

All interested parties and stakeholders

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Dear colleague,

## **Implementing the Electricity EU Network Codes (as defined below)**

### **Implementing the EU Regulation on Capacity Allocation and Congestion Management (CACM Regulation) in GB, and**

### **Consultation on Ofgem's proposed application process for NEMO designation and application of designation criteria**

On 5 December 2014, Member States voted to adopt the EU Regulation on CACM<sup>1</sup>, following a period of development lasting over 4 years. The CACM Regulation is the first of the ten EU "electricity network codes"<sup>2</sup> (ENCs) developed in accordance with the EU Third Energy Package<sup>3</sup>. The ENCs are Regulations governing the design, operation and planning of the European energy sector.

The adoption of the CACM Regulation is an important milestone and marks the start of a program of work to ensure GB is fully compliant with the requirements of these new and planned Regulations. This will involve and affect players from across industry, will see changes to many established industry documents, and will take several years to fully complete.

This letter sets out the approach we intend to take to implement ENCs in GB, building on comments made by government<sup>4</sup>. The letter outlines:

1. The general principles we intend to apply when acting in order to assist in the implementation of the CACM Regulation and the forthcoming ENCs;

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<sup>1</sup> A copy of the text voted upon by Member States can be found on the European Commission's website: [http://ec.europa.eu/energy/gas\\_electricity/electricity/doc/cacm\\_final\\_provisional.pdf](http://ec.europa.eu/energy/gas_electricity/electricity/doc/cacm_final_provisional.pdf)

<sup>2</sup> The term Electricity Network Code has been used to describe the new Regulations developed through a specific process involving the European Network of Transmission System Operators (ENTSO-E) and the Agency for the Cooperation of Energy Regulators (ACER) and agreed by Member States. Once they enter into force, following scrutiny by the European Council, and the European Parliament and publication in the Official Journal of the European Union, they will become directly applicable Regulations. We use the terms Electricity Network Code, guideline and Regulation interchangeably.

<sup>3</sup> The Third Energy Package of 2009 is a suite of EU legislation for European gas and electricity markets to promote the completion and efficient functioning of the single European energy market. It provides the legal basis and procedures for ENTSO-E and ACER to develop EU network codes.

<sup>4</sup> Government presented on EU electricity network code implementation at the 13<sup>th</sup> DECC-Ofgem European Stakeholder Group, 29 October 2014: <https://www.ofgem.gov.uk/publications-and-updates/minutes-and-presentations-13th-decc-ofgem-european-stakeholder-group-electricity>

2. The critical first steps to implementing the CACM Regulation; and,
3. The proposed application process for designating Nominated Electricity Market Operators (NEMOs) and the application of designation criteria.

## **1. Implementing Electricity Network Codes in GB**

ENCs, once they enter into force, become European Regulations. As Regulations they apply directly to all addressees and apply directly to GB without being transposed into national laws or regulatory frameworks. European Regulations also take precedence in the legal “hierarchy of laws” over domestic law (i.e. if a domestic law is incompatible with a European Regulation, it is the European law which takes precedence). In the event that a Member State does not comply with a European Regulation, it can face infraction proceedings (which can involve very substantial fines). As such, the Member State is ultimately responsible for implementation in the UK.

However, ensuring full and timely implementation, particularly of those aspects of Regulations where further action is required to develop, define and/or approve rules or obligations, will require significant effort and engagement from government, Ofgem, Transmission System Operators (TSOs), Distribution Network Operators and wider industry. Implementation will see changes being made to interconnector access rules, charging methodologies, industry codes and licences and is likely to require legislation in a limited number of cases.

Implementing 10 new ENCs will also increase the complexity of the rules facing market participants. As a result it will be important to record the rationale for changes along with clarifying which rules apply to which parties on an enduring basis. Ofgem’s guiding principles in determining how to ensure compliance with European Regulations is that:

- We will only make changes where needed; and
- Where changes are needed to implement part of a European Regulation, we will make only those changes necessary to the relevant industry document to ensure compliance with the European codes and guidelines.

To implement every Regulation there will need to be an initial exercise to determine which elements apply directly, which need additional action to put in place and, where this is the case, which parts of the GB framework will need to change to achieve this. This exercise will take place in an open and transparent way providing all parties with the opportunity to consider and comment on what changes will be required to the GB framework, by whom and by when.

