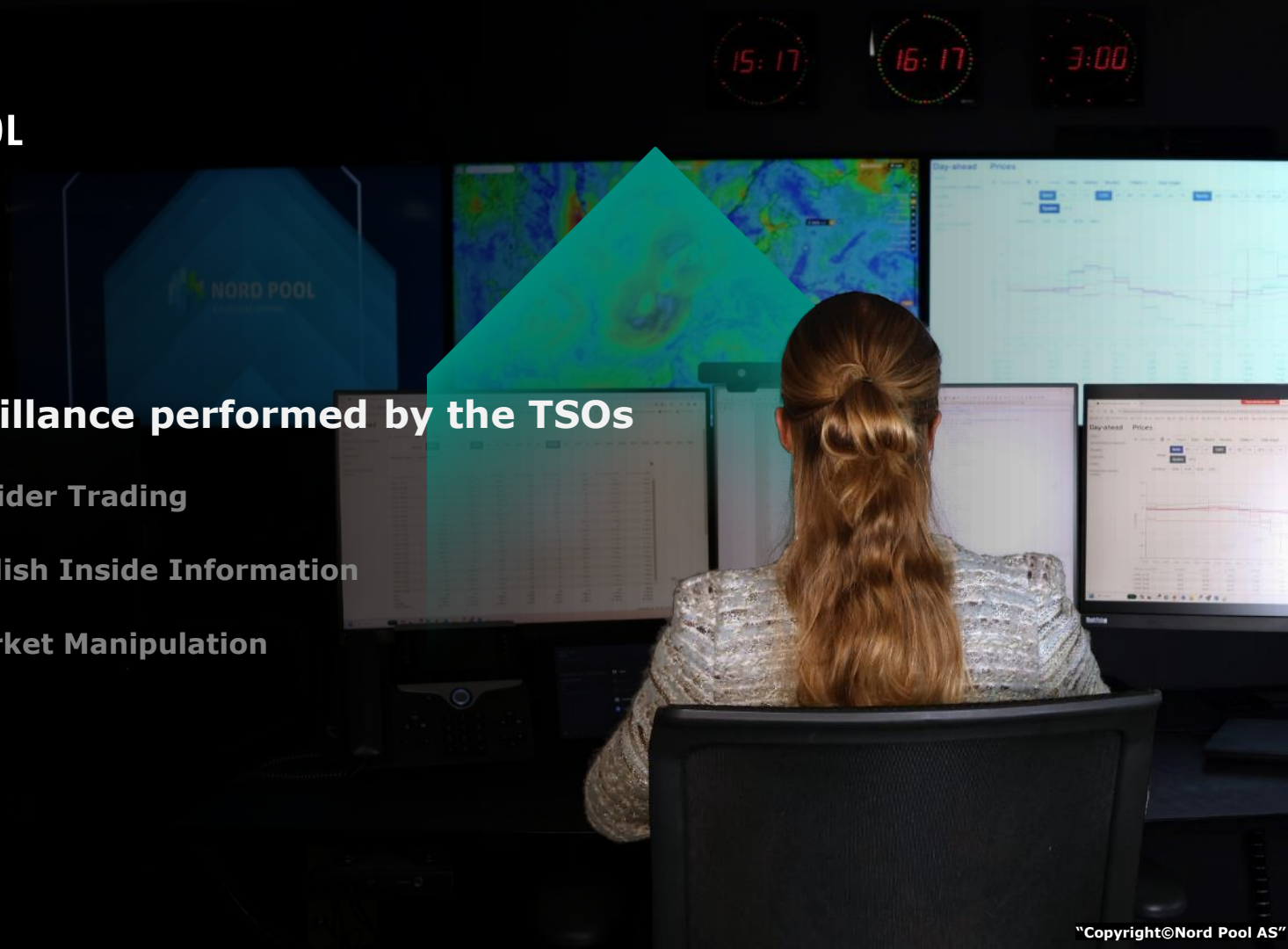


Baltic TSOs' requirements under REMIT

- REMIT - Regulation on wholesale Energy Market Integrity and Transparency
- The Baltic TSOs are obliged to monitor for breaches of REMIT Article 3, 4, 5
  - Prohibition of insider trading
  - Obligation to publish inside information
  - Prohibition of market manipulation
- According to REMIT, Baltic TSOs shall:
  - establish and maintain effective arrangements, systems and procedures to identify such breaches.

