– Position paper –

Statement on the Electricity Bidding Zone Review (BZR) Methodology

Brussels, 25 August 2020 | Following referral on 7 July 2020 by all NRAs, ACER became competent to decide on the Bidding Zone Review (BZR) methodology i.e. the *Proposal for the methodology and assumptions that are to be used in the bidding zone review process and for the alternative bidding zone configurations, pursuant to Article 14(5) of Regulation (EU) 2019/943* (BZR proposal). We welcome the fact that ACER are now assessing and deciding on key aspects of the proposed methodology, and fully support efforts to ensure a meaningful and effective review. The announcement that ACER will consider stakeholder feedback to its consultation held earlier this year is very positive. In this statement, we highlight some of the key elements that should be considered more clearly in the proposed methodology.

Full consideration of the forward and balancing markets, in addition to the short-term physical market

To begin with, we fully support the objective to ensure that market delimitations, i.e. bidding zones, reflect significant structural long-term grid constraints and achieve a BZ configuration that best fulfils all of the CACM objectives. A key aspect of the CACM market efficiency objective is to ensure that the bidding zone configuration, appropriately supported by remedial actions as relevant, maximises cross zonal capacity for SDAC and SIDC within strict security constraints and without moving internal bottlenecks to the cross-zonal borders.

However, any reconfiguration should avoid being made solely based on considerations linked to the short-term physical market, e.g. day ahead and intraday, and power (grid) system efficiency. The assessment of the configuration impact on market efficiency, competition, liquidity and overall welfare must also consider in particular effects on forward markets, but also on real-time balancing mechanisms.

The overall assessment – covering those multiple timeframes – needs to be made based on a range of appropriate measurement criteria, as well as a clear recognition of the crucial interplay between these short and long term markets in order to secure overall market and power system efficiency. Furthermore, a common pan-European approach to core aspects of the methodology is essential, given the nature of the coupled European electricity market in

the day-ahead (SDAC) and intraday (SIDC) timeframes, and the increasingly integrated balancing market.

A thorough assessment of market liquidity impacts is needed as part of a broader market efficiency analysis

Any loss of liquidity in short term physical or long term (derivatives) markets can result in a negative impact on socio-economic welfare and accordingly some negative consequences for final consumers. The approach currently described in the All TSO's methodology to assess liquidity impacts - a market-depth analysis using an aggregated market model[1] is not sufficient. It is vital to look at liquidity impacts in all market timeframes - forward, day-ahead, intraday and balancing. We therefore welcome ACER's focus on finding the right approach to assess these aspects, and the recent DNV GL study commissioned to look at market liquidity and transaction costs in more depth. However, while the study is a good starting point, the approach for assessing forward market liquidity in particular requires further development. We do not believe that the approach to assess hedging efficiency[2] will fully capture the cost of hedging or the subsequent changes to welfare resulting from any loss of liquidity. The bid-ask spread is an important alternative indicator but a holistic assessment is needed, also taking into account impacts on churn rate, market-depth and transaction volumes. We acknowledge the challenge of quantifying and monetising forward market impacts for alternative BZ configurations. However, even if the analysis remains qualitative, this does not diminish the importance of this assessment. Market liquidity is only one part of the analysis of market efficiency - a thorough analysis of the interaction between liquidity, competition and cross-zonal transmission capacity is needed.

Harmonisation of certain aspects of the methodology to avoid a fragmented regional approach

The development of alternative configurations to be assessed is a fundamental part of a transparent and meaningful BZ review. We do not believe that the current set of configurations, based on individual TSO assessments, especially in the Central Europe Bidding Zone Review Region (BZRR), provide an adequate and unbiased basis for the review. The regional BZRR approach, in combination with a lack of consensus of TSOs within a region on alternative configurations, risks basing the BZR on an incomplete set of configurations. ACER should ensure that the methodology is able to deliver a balanced set of configurations with a pan-EU scale perspective, including assessment of both possible splits and mergers, and

[1] The BZR proposal Art. 13(4) states: *'A quantitative assessment of the market liquidity shall be performed based on market-depth analysis, focusing on the price change between the respective orders taking into account cross-zonal possible exchange. This analysis shall be done at least for day-ahead market, but may incorporate additional timeframes, if technically possible.'*

[2] The proposed indicators are an analysis of correlation and the calculation of the ex-post risk premium.

assessing effects across multiple bidding zones.[3] To combine such an expert-based approach with model-based methods, locational marginal pricing (LMP) simulation can be a useful theoretical modelling tool to cluster nodes and assess alternative bidding zone configurations.

Importantly, there should be clear and harmonised principles for the assessment of aspects such as network congestion and market efficiency. Currently some modelling assumptions and evaluation criteria lack detail, leave room for interpretation and may be applied differently by TSOs in different BZRRs.

Systematic stakeholder engagement will contribute to a more robust methodology

Stakeholders can provide input and expertise on multiple aspects of the BZR, including the modelling assumptions, scenarios or approaches to evaluating impacts against specific criteria. Systematic involvement is therefore crucial, and also ensures the analysis is as transparent as possible. However, the current level of stakeholder engagement foreseen in the ENTSO-E (TSO) proposal is inadequate. The following ways of involving stakeholders should be considered:

- *Establish a dedicated Bidding Zone Stakeholder Advisory Group* to provide support and expertise at key stages of the review. This could include advising on assumptions on demand and generation, network development, the expert or model-based scenarios as well as the approaches required to evaluate the CACM criteria.

- *Involve stakeholders at key steps of the evaluation.* The current BZR proposal only foresees stakeholder involvement during the third step of the evaluation approach i.e. the assessment of the final recommendation. Stakeholders should be involved at all key stages of the evaluation in an appropriate manner, including via expert workshops or dedicated studies or surveys.

- *Consult on the draft BZR report*, as has been done for previous bidding zone reviews.

- *Include a specific provision for cooperation with NEMOs,* who are responsible for among others the market coupling operator (MCO) functions for SDAC and SIDC, regarding configuration aspects which would affect the design, functioning and operation of SDAC and SIDC. A provision for cooperation with relevant market stakeholders (e.g. via Europex) including the operators of (derivative) long-term markets and balancing markets, should also be explicitly included.

[3] As just one example, it would be useful to have a common approach as to what severity of structural congestion triggers a Member State to propose an alternative configuration (as opposed to each Member State making their own assessment).

DSR and innovation in the power system must be fully taken into account in the modelling

In terms of the load data used in the scenario modelling, the proposed methodology should do more to take into account demand-side response (DSR) and other innovation that will provide additional flexibility. The integration of end consumers into the energy markets as well as other market-based flexibility options and new business models will change how load reacts to price signals. Emerging dedicated flexibility markets, which are also in line with the requirement for market-based redispatch in the Electricity Regulation (EU) 2019/943, address the load side in particular by providing the right incentives to increase or decrease load in affected regions, to adapt to volatile and weather-dependent generation patterns, and thus balance the grid locally.

These developments will impact load patterns as well as congestion management, and should therefore be explicitly included in more detail in the methodology. There is a strong basis for their inclusion, given that the Clean Energy Package requires that bidding zones are assessed on the basis of their ability to create a reliable market environment, including for flexible generation and load capacity. Furthermore, the modelling of renewables is fundamental for meaningful results, as their share will increase in the power system in the target year time frame and beyond. It is therefore important that the assumptions are clear and reflect the bidding behaviour of renewable assets.

About

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