

Impacts of bidding and price area division on the Finnish electricity market players and on the electricity market

Executive summary

Followed by the declaration by the Nordic council of ministers, Fingrid has commenced a project to analyse division of Finland into two price- or bidding areas. This study, commenced by Pöyry, is part of the Fingrid's project and covers the power market perspective of price- or bidding area division. Congestion management mechanisms are only treated from this perspective. The primary questions are the effects of price area division on Finnish electricity market and on Finnish electricity market players. In the course of the study the bidding area alternative has been found less plausible for Finland, hence the focus of this study is in price area division alternative.

Finnish electricity market players are critical towards national congestion management by splitting the country into price areas. The counter trade is seen to function well and credibly. Overall, market players hold the view that price area division is an oversized action to a limited congestion problem in Finland. The positive attitude towards current congestion management approach is assessed by Pöyry to partially result of low knowledge about moving the internal bottlenecks to the national borders.

The transition into two price areas entails changes to market operations and requires updating the market players' IT systems. Each price area comprises a balancing area of its own. Market actors are required to plan, forecast and execute electricity procurement, selling and production separately in each balancing area. Northern Finland is likely to become a problematic area from the retail market perspective. The competition in retail market is expected to weaken since some of the retailers are expected to opt out from operating in the Northern Finland due to additional operational, IT- and hedging costs followed by operating in several price areas. Weakening competition is likely to result in mark-ups in retail prices. Coupling the Northern price areas of Finland and Sweden would enhance the situation significantly.

The competition in the wholesale market is not assessed to change significantly by price area division. The risk of market power abuse in the small price area of Northern Finland is already present in counter trade arrangements. The cost effects of such market power abuse would however be greater in the price area alternative. On the other hand, the transparency of price area alternative could ease monitoring market behaviour and possible market abuse.

The higher the number of price areas, the weaker the liquidity of market for Contract for Differences (CfD). Weak liquidity leads to higher risk premium in CfD prices. It is likely, that the introduction of additional price areas would result in concentration of trading in CfD-markets in fewer price areas with higher liquidity. Consequently, the market players in smaller price areas would face the price risks in congestion situations.

The market players' knowledge of counter trade mechanism and counter trade transactions seems to be relatively limited. Furthermore, the frequency of bottleneck reallocation to the national borders is not widely known. More transparent information by Fingrid of counter trading and congestion reallocation to the national borders would enhance better understanding of the magnitude of the existing congestions in Finland.

The transition from a congestion management mechanism based on counter trades and bottleneck reallocation to the borders into a mechanism based on price areas, is assessed to

bring along new requirements on regulation of Fingrid. In price area alternative the prices are split due to increased transmission followed equally by changes in production / consumption situation or by disturbances in the power grid. If either price areas or bottleneck reallocation to the borders is the primary tool for congestion management in the future, TSOs should be more strongly obliged to be prepared to handle critical disturbances in the power grid. The regulation should be strong enough to permit the market players to rely on TSOs operation in the interest of the electricity markets.

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