Article 3

Prohibition of insider trading

Article 4

Obligation to publish inside information

Article 5

Prohibition of market manipulation

'Article 15

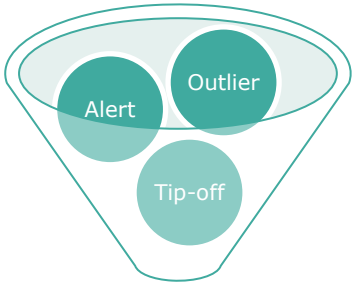
Obligations of persons professionally arranging or executing transactions

Setup for monitoring

MARKET MONITORING STRATEGY AND RISK ASSESSMENT

- Balancing markets – highly interlinked within the Baltics
- Baltic TSOs cooperate closely on monitoring the markets
  - Exchange expertise, consistency in guidance of MPs, consistency in handling suspicious events
- The TSOs have similar Market Monitoring Strategies – ensure consistency in market monitoring
- Monitoring based on a Risk Assessment (RA)
  - Lists common types of market manipulation and insider trading, and perceived risks of occurrence in the Baltic balancing markets
  - TSOs focus on behaviors with high risk of occurrence and with significant negative consequences
  - The RA is used as basis for developing automatic tools and ensure the focus of the Market Surveillance team

Market monitoring process



Incident

Analyst assessment

- Market **fundamentals** analysis: zonal configuration, prices, consumption, supply, imports/exports
- **Behaviour** analysis: type of market participant, historic bidding, unavailability

Explained behavior: incident is discarded

Unexplained behavior: incident is escalated and the whole **Market Surveillance team** provides input

Need for further information?

Questions to market participants

No reasonable suspicion

Reasonable suspicion of a breach:

Submits a **Suspicious Transaction and Order Report (STOR)** to the relevant NRA(s) and ACER

Interaction with market participants (I)

- Market Surveillance (MS) may contact Market Participants (MP):
    - With questions when necessary to conclude on a suspicion of a breach
    - For the purpose of improving market monitoring
- MPs in the Baltics are (or will be) obliged to respond to MS' questions
- MS will notify the responsible NRA(s) and ACER if MS' investigation confirms reasonable suspicion of a REMIT breach
- MS will not share information to the MP whether a case is notified to the NRA (ACER Guidance)

Interaction with market participants (II)

- Contact with MPs may be used to provide guidance to MPs to contribute to the well-functioning of the market
    - As long as there is no danger of evidence being destroyed
- Guidance on specific trading practices may be provided on request from the MP
- Please contact the respective TSO to discuss any specific questions related to REMIT compliance

Contact information:

- Elering: REMIT@elering.ee
- Litgrid: REMIT@litgrid.eu
- AST: Surveillance@ast.lv

Notifying Market Surveillance regarding suspicious activity

- Tip-offs from Baltic MPs, analysts working close to the market, and other interested parties is invaluable input to Market Surveillance work
- The MS team handles all correspondence related to tip-offs in strict confidence
- Tip-offs may be given through phone or email
- Contact details can be found on the relevant TSOs webpage

