Regulation of Market Players with Significant Market Power
Hungarian Case Study

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Regulation of Market Players with Significant Market Power (Agenda)

- Conditions of efficient competition
- Competition authority or NRA?
- Designing SMP model
- Implementing SMP model in Hungary
  - Market Analysis
  - Obligations
- Implementation possibilities in Cyprus
Market Structure and Market Condition problems hindering efficient market operation (1)

Key Problems on EU and non-EU ERRA markets (but to different extent and with different focus):
– Concentrated markets
– Lack of investment
– Security of Supply
– Supportive legislative framework
– Market integration
– Price trends, price regulation, regulated end-user prices (in several EU member states has end-user price control for households and in some member states for non-households as well)
– Independence of network operators
– Regulatory power
– Customer protection
Market Structure and Market Condition problems hindering efficient market operation (2)

Conditions of effective competition

- Market structure, which facilitates efficient competition
- Access to networks
- Supply market - reserves, import
- Market size, possibility of regional markets
- Number of players
- Eligible customers with willingness to change supplier
- Adequate pricing, price signals
Potential regulatory measures on concentrated markets

What to do, when the competition is not efficient enough controlling the wholesale and retail prices?

US – FERC practice: Competition test (the relevant market should be competitive and the market player should demonstrate the lack of market dominance)

EU Telecom practice: Significant Market Power (SMP) concept
   – Ex Ante (compared to the Ex Post interaction of Competition Authorities)
   – Market analysis of the different markets (identification of players with significant market power on the relevant markets)
   – Impose Ex Ante obligations

Let us discuss this possibility in theory and in practice!
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Why not competition law?

Competition Authority

1. Analysis of an existing case acc to concrete facts
2. Ex post control (perfect possibility for withholding info and foreclosure)
3. On a concrete case, focusing to specific abusive behaviour
4. Maintaining effective competition in general
5. Regulation of complete sectors is not a goal
6. General scope – no lex specialis
7. Not designed for telling market participants what to do
8. Not dependent on information – no evaluation of alternative actions needed, no continuous monitoring
Why not competition law? Why sector specific regulation?

NRA

1. Intends to prevent future possible abusive behaviour
2. Ex ante market regulation
3. All relevant markets of the sector will be assessed in the given sector, including interferences
4. Identification and prevention of abusive behaviour characteristic to sector
5. Same methodology and procedure for all markets in the sector (quasi normative competence)
6. Sector-specific scope
Regulatory gap

Regulatory gaps
(e.g., scope of the regulation, cross-border issues, non adapted instruments, etc.)
Different approach

Electricity and gas directives
- Sector-specific regulation of the networks
- Not for production and trading
- Law decides
- Possibility for member states’ unilateral actions in preventing abuse

2002/2009 telco framework
- Activities classified by markets
- 3 criteria test – assessment the degree of competition
- NRA decides acc to an assessment
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Changes in public policy

Privatisation
Opening to competition
Reorientation of regulatory oversight from direct control of final output prices towards the promotion of competition
EC harmonisation
Competition regulation and liberalisation

Regulatory regimes

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Deconstructing competitive restraints

Market opening before Competition

Enhancing competition

Sustainable competition

The liberalisation process
How to implement SMP concept in energy?

1. Starting from theory of regulation – market regulation, nature of SMP, goals, importance

2. Assessment of market failures and problems:
   1. Sector inquiry Commission
   2. Sector inquiry Hungarian Competition Office
   3. Regulatory model proposal – Energy office

3. Analysis of goals and tools

4. EC harmonisation – the NRA and its competencies

5. Preconditions – scope of possible introduction

6. Toolkit of possible remedies

7. Two scenarios – most effective – least effective model

8. Normative or regulatory?

9. Timely dimension – the level of competition – the type of regulation

10. Regulation - at which level?

11. Need for transitory rules
Any EC constraints?

Art. 23. (1) NRAs should at least be responsible for ensuring
– non-discrimination,
– effective competition and the
– efficient functioning of the market,
Which should include
– monitoring and regulation

Art. 23. (8) Member States shall create
– appropriate and efficient mechanisms for
– regulation, control and transparency so as
– to avoid any abuse of a dominant position, in particular to the
detriment of consumers, and any predatory behaviour.
– These mechanisms shall take account of the provisions of the Treaty, and in particular Article 82 thereof.
Benefits for the NRA

