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ACER consultation document „The influence of existing bidding zones on electricity markets“ (PC_2013_E_04, 31 July 2013)

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VIK, representing energy intensive consumers of various industrial sectors in Germany¹⁾, welcomes the opportunity to express its views on the discussion about present and possible future bidding zone delimitation. To approach an integrated European electricity market, it is important to merge existing bidding / price zones into fewer but larger zones, so as to best approximate the ultimate aim of a single European price zone. That being said, any restructuring of bidding zones must be limited to an integration of existing zones, while refraining from the splitting up of existing zones in which a functioning market already is established.

General remarks

VIK has supported the European goal of creating an integrated energy market from the beginning. It is essential for European industrial consumers that Europe creates a level playing field where consumers can purchase electricity at competitive non-discriminatory prices. Competitive commodity prices can only be achieved by competition in a well organized, transparent, and liquid market.

In creating such an integrated market, it is important to take into account the achievements reached so far. This is especially valid with regard to the bidding and price zones. While the overall aim of market integration is to create larger zones, ultimately leading to one single zone (or few large zones), it is important not to fall back behind what has been achieved up to now. Therefore, on the path to only one single zone (or few large zones), it is essential that existing zones will be integrated into larger bidding zones. It would be a significant step backwards to split up existing bidding zones. This has to be avoided, since it would reduce liquidity, thus weakening functioning markets.

¹⁾ Our remarks refer to the delimitation of price / bidding zones in general, but especially to the German-Austrian price zone.

That means: Although introducing new market zones might be justified from a network topology point of view, it usually has negative impacts on electricity market functionality and competition, especially when it means that existing zones would be split up, destroying functioning markets.

For example, the German single price zone has been extended to Austria in the past. This is an example of successful integration of existing zones. Splitting up such a zone, possibly even in more than two smaller zones, would clearly be a step backwards with respect to the overall goal of market integration. Moreover recently, a more integrated balancing market has been created by stronger cooperation between the four balancing zones. This has led to an increase in liquidity in the balancing market as well as a reduction in balancing costs. Such achievements would be thwarted if the market would be split up.

Therefore, VIK advises against changing existing zones without an in-depth analysis on the local and overall effects. It is important to create zones not solely according to network topology. Instead, the delimitation of a bidding zone should be on the basis of the most economical solution. In some cases this might be network topology. But generally it will be the case that – maybe with some investments – another solution becomes more appropriate. Estimations of the overall socio-economic benefits of new bidding zones should be taken into account. Zones should be defined on the basis of creating the greatest social welfare for the market as a whole. In that sense, it is also important to consider criteria like market power.

To conclude, VIK strongly believes that the socio-economic benefits of a very liquid single pricing zone clearly dominate other considerations, and a possible splitting-up of existing zones into several smaller zones would have negative consequences on all market participants. Therefore, zones that are already integrated and have developed a liquid market must be maintained and not be split up, while temporary bottlenecks within such zone should be solved by redispatch, and structural congestion by investments in grid capacity. Redispatch mechanisms should be designed so as to give clear and transparent incentives for grid expansion by the grid operator. When redispatch mechanisms are not cost-based but market-based, not only generators but also consumers need to be able to participate in this market.

Detailed 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?*

VIK: The best option to alleviate congestion is grid expansion, especially in the case of permanent and long-term constraints. As soon as grid capacity between different zones or within a zone is sufficiently expanded, loop flows and grid congestion will no longer be a problem. At the same time it is clear that it would be a suboptimal solution to expand grid capacity to an extent that no congestion whatsoever occurs. Therefore, the optimal solution is a situation where the grid is expanded but still allows for congestion in some (rare) situations. As soon as existing grid bottlenecks between today's zones are eliminated (or reduced to an acceptable level) by grid expansion, the concerned zones could be integrated into a larger zone. However, splitting up of existing zones cannot constitute part of the solution. Should there be a bottleneck within a zone, then this is usually a temporary problem to be solved by expanding grid capacity.

In the meantime, until the grid is sufficiently enhanced (and also in the future, when congestion temporarily occurs despite an enhanced grid), redispatch should be used to deal with congestion. Splitting up a zone for a few years and then reuniting it once the grid bottleneck is eliminated would be a very costly solution, given the huge transition costs associated with such a split-up and the welfare forfeited by breaking up a functioning intra-zonal-market.

Redispatching costs should be recovered via the grid fees, as is the case today.

- 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?*

VIK: Today's bidding zone configuration could be improved in the future by merging different zones into larger ones. This holds especially for relatively small adjacent zones between which grid capacity already is relatively large, so that the grid expansion still necessary should be relatively easy to achieve.

- 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?*

VIK: -/-

- 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?*

VIK: Industrial consumers are de facto limited to the price zone they are located in, with regard to their procuring electricity. This limits the options for purchasing as well as competition between suppliers in different zones. Therefore, enlarging the existing bidding zones would benefit consumers, whereas splitting up zones would further decrease their purchasing alternatives.

- 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?*

VIK: We cannot assess in detail the development in terms of liquidity, but generally the market liquidity (both day-ahead and long-term) will increase within a large bidding zone.

- 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?*

VIK: Within the German-Austrian price zone, liquidity in the forward market (1 to 3 years) is high enough to hedge electricity prices for this period.

- 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?*

VIK: Investment signals coming from different prices in different price zones are reliable only to a certain extent. This is due to the discussion about realignment of zones. If a prospective investor in generation must take into account the possibility that bidding zones might be redefined in the near future, possibly several times, he might be reluctant to invest in a power plant with a lifecycle of several decades.

Regarding grid expansion, different prices in different zones might signal existing congestion on the border between these zones. This is an indication that grid expansion is needed. Whether this also is an appropriate incentive for the TSO to invest in additional grid capacity highly depends on the specific regulatory framework in place in the respective country.

- 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 ?*

VIK: According to a recent study by the German Monopoly Commission, at the moment there is no dominating market position by one of the biggest companies. The biggest 4 generators have a common market share of 58 per cent, taking into account total conventional generation capacity in Germany and Austria. Referring only to Germany, this share rises to 68 per cent. This illustrates that the splitting up of the German-Austrian bidding zone would increase market power and give rise to market dominance concerns. It also shows that in larger price zones there is usually less 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?*

VIK: When considering the grid situation, it is important not to refer to today's state of the grid but to take into account the various grid expansion projects planned or already underway. The same holds true for investments or de-investments in power plants. Such a forward-looking analysis can show that regions where grid congestion exists today may be bottleneck-free in the near future. This may lead to the result that a perceived necessity for splitting zones might vanish, and that the integration of two or more zones into a larger one might be feasible.

- 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?*

VIK: It is important to consider the progress achieved so far. Any splitting up of zones would be a step backward, so, to reach the goal of an integrated electricity market, merging of complete zones without splitting them up should be at the focus of NRAs attention.