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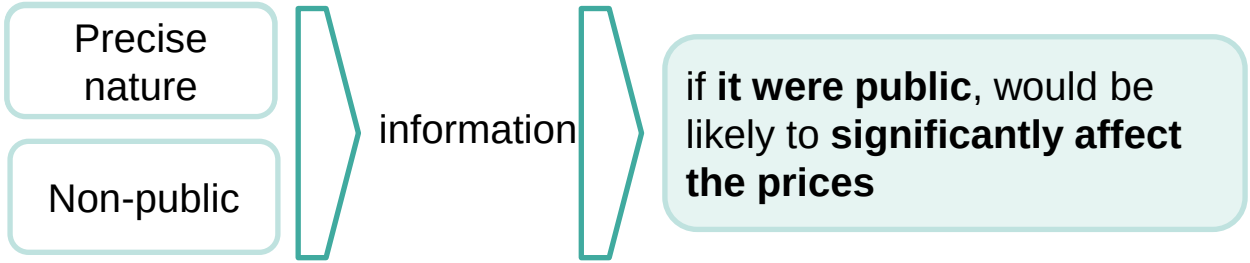
What is inside information?

REMIT ARTICLE 2

*'Inside information' means information of a **precise nature** which has **not been made public**, which **relates**, directly or indirectly, to one or more **wholesale energy products** and which, **if it were made public**, would be likely to **significantly affect the prices** of those wholesale energy products.*



- *"Information regarding the market participant's **own plans and strategies for trading** should **not** be considered as inside information." (REMIT recital 12)*
- Likely to significantly affect prices – if a **rational trader** would consider it **important for trading decisions**

What does the prohibition of insider trading entail?

REMIT ARTICLE 3

- According to REMIT Article 3:
  - It is prohibited to use inside information for trading – that's insider trading!
  - It is not allowed to give advise on trading based on inside information
  - It is not allowed to disclose inside information to another person, who does not have a clear need for the information
    - It is important that inside information is disclosed internally **only** to those employees who must have the information to perform their professional duties.

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IT issue disabling participation in the balancing market

EXAMPLE

- Inside information often relates to unavailability of production, consumption or transmission. However, other information that qualify as inside information also require publication, e.g. IT-issues affecting how an asset can be offered to the market.
- A MP face an IT-issue during a day, disabling a flexible production unit from offering capacity and energy to the balancing markets, but they can still offer to the day-ahead market.
- It must be assessed it this constitute inside information.
- This is more likely to be the case for instance if the liquidity in the market is low and if market fundamentals indicate a tight market situation on the day in question.
- If the conclusion of the assessment is that the absence of the unit is likely to significantly affect the price, this information must be published, before trading using that information.
- REMIT recital 12 lists an exception that *own plans and strategies for trading* is not to be considered inside information. However, experiencing an IT issue is not a market participant's plan or strategy, and may thus be considered inside information that needs to be published.

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What does the obligation to publish inside information entail?

REMIT ARTICLE 4

- Market participants are required to publish inside information that they possess in respect of business or facilities that they are responsible for
- Inside information shall be published within one hour
- The publication shall fulfil the following quality criteria:
  - Published on a certified Inside Information Platform, e.g. Nord Pool UMM system
  - If an element of prognosis is used, the prognosis shall be performed with a reasonable accuracy
  - If a company website is used in addition to the Nord Pool UMM platform, publication shall be simultaneous and equivalent on both platforms
- No trading on inside information shall be done before publication
- In case of technical issues with the platform – be aware of emergency procedures (Nord Pool UMM's emergency procedure)

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What does the prohibition of market manipulation entail?

REMIT ARTICLE 5 AND 2

- Article 5 of REMIT prohibits engaging in, or attempting to engage in, market manipulation in wholesale energy markets
- In REMIT Article 2, market manipulation (1/2) is defined as follows:

(a)

