Clean Energy Package – The battle on bidding zones and cross-zonal capacity allocation

One of the Commission's most controversial proposals in the Clean Energy Package, was to limit the system operators' ability to handle internal bottlenecks by reducing interconnector capacity and to implement internal bidding zones as a measure to handle structural internal congestions. Moreover, the Commission wanted to have the final decision power on bidding zone delimitation. However, the proposal met strong opposition, most notably from Germany. Thus, the adopted provisions were watered-down substantially: Bidding zones can still contain structural congestion if their effect on other countries is limited or action plans to alleviate the problem are developed. Moreover, a minimum of 70 percent of interconnector capacity must be made available to the market. It is however not yet clear exactly how the 70 percent are to be calculated. Norway trades significant volumes of electricity with EU Member States and EU rules on bidding zone configurations and capacity allocation therefore directly affects Norwegian cross-border trade, and hence, indirectly, power prices.

The Commission proposal

The background for the Commission's proposal was the observation that bidding zones in the EU largely follow national borders rather than reflecting actual grid congestions, thus weakening price signals as incentives for solving congestions. In addition, TSOs have been known to reduce trading capacity on interconnectors to reduce redispatch and counter-trading related to internal congestion.

The central provisions addressing this issue in the proposed recast of the electricity market regulation[1] were article 13 on bidding zone definitions and article 14 on the principles for capacity allocation and congestion management.

On **bidding zones** (article 13), the Commission proposed that their definition should be based on the location of long-term structural grid congestions and be designed to maximize economic efficiency and facilitate cross-border trade. Current bidding zones should be reviewed and adjusted based on this principle. Moreover, the Commission should have the final say regarding bidding zone definition.

On **capacity allocation and congestions management** (article 14), the Commission proposed a legal framework to prevent TSOs from reducing cross-border capacity to alleviate internal congestions. As much interconnector capacity as possible should be made available to market participants and TSOs should use counter-trading and redispatch to handle internal congestions, unless it could demonstrate that it would not be economically efficient at the EU level or putting operational security at risk.

The agreement after trilogue

Considerable changes were made to the Commission's proposal in the final version of the regulation[2].

Regarding the **bidding zones (changed to art. 14)**, Member States retained control over their configuration to the detriment of the Commission. The general principle that bidding zone delimitation should be based on long-term structural congestion and that bidding zones should not contain such congestions, was

[1] COM (2016) 861 final

[2] Provisional version of the electricity market regulation approved by the Parliament.

however kept. Structural congestions within a bidding zone will still be allowed if a) the capacity usage rate is at least 70 percent of cross-zonal trading capacity and b) they do not affect adjacent countries significantly. The Commission will only make decisions on bidding zone delimitation if Member States are unable to come to an agreement.

In addition, ENTSO-E was given the task of reporting every three years on structural congestions between and within bidding zones. If structural congestion is identified by ENTSO-E or TSOs, the affected Member State should either establish an **action plan (art. 15)** to reduce the structural congestion within four years or amend the current bidding zone configuration.

The final provisions for **capacity allocation and congestion management (art. 16)** introduce the 70 percent minimum requirement on cross-zonal interconnector capacity. In order to adhere to the provision, counter-trading and redispatch should be used.

The rules regarding the calculation of the 70 percent, derogations and exceptions are not easy to interpret. Regional coordination centres are responsible for calculating the relevant capacity requirements, assessing their feasibility, and coordinating a reduction in cross-zonal trade capacity where the targets are not feasible, and are to report to ACER every three months on any failures to meet the required target.

Why the changes?

Council: The discussions revolving around article 13 and 14 were among the most contentious issues as the Council developed its general approach with positions for further trilogue negotiations.

Germany strongly opposed the Commission's proposals, especially as they would give the Commission more influence on bidding zone configurations. The German one-zone policy, despite considerable internal structural congestions, have caused loop flows through neighboring countries and reduced availability of cross-zonal interconnector capacity for trade due to physical flows. In addition, Germany has been accused of limiting trading capacity further in order to reduce redispatch costs within Germany, notably on the Danish border. Still, Germany favored regulations that would allow enough time to increase internal transmission capacity north-south.

