

ENTSO-E consultation on its draft bidding zones review report



EFET response – 9 March 2018

The European Federation of Energy Traders (EFET) thanks ENTSO-E for the opportunity to provide our views on the draft report on the bidding zones review. We would like to frame this response in the broader engagement of EFET in the ENTSO-E bidding zones review since 2013 through active participation in the Bidding Zones Stakeholder Advisory Group, in contributions to formal and informal consultations, and in the general support we repeatedly expressed in various fora for the ENTSO-E bidding zones review process.

We took the decision to emancipate ourselves from the consultation format proposed by ENTSO-E for this consultation on the draft report. Indeed, we believe the questions posed by ENTSO-E to get the input of market participants on what would be the impact of a bidding zones change compared to the status quo on the list of criteria listed in the CACM Guideline are inadequate:

- Market participants' views concerning the effect of bidding zones changes on the criteria listed in article 33 of the CACM Guideline have already been gathered by ENTSO-E in the course of the project – at least as far as market efficiency questions are concerned¹.
- Now is not the time anymore to run such an exercise. We would expect the consultation document to ask market participants' views on the analysis conducted by ENTSO-E and the proposed recommendation, not to ask market participants to conduct their own analysis. Analysing the impact of a bidding zones change compared to the status quo was the task of ENTSO-E itself, not something that market participants were ever expected to perform, let alone in four weeks.

¹ See our response to the ENTSO-E survey on market efficiency with regard to bidding zones configuration, dated 26 August 2016, available at:

http://www.efet.org/Files/Documents/Electricity%20Market/General%20market%20design%20and%20governance/EFET_ENTSOE-BZ-consultation_26082016.pdf. See also our response to the informal ENTSO-E survey on the effects of the various expert-based scenarios on market liquidity, dated 20 November 2017, available at: http://www.efet.org/Files/Documents/Downloads/EFET_ENTSO-E%20liquidity%20survey_20112017.pdf.

Instead we present below our comments on the draft report in a free format. Our comments aim to take stock of the report, but also to provide recommendations for the conduct of future reviews, based on the experience of the past five years.

1. The recommendation

Given the lack of evidence unearthed during the study, ENTSO-E made a clear statement that they could not come to a definitive conclusion as to the merits of maintaining the status quo or amending the current bidding zones delineation according to one of the analysed scenarios. While we regret the fact that the analysis could not bring conclusive evidence of the benefits of one or the other bidding zone delineations (including possibly the existing one), we welcome the clear statement of ENTSO-E in that regard. We also understand that according to the CACM Guideline, ENTSO-E had to make a formal recommendation and hence took the lowest risk option to maintain the status quo. We also take note of ENTSO-E's disclaimer with regard to the BNetzA/E-Control agreement to split the German-Austrian bidding zone.

If the European Commission were to review the CACM Guideline in the future, the possibility should be open for ENTSO-E not to make a recommendation, should the organisation unhappily run into the same type of trouble as during this first study.

2. The analytical framework

Back in 2014, EFET suggested conducting this first review as a learning exercise to ensure that ENTSO-E, with the help of regulators and market participants, develops a sturdy methodology to be used in further iterations of the review. Proposing to conduct this first review as a learning exercise did not mean we did not take it seriously: rather the contrary, it was intended to ensure the reliability of future decisions on bidding zones delineation. Our suggestion was not followed, and after more than four years of analysis, the lessons learnt of this first review are rather don'ts than dos.

Here is a summary of some of the flaws we identified and believe led to the impossibility for ENTSO-E to draw conclusions from its analysis:

- **Criteria for the analysis:** ENTSO-E decided to stick to the 13 elements listed in article 33 of the CACM Guideline (further broken down by ENTSO-E into 20) and use them as criteria for its analysis. These elements were never translated into relevant criteria that could be compared against each other. This resulted in a series of results, some quantitative, some qualitative, that could not be consolidated with a view to comparing the different scenarios.

We believe that most of the elements set out in the CACM Guideline, in particular those related to network security and overall market efficiency, can be boiled down to the question of welfare maximisation. This is after all the main objective that we

collectively pursue with the establishment of the internal energy market. Hence, the quantitative part of the analysis should be centred on the costs and benefits of the various scenarios against an overall welfare metric. For instance, we believe that for all the bidding zones delineations, operational security can be maintained (a scenario in which this would not be the case should be outright excluded); the question is rather how much it would cost to maintain the requisite degree of system security in a specific bidding zones delineation.

