

## Modelling Prices in Competitive Electricity Markets

Edited by Derek W. Bunn



## Contents

	List of Contributors Preface			xiii xvii	
1			and Behavioural Foundations of Competitive Electricity Prices	1	
		ek W. Bı			
		Introd		1 5	
			t fundamentals		
			tional reform and strategic evolution	11	
	1.4	Summ	ary comments	17	
PA	RTI	PRIC	ES AND STRATEGIC COMPETITION	19	
2		_	rs' Response Representation for Market Simulation in the	21	
	Spanish Daily Market				
	Efraim Centeno Herndez, Julian Barquin Gil, Jose Ignacio de la Fuente Leon,				
			uhoz San Roque, Mariano J. Ventosa Rodriguez, Javier Garcia		
			Alicia Mateo Gonzalez, and Agustin Martin Calmarza	21	
		Introd			
	2.2		y bidding-based Spanish electricity markets	22	
		2.2.1	, S	22 23	
		2.2.2	Bidding structure Clearing and price determination	23 23	
		2.2.3		23	
		2.2.5		24	
			Bidding information availability	25	
		2.2.7	·	26	
		2.2.8	Chapter overview	26	
	2.3		p-phase clustering procedure for the analysis of bid functions	27	
	2.5	2.3.1		27	
		2.3.2	1	28	
		2.3.3		29	
			BF codification	29	
		2.3.5	Defining the dissimilarity between BF	30	

vi		Contents	
		2.3.6 Centroid calculation of a cluster of bid functions	31
		2.3.7 Example case	31
	2.4		
		(ARIMA) models	35
		2.4.1 Analysis using an ARIMA model	36
		2.4.2 Analysis using TF models and weighted estimation	40
		2.4.3 Case study	47
	2.5	2.4.4 Section conclusions  Discovering electricity market states for forecasting the residual demand	49
	2.3	function using input-output hidden Markov models	49
		2.5.1 Hidden Markov models and the analogy with electricity markets	50
		2.5.2 Model description	52
		2.5.3 Example case	54
	2.6	Conjectural variations approach for modelling electricity markets	58
		2.6.1 Conjectural variations	60
		2.6.2 Implicit elasticity estimation	62
		2.6.3 Case study	64
	2.7		65
		endix: Nomenclature	66
	Refe	rences	67
3	Complementarity-Based Equilibrium Modeling for Electric Power Markets		
	·	amin F. Hobbs and Udi Helman Introduction	<b>6</b> 0
		Definitions	69 71
	3.2	3.2.1 Complementarity	71
		3.2.2 Karush—Kuhn-Tucker conditions	72
	3.3	A general complementarity-based model of energy commodity markets	72
		3.3.1 Notation	73
		3.3.2 The competitive market model	75
		3.3.3 The Cournot market model	77
	3.4		
		transmission network	78
		3.4.1 MCP power market model: generators Cottrnot in sales, Bertrand	
		in transmission	78
		3.4.2 EPEC power market model: generators Cournot in sales, Stackelberg	92
		in transmission 3.4.3 A simple numerical example	82 84
	3.5	A large-scale application: the North American Eastern Interconnection	92
	3.6		94
		nowledgments	95
		erences	95
4	Pric	ce Impact of Horizontal Mergers in the British Generation Market	99
	<i>John</i> 4.1	n Bower Introduction	99
	4.1	4.1.1 Difficulties in applying current merger analysis tools to	77
		electricity markets	100

			Contents	Vii
	4.2	England and Wales wholesale electricity market		102
		4.2.1 Market power in the Pool		102
		4.2.2 Coal contracts		104
		4.2.3 Pool price cap		106
		4.2.4 Plant divestment		106
		4.2.5 Replacement of the Pool with NETA		107
		4.2.6 Gas moratorium		110
		4.2.7 Market abuse licence clause		112
	4.3	Analysis		113
		4.3.1 Analytical method		113
		4.3.2 Variables		116
		4.3.3 Results		118
	4.4	Price forecast		120
		4.4.1 Events in 2002/03		120
		4.4.2 Estimating the price impact of proposed mergers		122
		4.4.3 Discussion		123
		4.4.4 Conclusion		124
		eral references		125
	Of g	em references		126
PΔ	ART I	SPOT MARKET DYNAMICS		129
- 1		STOT MINNED DITAINED		12)
5		ing for Weekly Seasonal Unit Roots in the Spanish Power Pool	l	131
		el Leon and Antonio Rubia Introduction		121
				131
		Data Tasting for second unit roots		132 133
	5.3	E		133
		5.3.1 HEGY weekly seasonal unit root test		134
		<ul><li>5.3.2 Prewhitening method</li><li>5.3.3 Canova-Hansen seasonal stationarity test</li></ul>		138
	5.4	·		140
		endix A: Prewhitening procedure		140
		endix B: Critical values of the HEGY test		141
		nowledgements		143
		erences		144
	Ker	siences		144
6	Nor	llinear Time Series Analysis of Alberta's Deregulated		
	Elec	tricity Market		147
	Apo	stolos Serletis and Ioannis Andreadis		
	6.1	Introduction		147
	6.2	A noise model		147
		6.2.1 The power spectrum		148
		6.2.2 The structure function test		149
		6.2.3 The Hurst test		150
	6.3	A multifractal formalism setting		151
	6.4	On turbulent behavior		152
	6.5	On nonlinearity		153