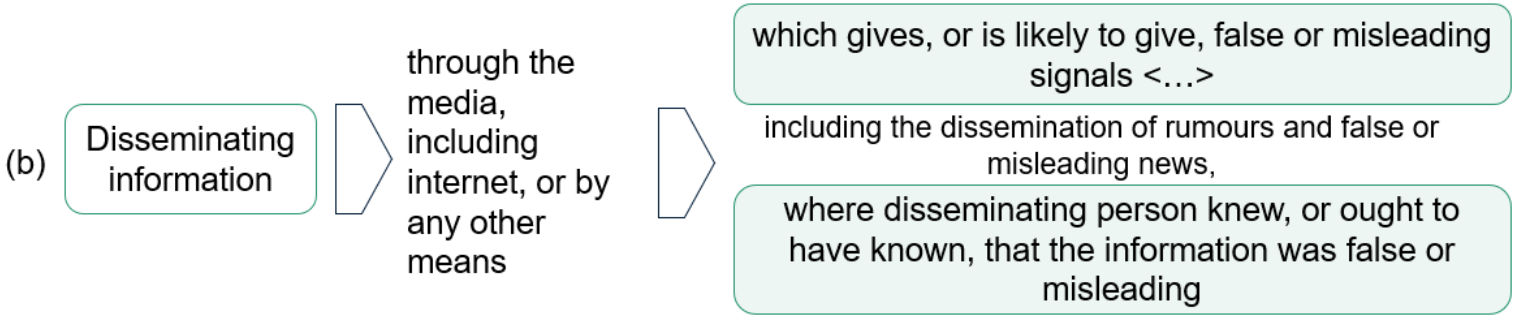
- Entering into transaction
- Issuing, modifying or withdrawing any order to trade
- Engaging in any other behaviour

→ Relating to wholesale energy product, which:

→
- (i) gives or is likely to give, **false** or **misleading signals** as to the supply of, demand for, or price of wholesale energy product
- (ii) secures or is likely to secure <…> **the price** <…> **at an artificial level**
- (iii) employs a fictitious device or any other **form of deception** <…>

Definition of market manipulation (2/2)

REMIT ARTICLE 2



Capacity withholding

Based on ACER's guidance:

Electricity generation capacity withholding refers to the practice of keeping available generation capacity from being competitively offered on wholesale electricity market, even though offering it competitively would lead to profitable transactions at the prevailing market prices

Physical withholding

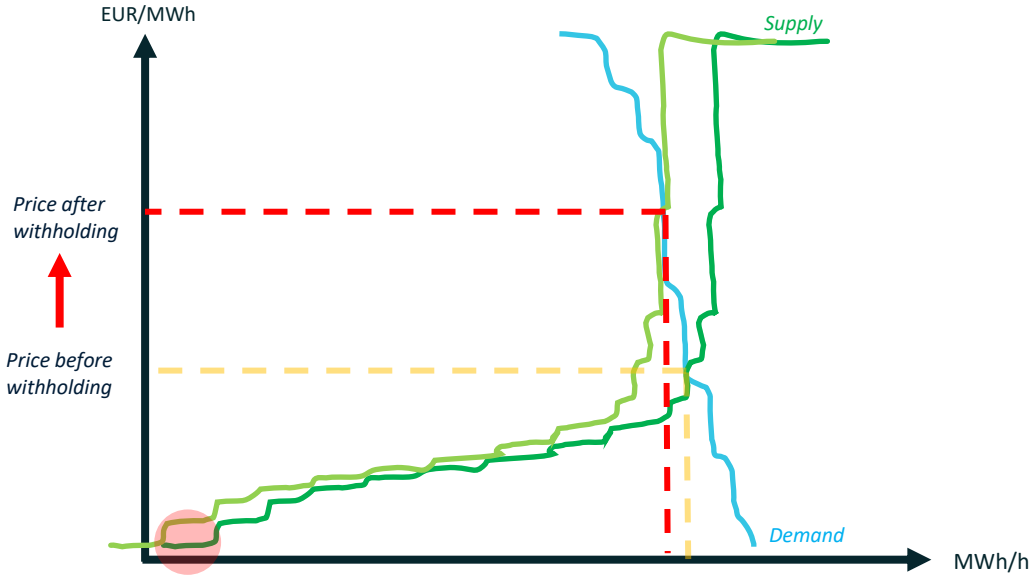
When capacity is not offered at any price