• Increased scope for systematic intervention
• Complex evaluation of market data
• Large discretion in the scope and choice of remedies
• Policy making functions in the most important regulatory domain: enhancing competition, increase of consumer welfare
• Strengthens regulatory autonomy (transparency, independent decision making)
• For multi-sector regulator: combined use of stuff
Problems to be solved

- Alignment with existing normative rules
- Data collection, evaluation
- Timing
- Special rules of procedure
- Remedies
- External: checks and balances (judicial review, diversity of knowledge)
- Internal: staff and resources
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Implementing SMP concept in Hungary

• Conception of SMP originates from telecommunication sector.
• It had not been used in the energy sector in this form.
• It means previous (ex-ante) intervention on market processes (in contrast to post-intervention tools of the competition regulation).
• Appeal to court against HEO’s SMP resolution does not result postponement.
SMP concept – It is „only“ the second best option

- **Purpose:** In the transient period of competitive market building (efficient competition) to reduce the possibility abusing market power and supporting the creation of efficient competition
- Is this SMP concept *in good hands*??
  - Competition authority could react „only“ after the detection of abuse of market power (Ex Post)
  - One of the role of Regulators to support efficient competition (Directives, Act) → Ex Ante intervention
- Strong legal „guarantee“ (Constitutional Protection) against Administrative Expropriation (over-regulation):
  - Determination of „Relevant markets“ and market analysis should be based on procedures described by Competition Law (as „watchdog“)
  - Limited (by Law) intervention possibilities
  - Possibility of Appeal to Court
SMP concept – (Do you know best functioning “second best solution”?)

Is it a simple tool to use it?

– NO! – the market analysis require substantial sources (internal and maybe external manpower as well) → however this activity is very useful understanding the market mechanisms

– Nevertheless of pre-conceptions, political expectations, or signals indicating the lack of competitive market; in case the market analysis does not confirm the necessity of interaction – the Regulator cannot impose lawfully SMP obligations (it is good and bad in the same time)!
Chart of SMP procedure

- SMP identification, Imposition of obligation(s) (resolution)
- Abandonment of procedure
- Notice of all affected parties
- Market analysis at all relevant markets
- Determination of relevant markets

**Market player with SMP?**
- Efficient market?

**NO SMP**

**SMP**
Chapter XIII: PROMOTING COMPETITION IN THE ELECTRICITY MARKET

Section 106 §:

„The Office shall monitor the offers and transaction prices on the electricity wholesale market, and shall analyze the reasons behind the movements in such prices. To this end, the Office may request information from the authorized operators covered by this Act as regards the prices applied in their wholesale transactions and offers on the electricity market, including the information, circumstances and correlations underlying movements in those prices. The Office shall be entitled to use the data thus received - while maintaining confidentiality of the information qualified as business secrets - solely for the analysis of movements in, and on the current situation of, the wholesale market. “
Section 107 §: „(1) With a view to promote effective competition on the electricity market, to avoid any abuse of a dominant position and to protect the interests of users, the Office shall conduct a market analysis:

1. in the wholesale electricity markets;
2. in the retail electricity markets;
3. in the markets of generation capacity and electricity required to ensure ancillary services.

(2) If competition in any market identified based on the findings of the market analysis is not sufficiently effective, the Office shall identify it as one with significant market power if it has a dominant position on a relevant market on its own or together with another market operator - where there is a lack of competition - and it enjoys a position equivalent to dominance, that is to say, a position of economic strength affording it the power to act to an appreciable extent independently of competitors and consumers.”
**Hungarian SMP regulation (Electricity Act)** (3)

*Section 107 §: „ (3) In the process of identification of operators with significant market power the Office shall take into consideration:

a) the presence of an authorized operator in the geographical area of a particular market and in the closely related markets, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the authorized operator in question;

b) the size of the authorized operator and its market share;

c) the scope of activities of the authorized operator and of the companies it controls .....;

d) the existence of barriers to market entry, growth and expansion;

e) lack or low level of countervailing buying power;

f) lack of potential competition;

g) economies of scale and activity;

h) supply and demand.*
Section 108 § : „ The Office shall impose, to the extent required for the protection of consumer interests, an obligation or obligations within reasonable limits upon the authorized operator that had been identified by the Office as having significant market power from among the obligations specified under Sections 110-111 and in specific other legislation with a view to promote effective and sustainable competition on the relevant market.”
Section 108 § : „(1) The Office shall carry out a market analysis in the relevant markets as necessary, no later than within three years from the conclusion of the previous market analysis.