To help start the reflection on finding the right quantitative criteria matching the various elements of the CACM GL, we propose a future study must look at lowest cost dispatch in each of the scenarios to establish efficiency and maximum welfare: lowest cost dispatch takes account of both the cost of managing system security (including the cost of managing internal congestions and loop flows), together with the benefits created by cross-border trade. This would already help combine many of the article 33 elements, such as point a.i, a.ii, b.i, b.ii, b.v, b.vi, b.vii and c.iv. Secondly the efficiency of the wholesale market (including forward markets) should be measured. Hedging costs for example can be measured by looking at bid-ask spreads and traded volumes. Liquid markets help to reduce risks and thus overall costs also for the development and integration of renewable generation. Other quantitative criteria could be developed, but it is essential that ENTSO-E, with the advice of regulators and market participants, develop a series of indicators for efficiency and welfare, which can be consolidated, i.e. that have a common metric and avoid double counting. We stand ready to help ENTSO-E in that regard.

We believe that, alongside the measurement of efficiency welfare gain/ loss, it will remain necessary for the architects of a next study to incorporate a mix of quantitative and qualitative criteria to assess liquidity (both in forward and short run timeframes of the market) and competition (both wholesale and retail) effects. These must stand alongside the purely quantitative analysis of network management costs, welfare gains and market efficiency, and will require a weighting or relative status to be assigned to them accordingly.

- **Scenarios:** EFET has always expressed our intuition that the current bidding zones delineation may not be ideal as we doubt that it matches the borders of EU Member States. While we understand the political difficulty that a recommendation to delineate bidding zones borders without regard for Member States borders may face at a regulatory and political level, we believe it is not the role of ENTSO-E to care for such concerns. Rather, ENTSO-E is expected to deliver a technical analysis with hopefully a strong recommendation for a bidding zones delineation expected to maximise welfare at European level. Hence, we were very disappointed to see ENTSO-E abandon the model-based scenarios partly for concerns related to the reliability of the modelling, but also partly for judging the results as politically unrealistic. Concerning the expert-based scenarios, we expressed our disappointment from the start of the project on the imbalance between the splitting and the merging scenarios, which was even reinforced by the inclusion of an additional splitting scenario upon request of the NRAs (“Big Country Split 2”). This brought the ratio of splitting to merging scenarios to 3 to 1.

For a potential next review, we recommend going back to the drawing board on the model-based scenarios and making sure that the results from the future clustering exercise, even re-processed and as politically sensitive as they may appear, be analysed according to the welfare maximisation metric like any expert-based scenario. For expert-based scenarios, and as mentioned at many occasions during this first study, we suggest, a proper balance between splitting and merging scenarios, in terms of numbers of scenarios as much as in terms of ambition of the spitting/merging cases.

- **Modelling:** Modelling the effect of alternative bidding zones delineations proved one of the major pitfalls of the study. The request of NRAs to model flow-based market coupling results proved particularly unhelpful as it dramatically increased the complexity of the analysis while focusing it on the day-ahead timeframe and foregoing the forward, intraday and balancing markets. Modelling was further hindered by the unavailability of the common grid model, differences in the TSOs' current treatment of the various levels of voltage on their network, and the unavailability of transaction data from REMIT.

As recommended back in 2014, EFET suggests simplifying the modelling of the effect of alternative bidding zones delineations on the management of networks as well as the functioning of markets. Modelling flow-based in the future also has its significant share of uncertainties (beyond the fact that it solely focuses on DA markets). A reasonably representative modelling of network management and market functioning would simplify the analysis and be more helpful.

3. The engagement with market participants

EFET recognises the aspiration of the ENTSO-E secretariat to engage with and involve market participants during the course of the study, most notably through the ambitiously named bidding zones stakeholder advisory group (BZ SAG). However, the reality sometimes fell short of the ambition. As the study progressed, we found it difficult to provide advice to the project that could be productively integrated in the study. Rather we often ended up in a situation where we were only informed of choices made by ENTSO-E or NRAs, or asked for input at too late a stage in various steps of the study for it to have an impact. The decision to discard the model-based scenarios and to include an additional splitting expert-based scenario are two examples of executive decisions by ENTSO-E and the NRAs, respectively, where we could not make our voice heard before a decision was taken. Our repeated verbal and written input on metrics to quantify the market efficiency criteria was also lost in the final analysis, to be replaced by simple qualitative assessments. Details on the assessment methodology was never made fully available and only made apparent in the draft report for consultation.

For the next iteration of the bidding zones review, we offer to ENTSO-E to lean more on the expertise that market participants can bring to the table. To ensure that market participants can duly discharge their role as advisors, as the name of the BZ SAG suggests, we recommend that we and other representative organisations are more closely involved with the project team and included in the decision making at every step of the study. Suggestions made by NRAs should be communicated transparently and assessed as proposals by the whole BZ SAG. We also request that information is made available to the wider community of market participants by way of a publicly available webpage on the ENTSO-E website.