Economic withholding

When capacity is offered above the market price and the bid does not reflect the marginal cost (including opportunity cost)

Link

Physical and economic withholding



Capacity withholding

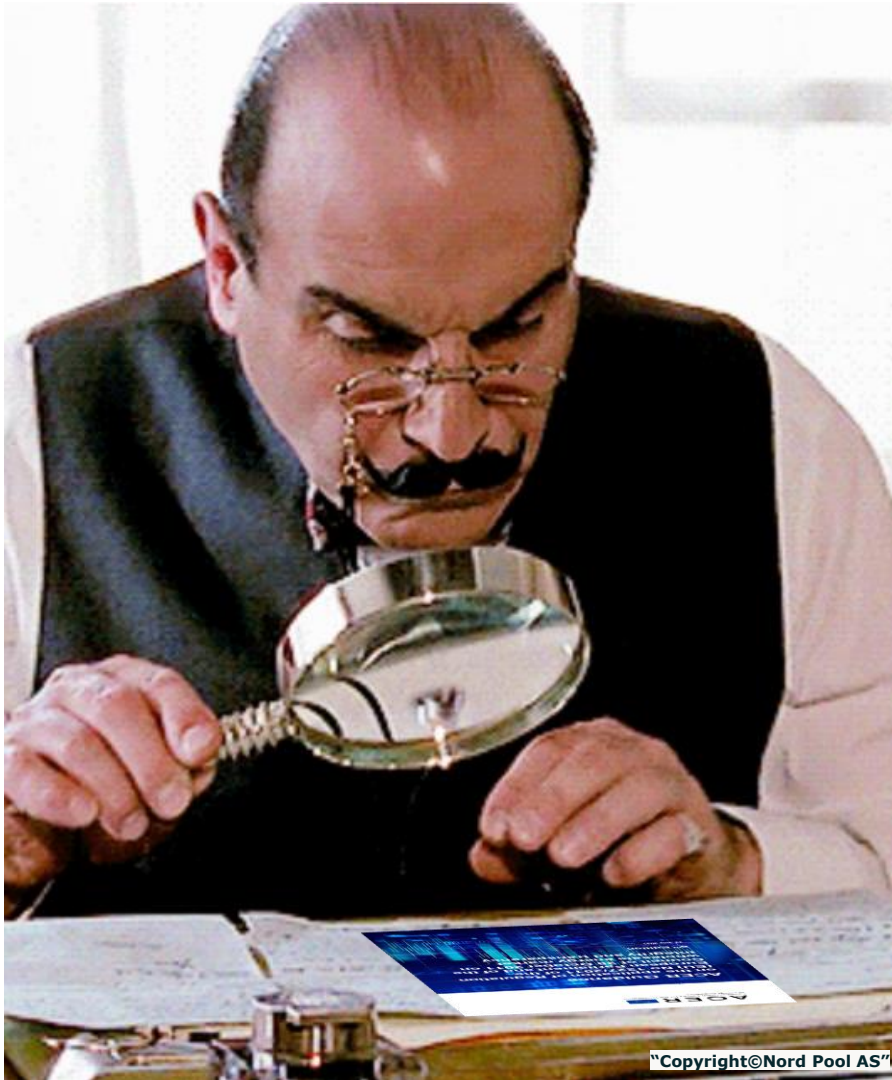
When is it market manipulation?

Based on ACER's Guidance, there is a 2-step approach for determining if bidding can qualify as capacity withholding:

1. Is the market participant able to influence the price or the interplay by its behaviour in the case-specific circumstances?
2. Does the market participant have no legitimate technical, regulatory and/or economic justification when it does not offer its generation capacity or has offered it above marginal costs?

