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Consultation response by  
EEX and EPEX SPOT on  
the First Edition of the  
Bidding Zone Review

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## 1. Bidding Zone Review – considerations from a market perspective

EEX and EPEX SPOT (members of EEX Group) welcome the opportunity to provide an evaluation of the draft report of the first edition of the Bidding Zone Review (BZR). As EEX Group operates power spot and derivatives markets across Europe, it is directly affected by any re-configuration of bidding zones in existing European electricity markets. This is true in particular for the German-Austrian market as EEX Group's core market and the most liquid European market, providing the reference price for power trading in Europe. EEX Group has also participated in the previous consultations of the bidding zone review, most recently in the stakeholder surveys on liquidity and transaction costs.

The first Bidding Zone Review has been an extensive process, involving massive resources and a great number of experts from all over Europe. The discussions in this forum, as well as, parallel policy developments affecting bidding zones, have underlined the need for single, coordinated European process to define bidding zone configurations. This is true in particular from a market perspectives, as well-functioning, liquid and efficient markets as there are in different parts of Europe require a predictable policy framework for defining bidding zones.

Bidding zones configurations can be changed. Assessing possible changes is an integral part of the process towards developing a fully integrated internal market for electricity allowing more renewable energy in-feed and higher security of supply at lower cost. This long-term vision needs to be the basis for discussion and be coordinated with other processes, most importantly long-term planning for grid extension in Europe and the use of redispatch measures. The Bidding Zone Review process in its future editions can serve as the transparent process involving all relevant stakeholders to define future bidding zone configurations, which can then be implemented with sufficient lead times.

EEX Group believes in a market design based on large and liquid bidding zones. The reality of the positive development of the German-Austrian electricity market (both spot and derivatives) proves the benefit of large bidding zones. Our experience shows that a large bidding zone is beneficial for the correct development of trading liquidity, number and heterogeneity of market participants, and the standardisation of products and processes. All these have led to a significant level of market maturity and trading professionalism. Also, the growing share of renewable energy sources can only be efficiently integrated into a market-based electricity system through the use of the largest possible bidding zone configuration with the highest possibly liquidity to synchronise supply and demand at all times. In parallel, the potential of local flexibility markets to manage congestion at a local level should be further analysed in particular in relation to grid expansion and potential bidding zone changes. EPEX SPOT can contribute its expertise from pilot concepts to this discussion.

From a market perspective, a particular risk is associated with splits of bidding zones. Any split of an existing bidding zone into two or more bidding zones is a case of serious market intervention and entails a number of negative consequences both for the energy industry and for consumers:

- Fragmentation and reduction of existing liquidity on spot and derivatives markets: when a bidding zone is split, derivative products need to be remodeled on the new zone. Market liquidity has to move from existing products to new products, there is a risk that liquidity in old products dries out, whilst liquidity in new products needs to be built from scratches. Liquidity is very likely to be lost during the transition from one configuration to another.
- Exposing market participants with open derivatives contracts to an underlying risk: this is the case when the underlying for derivatives contracts is lost before the product falls due
- Market concentration in smaller price zones and market power of individual market players
- Less balanced generation structure than in a bigger price zone, which would result in price fluctuations that are difficult to forecast
- Occurrence of different market prices and consequently different fees, levies and taxes (as based on market prices)
- For suppliers, smaller bidding zones mean additional resources are needed to ensure being balanced in each of them. This cost is in the end added to consumers' bills.

Splitting of zones also has the potential to undermine the current extension of the grid and as a consequence the further joint development of the European Internal Energy Market. Physical integration of energy infrastructure between Member States is a precondition for the proper functioning of EU energy markets and needed for the exchange of electricity across borders. EEX Group recognizes that European electricity transmission systems, notably cross-border interconnections, are not sufficient to allow the internal energy market to work properly and address the problem of energy islands in some regions of Europe. This is why it needs to be a priority to achieve the interconnection targets set at European level and avoid actions which would counteract these efforts.

The German-Austrian bidding zone is a case in point to illustrate both the need for clear decision-making and the possible magnitude of consequences uncoordinated changes to bidding zones can have on market efficiency. Market participants have faced great difficulty in assessing the political framework and its impact on this market, leading to an overall decrease in trading activity and a partial shift away from regulated, transparent market venues. This development has the potential to weaken the market price signal and decrease liquidity, meaning higher trading costs for all market participants and ultimately a less efficient market. Facts are that

- Trading volume in the German-Austrian power market decreased by 30% from 2016 to 2017, down from 3,920.3 TWh in 2016 to 3,217.3 TWh in 2017 on EEX Group derivatives markets
- The Austrian power market has virtually dried out, with only 0.119 TWh traded in EEX's Austria Power Future in 2018 (as of end February)
- This development confirms the experience with the Swedish bidding zone split, where volumes of future contracts decreased by over 20% from 2011 to 2015, with a drop close to 30% in volumes of EPADs used for hedging between regions

EEX successfully replaced the German-Austrian product with two different products for the German and Austrian market. However, this remains a step back in the development of power markets, even when volumes and liquidity eventually reach previous levels, and will have entailed significant

transition and transaction costs. Based on the example of a split in Germany, a study by independent consultancy Consentec shows that costs for redispatch can be reduced in some cases while continuous inefficiencies arise from uncertainties when determining total transmission capacities between the smaller zones. Based on this example, but with results generalizable to other bidding zone splits, the study shows that a split increases costs of power supply by up to EUR 100 million per year. Additional factors such as loss of liquidity and substantial transaction costs would add to those inefficiencies<sup>1</sup>. Experiences based on past re-configuration projects show significant costs up to a mid triple-digit million Euro range<sup>2</sup>.

