

**Responses to:
ACER public consultation on the influence of existing
bidding zones on electricity markets**

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Introduction

We understand that ACER has launched its bidding zone consultation as part of an ACER/ENTSO-E pilot project, whose objective is to test the process to review bidding zones set out in the draft Capacity Allocation and Congestion Management Network Code (CACM NC). We welcome the initiative of ACER to engage with stakeholders early in this process.

In this consultation response, we summarise our key observations on the ACER consultation and proposed process and then provide answers to the specific questions raised in the consultation.

Key observations

The current bidding zone configuration may be sub-optimal. However, changing the bidding zone configuration for the countries in question may not be the best solution to the problems ACER describes in its consultation. Europex see a risk that a process to redefine bidding zones may distract resources from other, less politically challenging, initiatives to integrate markets that may provide effective gains.

We recommend that ACER provide a clearer problem definition and undertake at least an initial assessment of the materiality of the problems it wishes to address. We believe that this would be a useful, and necessary, first step to the process.

Potential problems, for which bidding zone redefinition may be seen as one potential solution, include whether:

1. the wholesale market results in inefficient dispatch decisions
2. the resulting dispatch (and countertrade/redispach) decisions result in an inequitable distribution of costs and benefits between Member States, TSOs and market participants
3. the wholesale market does not provide signals for efficient location of investment in new transmission and generation capacity
4. there is market power in either the wholesale market or balancing timeframe
5. TSOs fail to make the maximum interconnector capacity available to market participants or limit interconnection capacity to solve internal congestion, i.e. restrict cross-border capacity while the congestion(s), or challenge of highly intermittent generation, in reality is within the Bidding Zone.
6. TSOs fail to invest in adequate transmission capacity and remedial measures to accommodate the significant increase in intermittent generation in more remote locations or locally
7. there is an inadequate degree of transparency

As a second step we recommend that ACER identify possible solutions to the problems that have been clearly identified and undertake an initial assessment of their expected effectiveness. Bidding zone configuration is one of the solutions that ACER/ENTSO-E may consider. Other potential solutions include:

1. Implementation of the key aspects of the European target model, including day-ahead market coupling, the intraday target model and the Balancing Network Code
2. Implementation of the requirement in the CACM NC for TSOs to coordinate re-dispatch and countertrade actions
3. Increase available cross-border capacity either through transmission investment or TSOs making additional transmission capacity to the market
4. Address other aspects of national or European electricity market policy, such as renewables subsidies and capacity mechanisms, which may also have an impact
5. Targeted remedies for specific situations, such as virtual phase shifters, setting minimum cross-border capacities or regulatory intervention to address market power

A phased process to identify and quantify concrete problems and solutions will enable the parties involved (ACER, ENTSO-E, Commission and Stakeholders) to prioritise efforts. Related to this, the European Commission recently published the results of a consultation study on the benefits of the European market integration¹. For example, the study found that the annual European wide benefit from implementing market coupling would be €2.5 billion.

A statistical analysis of different bidding zone configurations including Member States whose electricity markets operate according to different rules is very difficult and may easily be open to dispute. For example, it may be difficult to take into consideration the impact of on-going reform initiatives, such as the implementation of the CACM NC and flow based capacity calculation.

Furthermore, to assess the relevance of Bidding Zones based on economic parameters such as congestion revenue, re-dispatch, imbalance and ancillary service costs (etc...), is difficult because the given economic parameters are influenced by many different factors, such as the approach the TSO takes to calculating and make available cross-border capacity.

It is Europex's view that the key output of the ACER/ENTSO-E pilot project should be an assessment of the bidding zone review process that is set out in the CACM NC and, where necessary, recommendations to amend the bidding zone review process in the CACM NC. A transparent and consultative approach to the pilot project will be critical to deliver this output. ACER and ENTSO-E should not commit to a full review before the output described is delivered.

