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EU electricity bidding zone reviews: EFET recommendations

The European Federation of Energy Traders (EFET)[1] believes that any future altered configuration of electricity bidding zones across Europe must sustain at least current levels of liquidity and competition in the wholesale market; ideally it would contribute to an enhancement of liquidity and competition. We support the view that "liquidity is an important feature of a well-functioning market," expressed in the DNV GL report on *Liquidity and transaction costs: Methodology to estimate the impact of a bidding zone reconfiguration on market liquidity and transaction costs*, delivered recently to the Agency for the Cooperation of Energy Regulators (ACER). We are conscious that assessments of market efficiency must go beyond measurement of liquidity, as DNV GL point out. Yet we insist that the preservation of liquidity and of a healthy degree of competition within any given geographic market in electricity at the wholesale level are crucial.

We remain concerned about two aspects of the DNV GL report:
1) The metric used to calculate changes in risk premiums, and
2) The analysis of the effects and possible remedies to liquidity losses as a result of a bidding zones re-delineation.

With respect to the former, understanding how losses in liquidity affect the cost of hedging for market participants (i.e. what we call hedging risk premium) and create a welfare loss is possible only by assessing *ex-ante* risk premiums. If this is too complex, the best indicators we have to capture the cost of hedging and related welfare effects are the bid-ask spreads and the traded volumes for the different market timeframes per bidding zone. As to the second issue, we believe greater market liquidity in all market timeframes brings welfare gains. Liquidity losses, together with dwindling competition, would have the opposite effects. It is then important, beyond mere suppositions about market behaviour, to truly analyse in how far possible increases in cross-border (XB) transmission capacities could remedy such situations and compensate welfare losses.

With this in mind, we provide the following recommendations to TSOs for forthcoming bidding zones reviews.

- The DNV GL study is a good starting point to understand the importance and capture the effects of liquidity for market efficiency.
- While dispatch efficiency concentrates on day-ahead operations, the study rightly points to the **importance of the forward timeframe for the analysis of market efficiency**. The majority of traded volumes, and all hedging activities, take place before day-ahead.
- **Analysing the welfare effects of changing liquidity in the forward timeframe requires a metric that properly captures the cost of trading and hedging at that point in time:**

[1] The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

the bid-ask spreads. Whether a forward transaction turned out to be a profitable deal compared to a similar one in day-ahead gives no indication as to the actual cost of hedging, or the overall welfare effect in the market.

- **Further analysis of the effects of liquidity changes on the efficiency of intraday and balancing markets should also be conducted**, as these timeframes are becoming increasingly important with the growing penetration of RES-E.
- Ensure that **the comparison of the effects of liquidity / competition losses and of possibly increasing the availability of cross border transmission capacity is properly conducted**. This should materialise in an analysis of the overall ease with which market participants can hedge and trade before and after a BZ re-delineation in previously unified zones and all adjacent zones, taking account of all timeframes.
- TSOs should undertake quantified and monetised projections of liquidity in various BZ re-delineation scenarios and should then use the proper metric to calculate welfare effects of liquidity changes. Beyond the analysis of liquidity changes and their effects, the evolution of competition levels in individual markets post re-delineation, should be thoroughly analysed and quantified. Such quantifications should allow a balanced comparison with dispatch efficiency indicators, with the objective of reaching an optimal configuration for both market and system.

We welcome the Agency's initiative to capture the effects of BZ changes on market efficiency in general and liquidity and transaction costs in particular, as well as to provide guidance to TSOs, who will be in charge of carrying out future BZ reviews. ACER have recently announced that they are launching a procedure for the approval of the proposed methodology and assumptions to be used in the bidding zone review (BZR) process, as well as of the proposed alternative bidding zone configurations pursuant to Article 14(5) of Regulation (EU) 2019/943. We see this announcement as a good opportunity to reiterate our comments and recommendations, which we also shared with the Market Stakeholder Committee (MESC) on 17 June.