A group of market-liberal countries including Belgium and the Netherlands supported the Commission's proposal. Poland and the Czech Republic, two of Germany's neighbors who are affected by loop-flows with impact both on grid congestions in their own internal grids and on cross-border trading capacity, also supported the Commission's proposal. The German influence was still seen as considerable, as the matter was a high priority for the country.

The idea of a minimum share of interconnector availability came up during the negotiations, and first showed up in the Estonian presidency's compromise proposal presented on 30 November 2017 (it had not been included in a previous proposal dated 15 September 2017)[3]. The Estonian presidency writes that:

"The delegations pointed out that a bidding zone split is of political relevance and therefore the Member States need to be able to maintain this decision. Presidency proposes to establish a benchmark level of maximum capacity on the border that needs to be respected. Furthermore, Presidency proposes that after a period that is necessary to implement measures, the Member State would be able to choose whether it will apply a bidding zone split or whether it will deal with the congestion by remedial actions in order to comply with the set benchmark. Presidency proposes a clear deadline for the entire process and maintains that in case the benchmark is violated at the end of the process, the Commission is able to issue a decision about an optimal split of bidding zones in the Member State"[4]

Earlier in 2017, an agreement was reached between Denmark and Germany involving a gradual increase of the minimum available trade capacity on the German-Danish interconnector. The agreement involved setting a minimum available trade capacity that should increase from 400 MW in July 2017 up to 1100 MW in 2020[5].

The idea of a minimum available capacity also appeared in the ACER/CEER market monitoring report from October 2017 where it was suggested that the Member States could consider "[…] *setting a binding target for the availability of existing and future cross-border capacity, e.g. by defining a minimum share of physical cross-zonal capacity which should be made available for cross-zonal trade at, for example, the regional level".*[6]

In the Council's general approach, which was reached by a quality majority, and in the Estonian presidency's compromise proposal, a minimum of 75 percent was used[7].

[3] Estonian proposal as of 30 November 2017 and 15 September 2017.
[4] Estonian proposal as of 30 November 2017
[5] BMWI (2017) – Press release (German)
[6] ACER/CEER (2017) – Annual Report on the Results of Monitoring the Internal Electricity and Gas Market 2016 – Electricity Wholesale Markets Volume.
[7] Council of the European Union – General Approach on the Electricity Market Regulation.

Parliament: The Parliament's position in the negotiations largely reflected the general approach on article 13 and 14, and also included the 75 percent minimum provision[8].

Trilogue: In the final agreement between representatives of Parliament, Council and Commission, the minimum was set at 70 percent.

Assessing the outcome

The final version of the regulation maintains the original proposal's main principles on bidding zone definitions based on structural congestion and to make maximum interconnector capacity available for market participants. It does not give the Commission decision power to ensure that these principles are carried out in practice, and it provides Member States with more time to adapt their power systems through derogations and caveats.

In the long run, however, the regulation will make it harder for Member States to reduce interconnector capacity in order to handle internal congestion. Hence, although the outcome may be viewed as a defeat for the Commission, laying down of the main principles may pave the way for improving price signals in the European electricity market in the longer run.

Norway trades significant volumes of electricity with EU Member States through interconnectors to Sweden, Denmark and the Netherlands. New interconnectors to the UK and Germany are under development. EU rules on bidding zone configurations and capacity allocation therefore directly affects Norwegian cross-border trade, and hence, indirectly, power prices.

As an example, the splitting of Germany into two bidding zones in line with the structural congestion between Northern and Southern Germany would lead to lower and more volatile power prices in the Northern bidding zone due to the substantial wind power capacities in the North. Through interconnectors, this would also lead to lower average power prices and increased price volatility in the Nordics, including Norway. The new interconnector between Norway and Germany, expected to become operational around the end of 2020, would strengthen these effects in Norway.

Sources

Commission (2016) Proposal for a directive on common rules for the internal market in electricity, COM (2016) 861 final, Brussels, 30.11.2016

Interviews with representatives of the Commission, Council, European Parliament and stakeholder groups in February 2019.

[8] Parliament – ITRE Committee report