Specific questions

- 1) How appropriate do you consider the measure of redefining zones compared to other measures, such as, continued or possibly increased application of redispatching actions or increased investment in transmission infrastructure to deal with congestion management and/or loop flows related issues?

¹ http://ec.europa.eu/energy/infrastructure/studies/ten_e_en.htm

What is the trade-off between these choices and how should the costs attached to each (e.g. redispatching costs) be distributed and recovered?

Answer: Whether redefining bidding zones is an appropriate measure depends on the problem that ACER is seeking to address. Loop flows are one issue amongst many mentioned in the consultation document. Others include market power caused by physical congestion, and the impact of connecting intermittent generation capacity in remote parts of Europe without adequate investment in transmission capacity.

Europex has a general preference for TSO investment in an efficient level of transmission infrastructure together with measures to ensure that TSOs offer the maximum available transmission capacity to the market. This is likely to address a number of the concerns touched upon in the consultation. This may involve, for example, TSOs improving coordination, adopting new measures such as flow based, and ensuring that the maximum capacity is offered consistent with system security (e.g. possibly allowing for remedial actions if cost efficient).

Other options that ACER should explore include locational transmission charging, reform of the Inter-TSO compensation mechanism, implementation of the European target model and regulatory intervention to seek to mitigate any specific market power concerns.

- 2) Do you perceive the existing bidding zone configuration to be efficient with respect to overall market efficiency (efficient dispatch of generation and load, liquidity, market power, redispatching costs, etc.) or do you consider that the bidding zone configuration can be improved?

Which advantages or disadvantages do you see in having bidding zones of similar size or different size?

Answer: From a theoretical perspective it is likely that, where bidding zones are not determined by physically congested network elements or are of significantly different sizes, that the outcome will be sub-optimal. However, there are a number of other factors that will impact on whether or not the outcome is optimal.

Better price signals (cost reflective) should in principle let markets deliver more efficient outcomes. However, redefining bidding zones may not always be the best solution as this depends on the extent of the problem. There are also a number of other factors that affect price formation (for example, renewable subsidies and capacity remuneration mechanisms), and ACER should also consider the relative merits of other remedies.

A number of issues in ACER's consultation relate to whether the current distribution of costs and benefits between Member States, TSOs and market participants is appropriate or fair. There are a number of routes through which the distribution of costs and benefits can be addressed, such as mechanisms to fund additional transmission

capacity, greater coordinated of re-dispatch and countertrading actions and amending the inter-TSO compensation mechanism.

It is Europex's view that the immediate priority of ACER and the European Commission should be implementation of key aspects of the European Target Model and other remedies easier to implement than reconfiguring bidding zones.

- 3) Do you deem that the current bidding zones configuration allows for an optimal use of existing transmission infrastructure or do you think that existing transmission infrastructure could be used more efficiently and how?

Additionally, do you think that the configuration of bidding zones influences the effectiveness of flow-based capacity calculation and allocation?

Answer: it is difficult for us to directly link the current bidding zone configuration to an optimal or sub-optimal use of transmission infrastructure.

What is easier to determine is that in determining available transmission capacity, TSOs may have an incentive to give priority to intra-zonal exchanges over cross-border exchanges. This is because it is costly for TSOs to constrain intra-zonal exchanges via countertrade and re-dispatch actions, while TSOs can constrain cross-zonal exchanges by reducing available capacity, which does not have a cost. Consequently TSOs may constrain cross-zonal exchanges to allow intra-zonal exchanges.

There are also other solutions that may provide for more optimal use of existing transmission capacity, such as implementing key aspects of the European Target Model, including day-ahead and intraday market coupling, as well as compatible balancing markets and mechanisms.

The implementation of flow based capacity allocation systems, which take into account network topologies and grid constraints, may also significantly improve the utilisation of the transmission network without altering the current bidding zone configuration.

- 4) How are you impacted by the current structure of bidding zones, especially in terms of potential discrimination (e.g. between internal and cross-zonal exchanges, among different categories of market participants, among market participants in different member states, etc.)?