EEX Group continues to support the Bidding Zone Review process in its future editions to evaluate bidding zone configurations in Europe and contribute to establishing a clear policy framework for markets to operate in. Establishing such predictable conditions will however require a number of significant changes to the process itself, addressing the main limitations faced by the first edition of the Bidding Zone Review. Future editions should

- provide a clear process, structure and timeline
- involve all relevant stakeholders throughout the process and in fundamental decisions
- provide clarity on the relation with parallel policy processes
- lead to clear results and recommendations which can be implemented
- be efficient on time and resources
- not be limited by conflicting policy objectives

EEX Group suggests a number of changes to the process and analysis performed for future editions of the BZR:

### 1.1 Process - feedback and suggestions on the first edition of the BZR

- **Market stakeholders should be more directly involved** in the process, e.g. by inviting them to all relevant meetings in addition to participation the stakeholder advisory group.
- **More deliberation** with stakeholders is needed on **fundamental decisions**, most importantly which bidding zone configurations are chosen for initial analysis and changes to them
- The surveys carried out are a positive initiative as they allow **stakeholder consultation** and address two crucial issues – market liquidity and transaction costs. Also, publication of the surveys in the report demonstrates transparency.

<sup>1</sup> Consentec, Economic efficiency analysis of introducing smaller bidding zones, 2015, <https://www.eex.com/blob/7412/97dfe4307af0ded860ba2c0e3ffb1e99/20150213-consentec-eex-bidding-zones-data.pdf>

<sup>2</sup> Frontier Economics/Consentec, Methodische Fragen bei der Bewirtschaftung innerdeutscher Engpässe im Übertragungsnetz (Energie), 2008, [https://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK6-GZ/2006/2006\\_0001bis0999/2006\\_001bis099/BK6-06-074/BK6-06-074\\_GutachtenId12789pdf.pdf?\\_\\_blob=publicationFile&v=2](https://www.bundesnetzagentur.de/DE/Service-Funktionen/Beschlusskammern/1BK-Geschaeftszeichen-Datenbank/BK6-GZ/2006/2006_0001bis0999/2006_001bis099/BK6-06-074/BK6-06-074_GutachtenId12789pdf.pdf?__blob=publicationFile&v=2)

- Future editions of the BZR should extend the use of this instrument to collect input on topics from external experts
- Quantitative analysis of market impacts should be developed to allow a comparison between benefits and costs at each step for market stakeholders: derivatives, spot, and retail markets.
  - Use of data gathered by regulators and ACER in their monitoring tasks could be used for this.
- **Flow of information to the Stakeholder Advisory Group** could be further improved, with sharing of information well ahead of relevant meetings
- More information could be made available on the relation of the BZR review to **other processes also affecting bidding zone configuration** (e.g. CCR process) to provide clarity to stakeholders
- Positive that the report calls for **harmonizing policy objectives** on bidding zones within and across borders

## 1.2 Report - feedback and suggestions on the first edition of the BZR

- **Analysis of effects on derivatives markets** should be explicitly included in the analysis in the next edition of the BZR process. This is where the greatest economic effects of bidding zone changes materialize given open interest and the fact that two-thirds of power volumes traded in Europe are in derivatives.
- **The first edition of the BZR report does not equally consider bidding zone split and merge scenarios.** This means the analysis misses the opportunity to provide a holistic picture of both benefits and drawbacks of the scenarios. The report includes several big country split scenarios, but only a small country merge scenario.
  - The next BZR should analyse merge and split scenarios on equal terms, chosen through a fully transparent and systematic approach
  - Analysis should include scenarios merging already liquid and mature markets areas, such as in the CWE region
  - The model-based scenarios developed in for this BZR can be used as a basis. In particular, the 'planned grid and post-processed' scenario (showing only three zones) should be further analysed. This would give an indication of the potential of a large bidding zone merge.
- The next edition of the BZR should include a **cost-benefit analysis**. This evaluation should take into account the main trade-offs in bidding zone configuration.

- Benefits of liquid derivatives markets should be quantified, giving an indication of the economic loss associated with loss of liquidity. This could be measured e.g. by expected changes to the churn rate in a bidding zone.
- 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. Also, the first edition of the BZR report does not include detailed data on redispatch costs.
- EEX Group believes both the inclusion of additional scenarios and cost-benefit analysis are possible within the scope of the CACM regulation. A number of different possible remedies could be implemented to **counter some of the issues faced with flow-based methodology**:
  - base estimations on more detailed flow based assumptions representing individual base case scenarios such as winter day, summer day, or windy day
  - methodology should be more systematic and not be subject to adjustments by individual TSOs
  - If it proves too complex to model the reality of the grid in all details, a more robust outcome could be achieved by applying a simpler model based on clear assumptions
- Effects of bidding zone splits on **incentives for grid extension** should be considered in future Bidding Zone Review processes
- Experiences from **former and ongoing bidding zone splits** should be considered, most importantly the example of the Scandinavian power market.
- **Some results are labelled ‘non-intuitive’** in the report, but warrant further analysis
  - E.g. Chapter 6.3.2. results show merging bidding zones coincides with less congestion and better performance, and splitting bidding zones coincides with higher congestion and worse performance.
- Future editions of the Bidding Zone Review should take into account the effects of **other parallel policy initiatives** which affect the bidding zones configurations analyzed.
  - Most importantly, the **Clean Energy Package** introduces additional legislation with an impact on bidding zone configurations

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