30.09.2013

ACER consultation on the influence of existing bidding zones on electricity markets (PC_2013_E_04)

Response of EnBW

EnBW welcomes the opportunity to respond to ACER's consultation on "The influence of existing bidding zones on electricity markets". We believe that the topic addressed in the consultation paper is of key relevance. In our response we mainly argue from a perspective of a company which is located and predominantly active in the CWE region.

General Comments

We believe that the review and any possible amendments of bidding zones must not hamper the liberalisation process, i.e. it must foster (cross-border) trading, competition and liquidity. It is thus important that the process described in the CACM is an integrated process and thus besides the technical aspects also market-relevant issues need to be equally taken into account. We also believe that in order to complete a functioning internal electricity market the extension of the current grid should be a priority (together with the efficient use of the existing grid through market-based usage (e.g. market coupling throughout Europe)).

We are convinced that bidding zones need to be large and should include a wide range of buyers and sellers that can interact on the basis of an unique wholesale electricity price signal within the zone. Furthermore, we see the need that the same price zone should be used across all traded timeframes (i.e. forward, day-ahead, intraday and balancing).

As a general view, we believe that measures that are more or less administratively determined (e.g. market splitting) will not solve the respective physical problems; rather they would even increase them or create new ones as:

- they would create stranded investments in the price area which has then a surplus in generation capacity while it would create new (but not efficient) investment needs in area which would be short in generation capacity.
- they are usually politically instable and may change over time and thus create huge uncertainties for all market participants including investors in physical assets (e.g. generation assets; energy intensive consumption units).

Thus, the main aim should be to establish larger zones rather than reducing the size of existing bidding zones.

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

First of all, we would like to re-emphasize that a close cooperation between TSOs is absolutely essential and we assume that some of the current issues could at least be reduced through such an improved coordination.

Additionally, in order tackle the physical issues raised in the consultation document, we believe that physical measures should be considered rather than administratively determined actions. This means that first and foremost expanding transmission capacity should be fostered as the most efficient way to deal with structural congestions. This can be combined with redispatching measures which should also be developed cross-border. In this context, it is important to emphasize that there should be maximum flexibility given to the market before measures such as redispatch actions are performed. Thus we do not support preventive redispatching actions by TSOs which would hamper market activities. We think that for a transitional period technical measures such as (virtual) phase shifters can been considered.

In general, we see a major danger in redefining existing bidding zones (with the possible aim in reducing the size of them) and thus would like to stress that any review must be done with great care. We do not see an approach to find the optimal “cutting” of zones as congestion areas may change over time (especially with an increasing in-feed of intermittent RES). Introducing dynamically changing bidding zones would be the worst case scenario for the further development of the electricity market with significant negative effects on retail and wholesale competition.

In any case, redefining the delimitation of bidding zones would be a massive measure with very significant impact on the market. If redefining the zones would result in smaller zones, it is absolutely essential to consider the associated costs and welfare losses resulting from reduced liquidity and competition in both the wholesale and retail markets before any

decision is taken. We think that these aspects are often underestimated or even fully neglected as unfortunately also e.g. in the ACER Consultation Document (section 2.3). Also, there is no evidence that there will be no need for redispatch actions in smaller bidding zones. Therefore, such redefinitions should only be considered very rarely and only after extensive cost-benefit analysis (and not only technically driven) where the potential benefits can be demonstrated to be sustain and significant; and finally a sufficiently long lead time would be absolutely essential.

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?

In general yes. Looking at the CWE are and particularly the German/Austrian price zone we think that the current zone configuration is efficient. In this area we see the most liquid electricity wholesale market in Europe: All timeframes form forward to intraday trading have seen an ever increasing volume with a churn rate of 7-10. Furthermore, we can also observe a very heterogeneous and competitive retail market where companies of all sizes are active. This has been further promoted with the start of market coupling in this region, increasing liquidity while at the same time reducing volatility. Actually, we are convinced that this framework is positive to facilitate the inclusion of the increasing RES generation in the market; smaller price zone would make this more complex and costly. Also it is not obvious to assume that all bidding zones should be of similar size as there are significant differences regarding the existence of structural bottlenecks, generation mixes and market structure which clearly result in different bidding zone sizes.

At the same time we think that that the economic welfare losses (if they can be considered as such at all) that may be caused by redispatch actions are comparatively small compared with the possible welfare gains by creating larger zones, due to increased liquidity and competition.

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?

Yes; see also Q2. We think that particularly for the CWE region existing transmission infrastructure is already used efficiently and with the introduction of flow-based market coupling will be further optimised. Thus we do not think that the size of a bidding zone is a key criteria whether transmission infrastructure is being used optimally or not.