(2) If the Office learns about any circumstance of significant importance in connection with the evaluation of competition in a relevant market, it shall carry out the market analysis without delay.

(3) A market analysis may be requested by any operator authorized to operate in the relevant market, if the conditions of competition in the relevant market have changed significantly and fundamentally since the last market analysis, and if the last resolution of relevance was adopted by the Office more than one year previously.

(4) In the process of evaluation of the request referred to in Subsection (3) above, the Office shall weigh the necessity of a market analysis, and shall request the opinion of the Hungarian Competition Authority on the matter.”
Hungarian SMP regulation (Electricity Act) (6)

Section 110 §: „(1) The Office, in order to promote effective and sustainable competition, to the extent required for the protection of consumer interests, may impose upon authorized operators with significant market power in the markets specified in Subsection (1) of Section 107:

a) obligations to ensure transparency in relation to the publication of specific information, such as accounting information, technical specifications, specific data of sales contracts, terms and conditions for the supply of and access to services, and prices;

b) if the authorized operator discriminates among its contracting parties with respect to the same transactions, the Office may impose an obligation to provide equal treatment, such as, in particular, to abolish any major contract clause that is considered discriminatory, covering prices, payment deadlines, discriminatory sales and purchase conditions and techniques, which have the capacity to prejudice against certain customers, and to exclude any contract clause for rendering the conclusion of a contract conditional upon undertaking any commitment which, due to its nature or with regard to the usual contractual practice, do not form part of the subject of the contract;
Section 110 §: (1) c) if the lack of effective competition means that the authorized operator concerned might sustain prices at an excessively low or high level, the Office may impose obligations relating to price controls, including obligations for cost orientation of prices and obligations concerning cost accounting systems and pricing systems, furthermore, obligations relating to price controls. Where imposing the obligation to employ cost-reflective pricing mechanisms, it shall be defined based upon and in consideration of the authorized operator’s expenses incurred in connection with operations and any investments, including appropriate return on such investments. With the exception of the obligation to make an offer under Subsection (5) of Section 111, the Office may not impose obligations relating to price controls or for cost orientation of prices upon authorized producers.”
Hungarian SMP regulation (Electricity Act) (8)

Section 111 § : (1) „The Office shall compel an authorized operator with significant market power on the markets provided for in Point 1 of Subsection (1) of Section 107 to supply a specific amount of electricity in an open and transparent way, either by way of public auction or supply through the regulated electricity market.

(2) With a view to ensure transparency, the Office shall require an authorized operator with significant market power in the market referred to in Point 2 of Subsection (1) of Section 107 to draw up a reference offer, broken down as prescribed, showing separately, among others, the service charges, payment terms, and the procedure to follow when switching from one service provider to another where applicable. The authorized operator required to publish a reference offer shall be bound to this reference offer in the form it was published containing the conditions specified by law, or by the Office on the strength of a market analysis, and may not deviate from it even with the consent of the other party.”
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Hungarian SMP regulation (Electricity Act) (8)

Section 111 § (4) “If the authorized operator is a member of a vertically integrated electricity company, the Office may, in addition to the requirements set out in Section 101 pertaining to unbundling, order authorized operators with significant market power in the market referred to in Points 1 and 2 of Subsection (1) of Section 107 to reorganize the internal structure of the integrated electricity company with a view to abolish any share held by the authorized operator affected in the transmission system operator or in an authorized distribution network operator.”
Hungarian SMP regulation (Electricity Act) (9)

Section 113 §: „The provisions of the Act on the Code of Civil Procedure pertaining to administrative lawsuits shall apply to the court procedures launched for the judicial review of an Office resolution adopted in a case governed under this Chapter subject to the exceptions prescribed in this Act.”
Hungarian electricity SMP procedures from 2008 till today (issued resolutions)

- Wholesale electricity market:
  - in 2008: MVM as SMP player – obligation: price cap and cost based pricing for the delivery to the Universal Service Suppliers (analysis, reasoning and obligation of the HEO resolution: 63 pages)
  - In 2011: MVM as SMP player – obligation: capacity and energy release on auctions (analysis, reasoning and obligation of the HEO resolution: 40 pages)

- System services markets (2008): MVM daughters as SMP – obligation: price cap and cost based pricing for the system services (reserve and balancing capacity and power) (analysis, reasoning and obligation of the HEO resolution: 44 pages)

- Retail markets: all Universal Service Suppliers as SMP players – obligation: sample offer to household customers
SMP – wholesale market in Hungary

