

– Consultation response –

Europex response to the consultation on the ‘First Edition Bidding Zone Review’

Brussels, 9 March 2018 | Europex’ response is divided into two parts. Comments on the content of the draft report for public consultation¹ are provided first, followed by comments concerning the process of the First Edition Bidding Zone review.

1. Feedback on the First Edition Bidding Zone Review: Draft report for public consultation

Selection of expert-based bidding zone configuration: Configuration selection is a vital part of the review, which defines the framework of the study. The selection of the four alternative expert-based configurations developed by the TSOs is described in section 4.1, taking each scenario in turn. It is explained that these configurations have been determined by the TSOs based on their expert knowledge and coordinated with the relevant NRAs during the pilot project, as required by CACM (EU Regulation 1222/2015). The review contains limited information on why specific scenarios were included – for example the DE/AT configuration was explicitly requested by several stakeholders, and the Big Country 2 Split configuration was included after coordination with the NRAs. However, there is little evidence of a systematic or transparent approach to configuration selection, including an explanation of the starting point, the basis on which decisions were made and what factors were considered in this process.

Balance of selected configurations: The configurations proposed for the review include the current bidding zone delimitation, three split delimitations and one merger delimitation. This already suggests a bias in terms of the type of delimitation, without adequate evidence to justify the choices made. Both split and merger configurations should be analysed on equal terms, considering the drawbacks and benefits of a wide range of configurations. A rigorous and transparent approach to the selection of scenarios would help ensure balance. The model-based scenarios should be further developed, while acknowledging the inherent challenges and limitations.

Impact on market liquidity: Stakeholders have attributed high priority to market liquidity in the analysis, reflecting the importance of bidding zone (re)configuration for the wholesale market. It is positive that

¹ All page references refer to the draft version for public consultation:
https://consultations.entsoe.eu/markets/first-edition-bidding-zone-review/supporting_documents/Final%20report%20for%20public%20consultation_090218.pdf

the multi-dimensional nature of market liquidity is acknowledged, and that it cannot be fully reflected by one indicator such as bid-offer spreads, trading volumes, churn rate and so on (p. 55).

Beyond the liquidity aspects analysed, Europex welcomes the recognition of the fact that a stable set-up of a bidding zone (i.e. long-lasting existence) is beneficial for liquidity (p. 58). This aspect could be further reinforced. It is imperative to consider the impacts of any changes on the long-term stability of markets, where long-term investment certainty is vital. Its importance is reflected in the fact that the stability and robustness of a bidding zone over time is a specific CACM evaluation criteria. The review also acknowledges the important effect of 'self-reinforcing' liquidity i.e. high liquidity is attractive for traders, leading to an increase in liquidity.

If eventually any split or merger of existing bidding zones is proposed, it must be thoroughly justified, and communicated well in advance, so as to reduce any potential negative effects on market functioning.

The review recognises that high connectivity between bidding zones is also beneficial for liquidity as it assures more trading possibilities (p. 57). As Europex underlined in its input to the ENTSO-E market liquidity survey in November 2017, this is an important aspect when considering liquidity impacts on coupled spot markets, and should be further highlighted in the review. The liquidity in any bidding zone that participates in the single day-ahead and intraday market increases significantly thanks to the implicit allocation of cross-zonal capacities.

The amount of cross-zonal capacity made available to the market is therefore vital for short-term market integration, competition and efficient price formation. It is crucial to have transparency on the share of interconnection capacity available for cross-border trade, as well as on the underlying reasons for any capacity restrictions. These are necessary first steps towards maximising cross-zonal trading capacity and the further integration of European wholesale energy markets.

Cost-benefit analysis: Liquid markets have a value in themselves. In this respect, the next Bidding Zone Review should include a comprehensive cost-benefit analysis, and ways should be explored to assess the welfare gains resulting from market liquidity. The trade-off between redispatch costs and market liquidity must be acknowledged.

Redispatch costs are discussed mainly under the CACM criteria 'operational security' (p. 42) and 'economic efficiency' (p. 50). However, the analysis remains qualitative and there is no detailed data on redispatch costs. The matter requires further detailed impact assessments, e.g. regarding the development and influencing factors of redispatch costs within and across bidding zones, the full assumable range of market impact scenarios and other relevant aspects.

Redispatch should not just be viewed as an additional cost, but its function to enable markets and the economic benefits of this should also be quantified.

Analysis of effects on derivatives markets: This should be explicitly included in the analysis in the next edition of the Bidding Zone Review. In derivatives markets, market participants with open derivatives contracts would be exposed to a changed underlying risk if the underlying of their long-term derivatives contracts is lost before the product falls due, especially if the underlying reference is only a single bidding zone (spot) price for the given delivery period.

2. Feedback on the First Edition of the Bidding Zone Review - Process

Transparency: There are clear efforts in the review to achieve transparency. For example, stakeholder input is clearly published and linked to the relevant analysis, including the responses to the ENTSO-E surveys on liquidity and transaction costs launched in November 2017. This practice increases the value and integrity of the review and should be continued.

Stakeholder engagement: Comprehensive and early stakeholder engagement is vital. Bidding zone (re)configuration has significant consequences for the markets, both spot and derivatives. The Bidding Zone Review should, to the extent provided for by the applicable regulatory frameworks, explicitly include the full involvement of all key market stakeholders, including spot market operators and long-term forward and futures market operators.

Stakeholders should be involved throughout the review process, including during the configuration selection process. It is important to receive documents well in advance of meetings, for example, in the Bidding Zone Stakeholder Advisory Group (SAG). Further notice and discussion would be appreciated in advance of major changes such as discarding the model-based scenario approach. The two scenarios developed from this modelling should be included in the next Bidding Zone Review report.

Bidding Zone Review decision-making process: There need to be clear rules in place for any reconfiguration of the existing bidding zones, with clear responsibilities. Given the importance of the outcome for many stakeholders, including the wholesale market, there is a need for a single, coordinated European process to define bidding zone configurations.

Survey formats: Surveys such as those launched in November 2017 on liquidity and transaction and transition costs are valuable opportunities for stakeholder input. However, there has been limited stakeholder feedback to the surveys mentioned. One reason for this might have been the complexity of the survey format. A simpler format could be considered to gradually add complexity.

About

Europex is a not-for-profit association of European energy exchanges with 27 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

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