

Power Bidding Zones: Expand rather than Divide

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A division of the joint German/Austrian power bidding zone which is currently under discussion would jeopardise liquidity on the market and the functioning of the market price signal. Therefore, with the fundamental achievements of the liberalisation on the power market at stake, it is imperative that a debate takes place in a transparent and coordinated process – with the long-term objective supporting larger rather than smaller bidding zones.

Large, transnational market areas are essential for well-functioning, liquid power markets. In Europe, this is embodied by the German-Austrian bidding zone which has defined a joint price for the entire market area since 2002. This is Europe's most liquid market within which the power price is established for Germany/Austria and which also acts as a reference price for Europe – “the lead currency in electricity”.

In this large area, a functioning and competitive market structure with a strong price signal has been established. Last but not least, this is also the reason why the transition of the entire energy system towards a higher share of renewable energies can be successful. This is because liquid trading and a strong price signal create incentives for the provision and use of flexibility by market participants – and demand for this will certainly continue to grow. However, a possible division of this joint bidding zone has been discussed for several years. This is driven, in particular, by countries hoping for a reduction of unplanned border-crossing power flows, for example through Poland and the Czech Republic, so-called “loop flows”. However, a division of the joint bidding zone would not change these since the flows of power on which trading is based would remain identical even after a division of the bidding zone. Regardless of the configuration of bidding zones, power which is traded across borders follows physical laws within the grid. Therefore, the

intensification of transnational cooperation in grid expansion and congestion management in grid operation is of fundamental importance for the further development of the European single energy market. This also includes the cross-border allocation of the corresponding costs.

In recent years, numerous studies on this subject have been published which have unanimously confirmed the expected negative economic consequences of a division – most recently in a study by consultancy Consentec¹. This study concluded that under certain conditions, a split of the bidding zone might lead to a reduction of re-dispatching costs, which is used as another argument in supporting a split. At the same time, however, this would lead to new costs as a result of the management of the new bidding zone border. So, ultimately, additional costs of up to EUR 100 million per annum would be generated. In addition, there are negative effects caused by lower liquidity and the concentration of market power in the newly created bidding zones and significant transaction costs which might even exceed the effect quantified in the study.

The arguments have been explained and are “out there” in the public domain – however, they still need to be given more influence within the context of a coordinated and transparent process for the assessment of the bidding zones. Unless the decision-making paths are perceived as being clear and the various processes are seen as being aligned with each other, this will lead to major uncertainty on the market and, as a result, to additional costs. For a transparent approach, the process provided for in the European “Capacity Allocation and Congestion Management” guideline needs to be observed. This means, in particular, that the redesign of bidding zones can only be effected in accordance with article 32 of this guideline (“Bidding Zone Review”) but cannot be anticipated under article

15 (“Capacity Calculation of Regions”). This process must then be carried out in a manner which is understandable and transparent for everyone – and this is where criticism has recently been voiced by participants.²

It is important that the derivatives market plays a bigger role in the debate in addition to the spot market, as the negative economic effects of a split would primarily be felt on this market. The hedging of the market is based on the joint bidding zone, and a split would raise numerous questions. For example: Should a split of the bidding zone occur, the basic value, on which the Phelix Future for Germany/Austria would be based, would be a system price whereby positions on the derivatives market could no longer be physically settled. However, some market participants are banned from concluding derivatives transactions without any direct physical reference. As a proposed alternative solution, derivatives contracts for the smaller bidding zones within which liquidity would also be lower than in the current joint bidding zone, would be offered.

In order to fully assess the consequences of a split, it is also helpful to take a look at the Nordic market where a split into several bidding zones took place in Sweden in 2011. Since then, liquidity has declined significantly. For example, the volume of the futures contracts cleared through the exchange has declined by 20%. In the case of the so-called EPADs (Electricity Price Area Differentials), which permit hedging between the prices in the individual small zones and the system prices, this decline even reached as much as 40% in Sweden.³ This example clearly shows that the achievements of liberalisation – including, first and foremost, a liquid market and a meaningful price signal – are jeopardised by bidding zones which are too small. Moreover, such a weakening of the “lead currency in electricity” would also affect the important reference price function of the spot market price.

As a result, as seen from the perspective of economics and the perspective of the market, there are many indications that, instead of smaller bidding zones, larger bidding zones in Europe should be considered as these are best suited to safeguarding a higher number of market participants and a correspondingly higher liquidity. In this respect, they ensure that trading participants can respond to changes in production and consumption fast and effectively at all times and ensure long-term hedging. This also brings us closer to the long-term aim of an integrated European internal

market for which the bidding zone Germany/Austria (as the core zone in Europe) is of particular importance.

Moreover, another key aspect is that any discussion regarding the assessment of the bidding zones and any changes of these takes place in a transparent and coordinated process with clear decision-making paths. The market must be actively involved in this process – and, in particular, the effects of changes to bidding zones on the derivatives market must be considered.

¹ Consentec, [“Economic Efficiency Analysis of Introducing Smaller Bidding Zones”](#)

² EFET, [letter to ACER on the Bidding Zone Review](#)

³ EFET, [“A reality check on the market impact of splitting bidding zones”](#)

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