- Date of resolution: 30th June 2008
- SMP Licensee: MVM Trade Zrt.
- Imposed obligation:
  - Public capacity (energy) auction
  - Two stages – on two consecutive days
  - For domestic use only
  - 10 % quantity limit (in case of oversubscription)
  - Price limit on auction sales
- Execution: 27-28 October 2008
SMP – wholesale market in Hungary

Facts and data of MVM auction:
- 20 products
- 5,6 TWh sold electricity (4,75 – 0,89)
- Lower risk premium compared EEX
- Price increase compared to the previous year, but product palette was different
SMP – wholesale market in Hungary

Additional obligations:

- Energy auction in the 1st quarter of 2009 - at least 1 TWh.
- 2008 price limit on universal service (report of execution until 31st Jan 2009).
- 2009 universal service starting price and price limit.
- 2009 general price limit (report on execution until 31st Jan 2010).
Criticism of HEO’s resolutions:

• EFET critique and notice: auction provisions (two stage, domestic use only) were trade restrictive, HEO to discuss with traders and modify its resolution.

• Critique of Hungarian traders: auction provisions were trade restrictive, HEO does not publish data and does not consult traders.

• DG TREN letter – ERGEG examination: two stage and domestic use only provisions were trade restrictive(?)

• Feedback by traders: auction winners re-sale electricity with an extra charge.
Opinion of HEO

- HEO’s decisions ensured access to MVM contracted capacities.
- Hungary was not obstructing cross border trade.
- Two stage auction balanced winning chances of customers and traders.
- Two stage auction ensured for DSOs to cover some part of their 2009 network losses.
- Domestic use only provision was for reducing retail price increase.
- Auction price limit was for avoiding unjustified wholesale price increase.
- On-site inspections at winning traders.
- Public wholesale market forum.
SMP – wholesale market in Hungary

Unexpected developments...

- June 2008: Negative DG COMP decision on long term PPAs.
- Legal uncertainties – while 2009 sales had started.
- Quantity of MVM contracted capacity had been decreasing.
- 10 EUR/MWh average extra charge compared to EEX prices.
- Profit increase at Hungarian retailers.
- Net-import reduction from yearly 6-7 TWh to 4 TWh (narrowing sources, regulatory decisions in north).
Incumbent with SMP forced to release energy via auctions
SMP – wholesale market

Average purchase and retail price of Hungarian traders
(HUF/kWh)

- Average purchase price
- Average retail price
- Price margin

3rd Training Course: Electricity Markets
June 4 – June 8, 2018 • Nicosia, Cyprus
SMP – wholesale market

Purchase of Hungarian traders (HUF/kWh)
SMP – ancillary services

Market shares on the Primary Reserve market (based on income)
SMP – ancillary services

• Dates of resolutions: 30th June 2008.
• SMP Licensees:
  - reserve market for balancing purposes: MVM Trade Zrt.
  - secondary reserve market: MVM GTER Zrt.
• Imposed obligations:
  - cost-based offers on TSO’s tender – ensured obligation in the Hungarian Commercial Code (MVM Trade)
  - cost-based offer in case of TSO call,
  - lack of call – price limit (GTER).
• Execution: Approval of Trade offer, imposition of GTER price limit.
After first SMP resolutions – potential follow up

- SMP resolution for Hungarian electricity retail market.
- New wholesale market analysis? Auction obligation until HEO decides differently.
  - according to necessity, but at least in 3 years,
  - in case of important changes immediately,
  - after 1 year by request of a Licensee.
- Possibility to analyze distribution network losses as a separate market.
- SMP regulation in natural gas sector as well.
The basic advancing movements of Tango: Simple steps forward and backwards, which can be performed with a slight bend.

**Rhythm:** slow-slow-quick-quick-slow

**Characteristic feature:** quick, sudden stop of dynamic advancing movements, which abruptly change between the passionate dynamics and a pause full of tension.
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Could the SMP concept help in Cyprus?

Potential SMP target
Possibilities supporting wholesale competition in Cyprus

• Without efficient wholesale competition we cannot expect retail competition.

• Possibilities creating multi-player wholesale market:
  • Restructure EAC (several generation units) (immediate effect)
  • Capacity (energy) release (short/medium term effect)
  • New IPPs (very long term effect)

• Potential tools forcing the elements of wholesale competition:
  • Competition Authority (ex-post)
  • CERA - SMP regulation (ex-ante)

What are the real constraints choosing the first or second best option?
THANK YOU FOR YOUR ATTENTION!

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