Our current intention is to use the industry chaired Joint Electricity Standing Group (JESG) as our primary interface with stakeholders: first to communicate when this process will start for each Regulation, second to provide regular progress up-dates, third to discuss cross-cutting implementation issues and lastly we may also use this as a forum to discuss the content. This will be ahead of any formal consultations for specific amendments to the GB framework as appropriate.

There will then be a need for different parties to ensure that changes are taken forward through the appropriate route and that the suite of changes is coordinated:

- We understand that government will make changes to legislation where there is no alternative route through which to ensure compliance;
- Ofgem expects to make changes to licences and require changes to access rules and charging methodologies where necessary;
- We expect changes to GB industry codes (both to implement the ENCs and to remove any duplication or inconsistencies) to be coordinated by relevant parties and the timely delivery overseen by Panels;

- We expect industry to revise contractual terms and arrangements accordingly;

A steering group comprising Ofgem and DECC as permanent members and involving others where appropriate has been set up to oversee and coordinate implementation across ENCs.

## 2. Implementing the CACM Regulation in GB

This section outlines the critical first steps to implementing the CACM Regulation. The CACM Regulation sets out the pan-European rules for day ahead and intraday cross-border trading (market coupling). To achieve this, the CACM Regulation establishes new entities such as NEMOs to operate single day ahead and intraday coupling, and specifies the approach to defining bidding zones, calculating cross-border capacities and managing congestion. It also requires TSOs and NEMOs respectively to develop and propose common methodologies, terms and conditions for approval by National Regulatory Authorities (NRAs) within fixed legal timelines.

The CACM Regulation does not specify an operational 'go-live' date. Rather it requires responsible parties to successfully complete all tasks outlined in the CACM Regulation. These requirements are set out on a National, Regional and Pan-European basis. Ofgem together with other NRAs are responsible for monitoring compliance with the requirements set out in the CACM Regulation and enforcing any non-compliance.

### Establishing roles and responsibilities

The first step to implementing the CACM Regulation is to assign roles and responsibilities. This task must be completed on or shortly after entry into force to allow these parties to develop common methodologies, terms and conditions:

1. **The designation of NEMOs.** The CACM Regulation requires the designation of entities as NEMOs, to establish and operate single day ahead and/or intraday coupling in coordination with TSOs and other NEMOs. It also creates a governance framework for NEMOs, requires NRAs to designate NEMOs, and requires at least one NEMO to be designated in each Member State within four months of entry into force. To implement this Ofgem will designate NEMOs in GB and then monitor and enforce their compliance. This letter sets out and consults on the approach we intend to take to designate NEMOs in GB.
2. **Assignment of responsibilities to the appropriate TSOs operating in GB.** We are already working with government and TSOs in GB to assign roles and responsibilities to TSOs. We will test our initial proposals for this process with stakeholders at JESG.
3. **Capacity Calculation Regions** need to be proposed by all TSOs to all NRAs within three months of entry into force to allow the development of terms, conditions and methodologies that calculate capacity and manage congestion at a regional level. All NRAs must make a decision on this proposal within 6 months of receiving it. We are already working with the relevant TSOs and NRAs, together with ACER and ENTSO-E, to develop Capacity Calculation Regions.

### Pan European and regional activities

Once roles and responsibilities have been allocated, the relevant parties will need to participate in pan European and regional processes to set out common methodologies, terms and conditions. These processes, and their approval by all regulators, or regional regulators, is important because the provisions of the CACM Regulation can only take effect following the conclusion of a series of steps, taking 31 months in total. These steps form a critical path and delay to any one element of the process will have a knock on impact on the time at which the CACM Regulation can take effect.

## GB implementation

In parallel to these activities and consistent with the principles set out in section 1, an exercise must be performed to determine and coordinate the changes that need to be made to existing GB frameworks. Considerable work has already been done to identify which provisions of the CACM Regulation apply directly and to identify potential changes to interconnector access rules, charging methodologies, industry codes and licences and legislation that may be required. Our current intention is to present a draft plan to implement these changes and to test our analysis of what changes are required and by when with stakeholders at the February JESG.

