

Bidding Zone Review: The importance of a thorough liquidity assessment

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Association of European Energy Exchanges



1. A sound BZ review is needed

- A comprehensive BZ review is vital, both in terms of the development of alternative configurations and their evaluation (against the CACM criteria);

Alternative configurations: The objective should be to analyse a balanced set of alternative configurations, including both possible splits and mergers and by integrating a model-based approach.

Evaluation: A thorough analysis of all criteria is necessary including the efficiency of market outcome, operational security and market liquidity.

- Measuring liquidity impacts not only on day-ahead markets but on all time frames, including forward markets, intraday and balancing.
- An integrated European approach, looking at the entire system, is needed. Any regional approach can only provide a fragmented analysis and may overestimate regional impacts. The basic work assumption should be a fully coupled day-ahead and intraday IEM as well as future coupled balancing markets.

2. Measuring both spot and forward market impacts

- **Current TSO proposal:** *‘A quantitative assessment of the market liquidity shall be performed based on market-depth analysis, focusing on the price change between the respective orders taking into account cross-zonal possible exchange. This analysis shall be done at least for day-ahead market, but may incorporate additional timeframes, if technically possible.’*
- **Liquidity is essential for a) efficient market dispatch & b) efficient risk management (minimising related costs). Both spot and forward markets need to be taken into account for such an analysis.**
- **Multiple indicators are necessary for the definition and measurement of liquidity, including:**
 - Bid-ask spreads;
 - Market depth;
 - Trading volumes;
 - Churn rate.

3. Previous splits may not provide a clear picture

- **How to consider higher day ahead volumes in Sweden and DE/AUT after the splits:** A significant part of the increased volumes is the result of a de-netting effect, i.e. before the split market parties could provide a netted position (cons-prod; buy – sell) for the larger BZ, which then needs to be reflected for each of the new BZ in the SDAC auction. This does not necessarily indicate a fundamental increase of liquidity.

=> The de-netting effect needs to be taken into account. An assessment is also needed of the changes in price risks and liquidity in long term hedging markets.

- **Assessing the potential for local market power in larger BZs:** The large volume of redispatch and the issue with redispatch market power in Germany may not be reflective of other zones. It is not a given that other large zones are prone to more market power as real-time approaches – each market structure must be considered.

4. The importance of a thorough liquidity assessment

Summary: How should liquidity be considered in the context of the BZ review?

- BZ configuration is indeed only one aspect that impacts market liquidity (with others being market structure, competition, etc.);
- Although it is challenging to measure liquidity impacts and define sufficient levels of liquidity, this does not diminish its importance.
- A certain level of remedial actions (e.g. redispatch) will be necessary to compliment the regular market outcome;
- However, any loss of liquidity (particularly in long-term forward markets) can result in negative impact on competition, socio-economic welfare and some negative consequences for final consumers (beyond distributional effects between market participants);

=> Liquidity is not therefore a 'complementary' criteria – liquidity impacts will affect welfare and need to be fully assessed in all time frames.

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