Important:

Legitimate economic reason – expectation of opportunity costs, expected value of producing at a different point in time or in a different market



Economic capacity withholding

- A legitimate economic reason for pricing above the marginal cost is based on the opportunity cost
- The opportunity cost is the expected value of the best alternative that was not chosen. Essentially, the benefit that could have been gained by making a different decision in the market.
    - For example, the expected value of offering energy-limited assets, such as hydro reservoir units, at a different point in time
    - Or, the expected value of offering an asset in a different sequential market, such as the forward, day-ahead or intraday market
- The price of foregone markets does not represent a relevant opportunity cost
    - It's not relevant to offer to the balancing market at a price at which the power was purchased in the intraday market, as foregone trading in intraday market is a sunk cost.
    - In general case, offering to mFRR and aFRR energy markets at the day-ahead price (and potentially including a premium), also does not represent a legitimate opportunity cost. This is as day-ahead prices represents a foregone trading opportunity and is therefore a sunk cost.

Economic capacity withholding: profit margins

- Market participants' pricing should always be based on the opportunity cost
- Commonly relevant input to the opportunity cost:
  - Marginal cost
  - Price expectation in later sequential markets, or
  - Price expectation in later MTUs (market time units), if and only if production in one MTU affects the ability to produce in that later MTU
  - Changes in expected profit from a change in production profile which is directly attributable to a potential activation in the balancing market.
- Profit margin is understood as an arbitrary premium on top of the bid that does not have a legitimate technical, regulatory and/or economic (i.e., opportunity cost) justification.
- In markets with marginal price setting, a **profit margin does not represent legitimate input** to the opportunity cost (and thus the bid)
- Increasing the offer by adding a profit margin can result in a cost-effective asset not being dispatched in markets with marginal price setting, potentially resulting in economic capacity withholding.

Physical capacity withholding

"Actions undertaken in the form of not offering the available generation capacity at any price."

Definition of Physical withholding in ACER Guidance

- The same reasons – technical, regulatory and/or economic – are relevant as a justification for not offering the asset.
- *Technical reasons* include unavailability of the unit or ramping restrictions of the unit, while *regulatory reasons* may include the contractual obligation of the asset to be offered elsewhere.
- It is recommended to consider the opportunity cost as a pricing input, *rather* than a reason for not offering the asset. This means that the asset should preferably be offered to all market segments, but at a price that reflects the expectation of sequential markets (in case of an energy-limited asset) or the expectation of later MTUs (in case of an energy-limited asset).

Economic or physical capacity withholding in the capacity market

- To avoid risk of engaging in economic or physical capacity withholding, it is in the balancing markets, recommended to enter all technically available volumes, and pricing them at opportunity cost.
- In general, the available volumes to the capacity market would be all prequalified volumes which are technically available. Deviating significantly from this, without technical, regulatory or economic justification risks qualifying as a physical capacity withholding.
- In the capacity markets, the main input to the opportunity cost is the expected profit the MP would have generated had it *not* reserved the capacity for balancing (e.g. profit stemming from participation in DA, ID, etc), minus the expected profit from the balancing energy market. MPs may have different risk profiles, meaning that the MPs opportunity cost may also reflect a preference for a more secure income and operational state.
- Different parts of the overall volumes offered in a MTU may also have different opportunity cost, i.e. a several bids with different costs.

Example: Pricing in the capacity markets

SIMPLIFIED FOR CONCISENESS– ONLY SOME MARKETS INCLUDED, AND TECHNICAL DETAILS REDUCED

- A run-of-river producer has 100 MW/h prequalified for mFRR upregulation (capacity and energy), and a marginal cost of €0/MW/h.
- Considering the MP's price forecast and forecasted production plan if operating freely in day-ahead, intraday and balancing market, the MP expect that 100 MW will generate a profit of €250/MW/h.
- Considering MP's price forecast and forecasted production plan if operating exclusively for upregulation in the mFRR energy market, the MP has an expectation that the 100 MW will generate a profit of €140/MW/h
- Thus, the opportunity cost for the offer to the mFRR capacity market is €250/MW/h - €140/MW/h = €110/MW/h. This is the price level where the MP is indifferent between being reserved for the mFRR capacity market, or being able to freely participate in DA, ID and balancing markets.
- In addition, it is assumed that the option of offering the capacity to the mFRR market implies a larger risk than offering to the DA, ID and balancing markets. If the MP is risk averse, this may lead to a preference towards the more secure income in DA and ID, compared to the *less secure* income in the mFRR energy market. This is a legitimate reason to increase the opportunity cost somewhat when placing orders to the mFRR capacity market.