Once a view on changes required to GB arrangements has been established, it will be for different parties to progress those changes in timescales consistent with those for completing pan European implementation. Ofgem will make licence changes where appropriate and within our powers and we will consider changes to access rules and charging methodologies as part of the annual approval cycle. However where necessary we may consider using our powers to direct changes to access rules and charging methodologies if needed. We expect industry code panels to identify and coordinate changes to industry codes (including removing any redundancy) and we will work with government on any legislative changes required to provide enforcement powers or give effect to the provisions of the CACM Regulation.

As noted above, work will need to be overseen by a steering group chaired by Ofgem and DECC and progress updates will be regularly provided to industry via the JESG.

### 3. Consulting on our proposed application process for NEMO designation and application of designation criteria

The final part of this letter focusses on the first task to implement the CACM Regulation; NEMO designation. We have developed a process to deliver this task in line with the CACM Regulation. An important part of this process is to assess whether applicants meet the designation criteria set out in the CACM Regulation. This is effectively an assessment of a party's capability to perform NEMO functions. To provide greater clarity on our approach, we have included the criteria together with a description of how we currently understand and propose to apply them in the annex of this letter. We welcome views on an appropriate interpretation of these criteria.

We intend to follow the initial designation process below to make sure we can designate at least one NEMO within 4 months of the CACM Regulation entering into force, subject to any change in the expected date of entry into force of Q2 2015:

- **27 February 2015** - we will publish an open letter inviting interested parties to submit an application to be designated as a NEMO for single day ahead and/or intraday coupling in GB.
- We will accept applications until **30 March 2015**;
- **1 April 2015** – we will assess applications against the designation criteria.
- **1 June 2015** - we will consult for 28 days on a draft decision<sup>5</sup>.
- We will make a final decision on / or before the NEMO designation deadline taking into account the date of entry into force of the CACM Regulation and consultation responses received.

After we have completed this initial designation process, we will accept applications for designation on an ongoing basis. We will use a similar process, assessing applications against the criteria and consulting on a draft decision before publishing a final decision.

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<sup>5</sup> Given the tight deadlines for NEMO designation set out in the CACM Regulation we believe it is appropriate to hold a four week consultation on the draft designation decision. We consider this approach to be in line with our consultation guidance.

## Summary of consultation issues

We would welcome the views of stakeholders on our process to designate NEMOs in GB, our understanding of the designation criteria, and how we propose to apply the criteria. Responses should be received by Friday 30 January 2015 and should be sent to [matthew.ramsden@ofgem.gov.uk](mailto:matthew.ramsden@ofgem.gov.uk).

Unless marked confidential, all responses will be published on our library and on our website, [www.ofgem.gov.uk](http://www.ofgem.gov.uk). You may request that your response be kept confidential. We will respect this request, unless the law requires us to disclose anything, for example under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004. If you'd like your response to remain confidential, clearly mark the document to that effect and include the reasons for confidentiality. Put any confidential material in the appendices to your response.

If you have any queries more generally on the matters referred to in this letter please feel free to contact [natasha.z.smith@ofgem.gov.uk](mailto:natasha.z.smith@ofgem.gov.uk).