As mentioned before, we think that a key reason for non-optimal use of existing transmission infrastructure is mainly due to insufficient (cross-border) cooperation between TSOs. This can been observed when following the discussion on “unplanned flows” in some CEE countries, which are apparently caused by the large in-feed of renewables in Germany. We think with a better cooperation between TSOs, these “unplanned flows” should not really appear and would be rather “planned” flows. In this context, it is also important to set up cross-border redispatching measures. Thus, we believe that this coordination should be further enhanced (or initiated, if non-existing) before any discussion about the size of bidding zones is started.

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?

As far we can judge, we do not see any discrimination potential in the current structure of bidding zones, particularly regarding the German/Austrian price area. Rather, the existence of the liquid German/Austrian price area has largely contributed to an increase in competition intensity even on an European level. Large and liquid price areas make it easier for new players to enter the market.

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?

As mentioned above, we believe that larger bidding areas are more beneficial for the market as a whole, also as they need should support a necessary critical mass of active market participants. Reconfiguration of bidding zones will certainly have negative effects on market liquidity; i.e. it will be split between the then smaller zones. In contrast to ACER we do not believe that this would be compensated by the use of mechanisms for implicit allocation of capacity between bidding zones. Particularly smaller players will reduce their activities and focus on zones where they are located in (i.e. generation and demand will only participate in the respective local market). As a consequence, market participants' ability to rely on the market is impaired because they expect a limited liquidity at certain times. Thus, in situations where the entire capacity is used, market participants with assets in a specific bidding zone (generation and consumption units) face a market with a reduced number of counterparties/demand and offers.

We are particularly concerned regarding the forward markets where liquidity will be negatively affected if smaller bidding zones would be introduced. Already with the announcement of a split of an existing zone, the forward market will also be split as there will be separate forward products for the planned zones. This also means that the liquidity of the forward market in the existing zone will be reduced (e.g. if the split will be in two price areas the liquidity will be split over twice as many products plus there will be a general decrease in activities). Also, the well-functioning of retail markets would be negatively affected as suppliers will no longer be able to offer competitive prices for a larger zone; this is as they now face two separate markets to source the necessary electricity. In general, liquidity of forward markets is a key requirement for competition in both the wholesale and the retail market. Otherwise, there can be no independent entry into the market. It is also important to recognise that consumers and generators will not be able from a risk management perspective to have their position entirely exposed to day-ahead prices.

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?

As mentioned before, our key focus lies on the German/Austrian price area plus the CWE region. We think that the German/Austrian wholesale market does provide sufficient hedging possibilities. It is by far the most liquid market with a churn rate of 7-10 and a liquid time horizon of up to three years. Market participants in neighbouring countries do take profit from the liquidity as all neigbouring TSOs are offering cross-border capacity to the German market on a yearly and monthly basis. For example, this is in our view the most prominent obstacle to actually hedge price risks in the Nordic markets as there is almost no possibility to hedge future prices in specific price areas: This is because there is almost no liquidity in the offered hedge instruments (CfDs) and TSOs, the only stakeholders who are “long transmission rights” do not offer them.

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?

We do not see a reason why the current bidding zones configuration should not provide the correct price signals for investments.

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?

For the German/Austrian electricity market we do not see an issue with market power.

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?

As mentioned before, we strongly recommend a proper cost-benefit analysis and not a pure technical analysis. Certainly, in addition to the negative effects on liquidity, hedging possibilities and competition issues, we see significant transactions costs on a company level (change of all systems and procedures)

We also want to stress the aspect of ancillary services which is often neglected in the discussion on the definition of price zone design. Having in mind the increase in RES and thus the increasing weather dependency of intermitting power generation in the EU, we think it is important that ancillary services markets (balancing, reserve) develop in an appropriate manner. If the size of price zones is reduced it might become difficult for TSOs to procure sufficient ancillary services. This can for example be seen in the Nordic system (see market message No 49/2013 of Nordpool Spot at http://www.nordpoolspot.com).

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?

Clearly, it is of utmost importance that NRAs fully understand the economic benefits of larger bidding zones compared to smaller ones. Taking the consultation into account, we are concerned of ACER's view regarding liquidity and price hedging possibilities (section 2.3. and 2.4). This view seems too positive in respect of reducing the size of existing bidding zones. We cannot imagine that splitting the well-established, liquid German price could in fact lead to higher liquidity, better hedging possibilities and more competition. A split of the market into separate zones on the basis that internal lines are occasionally congested seems not an appropriate measure. In fact it will create a significant barrier to cross border competition. Furthermore, regarding liquidity, we do not agree with ACER that only the overall liquidity of all zones covering a given territory is relevant if trading between zones is organised through implicit auctions or market coupling. Particularly, liquidity in forward

markets is relevant for price hedging needs and we question that why a split of an existing liquid bidding area should result in increased liquidity in the combined smaller areas.

***