Example: Pricing in the capacity markets

SIMPLIFIED FOR CONCISENESS– ONLY SOME MARKETS INCLUDED, AND TECHNICAL DETAILS REDUCED

- That assessment would be different in the case where acceptance in the mFRR capacity market would be conditioned on the unit having a certain production profile going into the mFRR energy market, e.g. if offering downregulation capacity (meaning the asset must be running), but the DA prices are expected to be below ones marginal cost. In such a case marginal costs can be a relevant part of opportunity costs in the mFRR capacity market.

Example: Pricing that might qualify as economic withholding

- Imagine a ficticious BSP («BSP AS») offering 30 MW upregulation balancing energy (mFRR/aFRR) from a consumption unit (e.g. fertilizer production) to the balancing market
- The BSP has a simple pricing strategy for upregulation:
  «Latvian DA-price + €200 EUR»

Hour	DA	mFRR offer	Reg. Dir.	mFRR price outcome	BSP AS results
…			…		
05:00	€ 30	€ 230	Up	€ 42	0 MW
06:00	€ 30	€ 230	Up	€ 250	30 MW
07:00	€ 100	€ 300	Up	€ 270	0 MW
08:00	€ 150	€ 350	Up	€ 340	0 MW
09:00	€ 100	€ 300	Up	€ 280	0 MW
10:00	€ 30	€ 230	Up	€ 290	30 MW
…			…		

Alternative, using opportunity cost principle:
"Value of lost production is €280"

Hour	DA	mFRR offer	Reg. Dir.	mFRR price outcome	BSP AS results
…			…		
05:00	€ 30	€ 280	Up	€ 42	0 MW
06:00	€ 30	€ 280	Up	€ 250	0 MW
07:00	€ 100	€ 280	Up	€ 270	0 MW
08:00	€ 150	€ 280	Up	€ 340	30 MW
09:00	€ 100	€ 280	Up	€ 280	30 MW
10:00	€ 30	€ 280	Up	€ 290	30 MW
…			…		

- Oddly, somewhat arbitratily this pricing strategy lead BSP AS to not be upregulated when prices in the market are at its highest. Unless that actually reflects BSP AS's costs in the different hours, that is bad for BSP AS, and bad for society
- Could it be market manipulation?

- *BSP AS have reasonable economic, technical or regulatory justification for pricing as they did, or did they in reality have the same opportunity cost (lost value of fertilizer) the entire day, regardless of hour where they reduced consumption?*