In particular, does the bidding zones configuration limit cross-border capacity to be offered for allocation? Does this have an impact on you?

Answer: PXs are not market parties, and as such are not directly affected. However, the configuration of bidding zones is an issue that is of importance to Power Exchanges.

- 5) Would a reconfiguration of bidding zones in the presence of EU-wide market coupling significantly influence the liquidity within the day-ahead and intraday market and in

which way? What would be the impact on forward market liquidity and what are the available options to ensure or achieve liquidity in the forward market?

Answer: it is difficult to determine what the impact of a redefinition of bidding zones would be on day-ahead and intraday market liquidity as there are many possible reconfigurations. There are other factors, such as local market conditions and rules that possibly would have a bigger impact.

For forward markets, smaller bidding zones and changes to bidding zones are both likely to increase the cost to market parties of contracting forwards, unless forward markets can be concentrated by other means (cfr. Regional System Price used as a reference for forward trading in the Nordic area complemented by CfDs for hedging basis risk; Zone vs. System Price)

- 6) Are there sufficient possibilities to hedge electricity prices in the long term in the bidding zones you are active in? If not, what changes would be needed to ensure sufficient hedging opportunities?

Are the transaction costs related to hedging significant or too high and how could they be reduced?

Answer: implementation of either financial markets (including CfDs) with Day-Ahead Regional or Zone prices as underlying references, or Financial Transmission Rights (FTRs) would improve the possibilities for cross-border basis risk hedging as they may allow other parties, not only the TSO, to offer hedging products.

- 7) Do you think that the current bidding zones configuration provides adequate price signals for investment in transmission and generation/consumption? Can you provide any concrete example or experience where price signals were/are inappropriate/appropriate for investment?

Answer: Efficient wholesale markets provide an adequate price signal for investment in transmission and generation capacity. However, there are other factors, such as the regulatory regime for investment, subsidies, capacity mechanisms, permitting and planning laws and locational transmission charges, which also impact on investment decisions.

- 8) Is market power an important issue in the bidding zones you are active in? If so, how is it reflected and what are the consequences? What would need to be done to mitigate the market power in these zones? Which indicator would you suggest to measure market power taking into account that markets are interconnected?

Answer: In general, if market power exists physically, (e.g. there is a dominant company in a weakly connected area) a market participant will be able to exert its market power either in the wholesale market or balancing market.

If market power does exist, specific and targeted regulatory measures to mitigate the impact of that market power may be more effective at addressing the problem than redefining bidding zones.

- 9) As the reporting process (Activity 1 and Activity 2) will be followed by a review of bidding zones (Activity 4), stakeholders are also invited to provide some expectations about this process. Specifically, which parameters and assumptions should ENTSO-E consider in the review of bidding zones when defining scenarios (e.g. generation pattern, electricity prices) or alternative bidding zone configurations? Are there other aspects not explicitly considered in the draft CACM network code that should be taken into account and if so how to quantify their influence in terms of costs and benefits?

Answer: ACER should not automatically proceed to a full bidding zones review. We propose that ACER should:

1. identify, articulate and seek to quantify the problems that it wishes to address
2. also evaluate alternative solutions to the problems that have been identified

Europex are concerned that launching a full bidding zones review will be a very intensive process which will not be conclusive, while neglecting to investigate alternative solutions, which may equally and in some cases better serve the objectives of welfare optimisation, cross-border competition and efficient utilisation of the transmission network.

- 10) In the process for redefining bidding zones configuration, what do you think are the most important factors that NRAs should consider? Do you have any other comments related to the questions raised or considerations provided in this consultation document?

Answer: The biggest challenge in redefining bidding zones is probably political. We would recommend that ACER follow a phased approach to the process, and also carefully consider alternative solutions to the problems identified.

The key output of the pilot project should be an assessment of whether the bidding zone review process in CACM NC is robust, and also consideration of all measures that can potentially deliver equal or better results than reconfiguring bidding zones.