6 March 2018 – Brussels MESC meeting

EFET view on the bidding zones review

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European Federation of Energy Traders so you can rely on the market

1. Lessons learnt since 2014



Looking back: 4 years ago at the workshop on the Technical and market reports that initiated the BZ review: Copy of March

Conclusions



- The current review process can only be seen as an exercise and provides no basis to change bidding zone delineation.
- Changing zones is a too important issue.
- Rethinking on how to assess the "overall market efficiency of bidding zones" is needed. Ideas:
 - Start with hypothetical system, with artificial but full data set
 - Cover much longer time frames (historical years) to allow for visibility of trends
 - Trial & Error can be a necessary approach for the analysis
 - But no Trial & Error on changing the actual bidding zone configuration!!!



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esentation

How we saw one of the most significant challenges coming

EFET suggested to start the first review as a learning exercise

- Based on hypothetical system with hypothetical data
- Covering various timeframes and all segments of the market
- Using a trial and error approach to test the methodology

BZ review approach over-complex a non-tested methodology

- NRAs request to model flow-based market results was too complex and gave excessive weight to DA markets
- Inconsistency in data led to modelbased scenarii being unusable
- After the first edition we still don't have a robust methodology for the analysis



EFET recommendations back in 2014 and assessment in 2018

- 2014: Bidding zones need to be large enough to promote liquid wholesale market and proper retail market functioning
 ⇒ 2018: Analysis of market efficiency lacking proper quantification
- 2014: Current bidding zones delineation is probably not optimal ⇒ 2018: Model-based scenarii assessing BZs beyond MS borders abandoned
- 2014: Bidding zones should be stable and robust over time
 ⇒ 2018: ENTSO-E recommendation favours stability, but regulatory decision on DE-AT BZ split was a uncoordinated process leading to many uncertainties.



2. Suggestions for the next review



Which BZ configurations to analyse next?

- When the next review is launched, it may cover expert-based configurations but only if soundly based on technical and market reports
 - BZ borders independent from MS borders
 - BZ borders in case of expected structural congestions
 - Not just splitting but also merging (e.g. NL-BE, ES-PT)
 - Put redispatch costs in perspective of congestion revenues
- Ideally: improve and redo clustering exercise
- Analytical results should never be dismissed by ENTSO-E as politically unrealistic



How to measure overall market efficiency?

- The mainly qualitative assessment and comparison of the 20 CACM criteria is pointless
- Instead: focus on assessing overall market efficiency quantitatively
 - Static efficiency
 - Lowest cost dispatch (after market & redispatch)
 - This should cover the <u>impact</u> of: redispatch volumes, loopflows, unscheduled flows or equally large zones (no need for additional criteria)
 - Dynamic efficiency
 - Quantify welfare impact of liquid forward market
- System security is crucial but should be achievable in all relevant configurations
- The possible inefficiency of redispatch should be part of the market efficiency assessment

How to measure static market efficiency?

• Internal congestions may lead to inefficient exchange







How to measure dynamic market efficiency?

| mea | neasure dynamic market emciency? | | | | | | | | | | | | | | | E | EX: | am | | | | | | | |
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How to measure dynamic market efficiency?



Bid-Ask Spread [€/MWh]

The bubble size equals the cost to hedge 10TWh of production or consumption 2 years ahead (i.e. hedge today the exposure in Cal2019) in the different countries, just based on the respective bid-ask spread. Costs related to market depth and exchange fees are not included.

- Hedging as such comes at a cost: the transaction cost. It is a function of:
 - liquidity (i.e. bid-ask spread)
 - market depth (i.e. potential price impact of placing relatively high volumes)
 - transaction fees (i.e. exchange fees)
- An increase in bid-ask spreads in Germany of 0,1 EUR/MWh means an additional cost of hedging of <u>EUR 450 million</u> (based on 2016 forward traded volumes)



How precise does the analysis need to be?

- Quantifying dynamic market efficiency is a prerequisite...
- ...but quantifying dynamic market efficiency cannot be precise
- Therefore extreme precision in the quantification of static efficiency is not necessary
 - E.g. modelling precise flow-based results is pointless



3. Stakeholder engagement



Role of the Advisory Committee

- The role of the Committee is to provide <u>advice</u>
 - Need to give a stronger role to the Committee
 - Members should be able to to participate in the determination of methodologies
 - Need to depart from the ex-post reporting culture and move toward a participative work approach
 - Information needs to be publicly available on the ENTSO-E website
- Regulators to make contributions within the Committee
 - ACER/NRAs interventions in first review (adding an expert-based scenario, requesting flow-based modelling) never agreed or discussed in the Committee and proved unhelpful
 - Regulators should discuss ideas with stakeholders and not bypass the Committee



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