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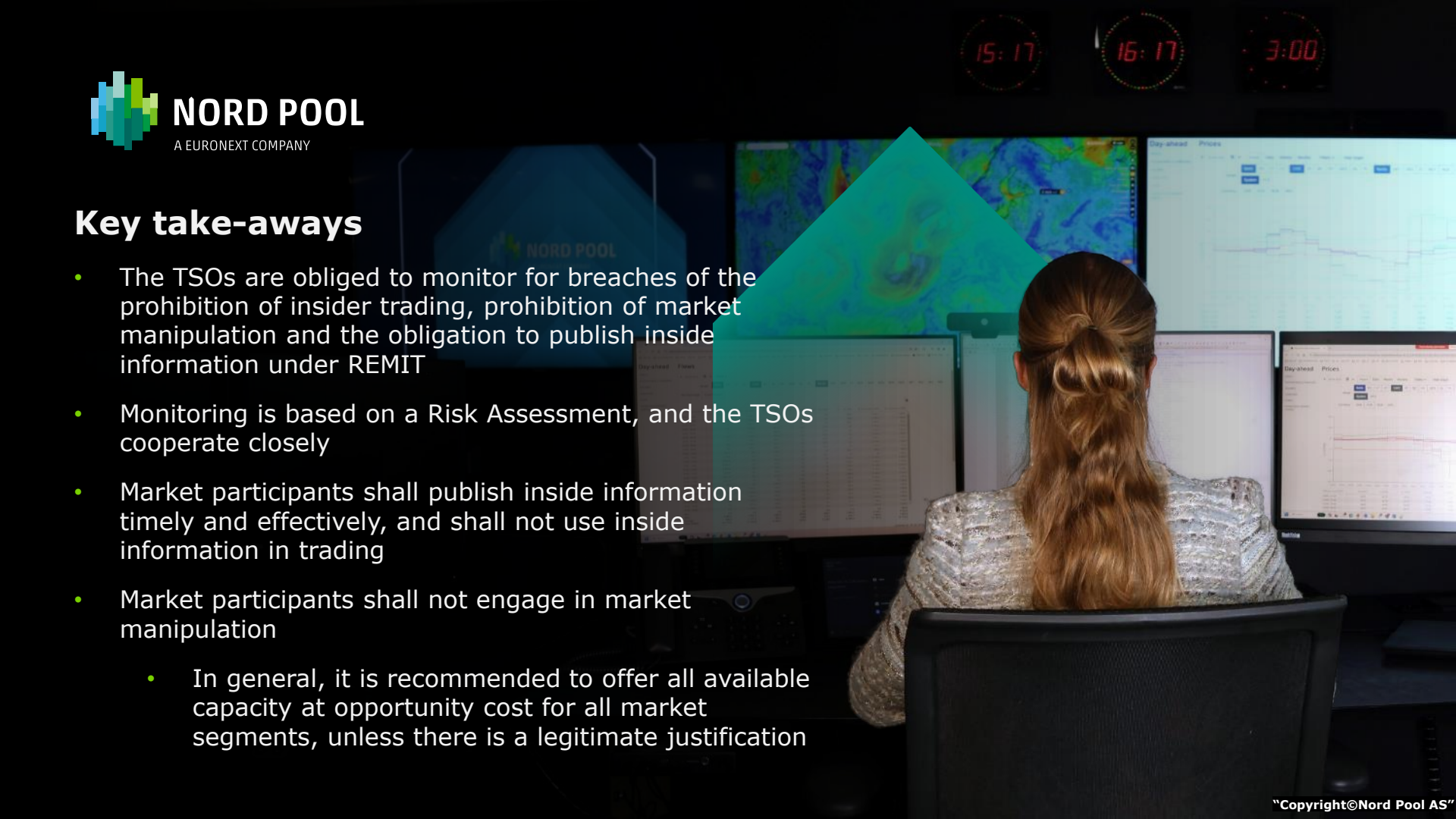
Key take-aways

- The TSOs are obliged to monitor for breaches of the prohibition of insider trading, prohibition of market manipulation and the obligation to publish inside information under REMIT
- Monitoring is based on a Risk Assessment, and the TSOs cooperate closely
- Market participants shall publish inside information timely and effectively, and shall not use inside information in trading
- Market participants shall not engage in market manipulation
    - In general, it is recommended to offer all available capacity at opportunity cost for all market segments, unless there is a legitimate justification



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Resources

- Regulations (EU) No 1227/2011 (REMIT)
- Regulations (EU) 2024/1106 amending Regulations (EU) No 1227/2011 (Revised REMIT / REMIT 2)
- ACER Guidance 6th edition, July 2021
- REMIT Documents (ACER)

Contact details

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- Litgrid: REMIT@litgrid.eu
- AST: Surveillance@ast.lv

- Nord Pool: market.surveillance@nordpoolgroup.com