Yours sincerely,

Mark Copley  
Associate Partner Wholesale Markets

**Annex: proposed application of NEMO designation criteria**

<b>CACM Guideline Designation Criteria: Article 6</b>	<b>Our understanding of criteria for application.</b>
<p>6.1.(a) it has contracted or contracts adequate resources for common, coordinated and compliant operation of single day-ahead coupling and/or single intraday coupling, including the resources necessary to fulfil the NEMO functions, financial resources, the necessary information technology, technical infrastructure and operational procedures or it shall provide proof that it is able to make these resources available within a reasonable preparatory period before taking up its tasks in accordance with Article 7;</p>	<p>Applications must include evidence of:</p> <ul style="list-style-type: none"> <li>- adequate capitalisation and financial security to cover its activities and risk exposure in order to operate efficient, reliable, and stable single day ahead and/or intraday coupling.</li> <li>- necessary user platforms and interfaces, including necessary information technology, technical equipment, and or contractual service level agreements, together with contingency plans, to operate efficient, reliable, and stable single day ahead and/or intraday coupling.</li> <li>- operational arrangements, including contractual arrangements with members, NEMOs, and TSOs, together with contingency plans, demonstrating how it will deliver the NEMO tasks. In particular, where applicable, these must include that it has or will enter into the operational and contractual arrangements required where there is more than one NEMO operating in a bidding zone, in accordance with Articles 43b and 54b of the CACM Regulation.</li> <li>- For the initial designation process, given more than one entity already operates day ahead coupling in GB, applications for designation as a NEMO for single day ahead coupling must provide evidence that it has or will enter into the operational and contractual arrangements required to allow more than one entity to operate day ahead coupling in GB including evidence that these arrangements allow for new TSOs and NEMOs to enter into these arrangements, as required by Article 43b(1)).</li> </ul>
<p>6.1.(b) it shall be able to ensure that market participants have open access to information regarding the NEMO tasks in accordance with Article 7;</p>	<p>Applications must include evidence that it is able to ensure market participants have open access to the arrangements, methodologies, rules, processes, and data required to be made public by the CACM Regulation.</p>
<p>6.1.(c) it shall be cost-efficient with respect to single day-ahead and / or intraday coupling and shall in their internal accounting keep separate accounts for MCO functions and other activities in order to prevent cross-subsidisation;</p>	<p>We consider competitive pressure in GB will provide appropriate incentives for NEMOs to operate cost-efficiently. However, in order to fulfil our ongoing monitoring requirements, make any subsequent approvals or decisions with respect to the CACM Regulation for example with respect to cost sharing and recovery according to Articles 72-77, and to prevent cross-subsidisation, applications must include evidence that they have separate accounts for the MCO functions and other NEMO activities, and can report a clear breakdown of all their NEMO costs.</p>
<p>6.1.(d) it shall have an adequate level of business separation from other market participants;</p>	<p>Applications must include evidence of adequate business separation that includes a clear description of their corporate structure.</p>
<p>6.1.(e) if designated as a national legal monopoly for day-ahead and intraday trading services in a</p>	<p>Applications must include evidence that they have separate accounts for services provided as a national legal monopoly to prevent cross-subsidisation.</p>

Member State, it shall not use the fees in Article 5(1) to finance its day-ahead or intraday activities in a Member State other than the one where these fees are collected;	
6.1.(f) it shall be able to treat all market participants in a non-discriminatory way;	Applications must include evidence that they are able to treat all market participants in a non-discriminatory way.
6.1.(g) it shall have appropriate market surveillance arrangements in place;	Applications must include evidence of training and monitoring procedures to identify and report any potential issues consistent with the requirements of Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency (REMIT).
6.1.(h) it shall have in place appropriate transparency and confidentiality agreements with market participants and the TSOs;	Applications must include evidence of appropriate transparency and confidentiality agreements with market participants and TSOs.
6.1.(i) it shall be able to provide the necessary clearing and settlement services;	Applications must include evidence that they have, or have contracted an entity which is able to provide: <ul style="list-style-type: none"> <li>- adequate capitalisation and financial security, together with procedures in place to ensure satisfactory guarantees for settlements, necessary to clear and settle exchange of energy resulting from single day ahead and/or intraday coupling.</li> <li>- the technical, operational and contractual arrangements to clear and settle exchange of energy resulting from single day ahead and/or intraday coupling. In particular, where applicable, evidence that it has or will enter into arrangements required where there is more than one NEMO operating in a bidding zone, or for the initial designation process arrangements required to allow more than one entity to operate day ahead coupling, as with our understanding of criteria 6.1.(a).</li> </ul>
6.1.(j) it shall be able to put in place the necessary communication systems and routines for coordinating with the TSOs of the Member State;	Applications must include evidence of information and technical equipment and/or contractual service level agreements together with contingency plans for communicating with relevant TSOs.
2. The designation criteria set out in paragraph 1 shall be applied in such a way that competition between NEMOs is organised in a fair and non-discriminatory manner.	We will consider each application for designation based on whether that applicant meets the designation criteria. Applications must demonstrate that any contractual arrangements with other NEMOs and TSOs allow additional NEMOs and TSOs to operate single day ahead and intraday coupling in GB.