## Contents

	6.6	On chaos	153
	6.7	Conclusion	158
	Acknowledgments References		
	Refe	erences	158
7	Quantile-Based Probabilistic Models for Electricity Prices		
		Jie Deng and Wenjiang Jiang	
	7.1		161
	7.2	Quantile-based distributions and the modelling of marginal	1.50
		distributions of electricity price	163
		7.2.1 Quantile modelling and two classes of quantile-based distributions	164
		7.2.2 Marginal distributions of electricity price	164 167
		7.2.3 Risk-neutral distribution of S&P 500 Index	169
	7.3	Quantile-GARCH models and the modelling of time series	109
	7.5	of electricity price	170
		7.3.1 Quantile-based non-Gaussian GARCH model	171
		7.3.2 Financial risk management applications: a case with the	-,-
		electricity price time series	171
	7.4	_ · · ·	173
	7.5	Conclusion	175
	Ack	nowledgements	175
	Refe	erences	175
0	E.	accepting Time Verming Consulance Metalogs in the Introdella Suct	
8		recasting Time-Varying Covariance Matrices in the Intradaily Spot rket of Argentina	177
		el Leon and Antonio Rubia	1//
	8.1		177
	8.2	VAR analysis for block bids	178
	8.3	Modelling the conditional covariance matrix	183
		8.3.1 Orthogonal GARCH (Alexander, 2000)	184
		8.3.2 Multivariate GARCH model (Engle and Mezrich,	
		1996) *	184
	8.4	$\mathcal{E}$	185
	8.5	0	187
		knowledgements	188
	Ref	erences	188
PA	ART I	III SPATIAL PRICE INTERACTIONS	191
9		entifying Dynamic Interactions in Western US Spot Markets	193
		hristine A. Jerko, James W. Mjelde and David A. Bessler	4.F.=
	9.1		193
	9.2		194
	9.3	3 Methods	196

			Contents	ix
		9.3.1 Vector autoregression		196
		9.3.2 Directed acyclic graphs		197
	9.4	Results		199
	9.5	Discussion		212
	Refere	ences		214
10	Tran	smission of Prices and Volatility in the Australian Electricity		
		Markets		217
	Andre	w C. Worthington and Helen Higgs		
	10.1	Introduction		217
	10.2	Data and summary statistics		219
	10.3	Multivariate GARCH model		221
		Empirical results ,		222
	10.5	Conclusion		227
	Refer	ences		228
PAR	RT IV	FORWARD PRICES		231
11				
		librium Economics and the Value of Security of Supply		233
		Harris		222
		Introduction  Construction of the moments of puice		233 234
	11.2	Construction of the moments of price 11.2.1 Model setup		234
		11.2.2 The supply stack and the offer premium X		234
		11.2.3 Generator contracting strategy in equilibrium		234
		11.2.4 Supplier contracting strategy in equilibrium		237
		11.2.5 Calculation of price distribution from option premiums		238
	11.3	•		239
	11.3	Commentary		244
	11.7	11.4.1 The transaction behaviour of the low load factor plant		244
		11.4.2 The transaction behaviour of the supplier		245
		11.4.3 The transaction behaviour of the market		246
		11.4.4 Cost of risk		247
		11.4.5 Market completeness		248
	11.5	Conclusions		248
		rences		249
12	Mod	eling Electricity Forward Curve Dynamics in the Nordic Mark	ket	251
		as Audet, Pirja Heiskanen, Jussi Keppo and Iivo Vehvildinen		
	12.1	Introduction		251
	12.2	The model		252
	12.3	Forward model in the Nordic market		254
		12.3.1 Products in the Nordic power market		254
		12.3.2 Estimation of the model parameters		255
	12.4	Model usage examples		257

x	Co	ontents	
		12.4.1 Conditional forecast for the forward curve	258
		12.4.2 Pricing of forward options	259
		12.4.3 Accuracy of a forward curve model	260
	12.5	Conclusion	261
	Appe	ndix: Estimation of model parameters	262
		owledgments	264
		rences	264
13	The	Forward Curve Dynamic and Market Transition Forecasts	267
	Svetle	ana Borovkova	
	13.1	The term structure of commodity futures prices	267
	13.2		271
		13.2.1 Weighted strength indicator	272
		13.2.2 Principal component indicator	275
		13.2.3 Indicators for seasonal commodities	277
	13.3	Critical regions and bootstrap methods	278
		13.3.1 Using the change indicators	278
		13.3.2 Smooth stationary bootstrap	279
	13.4	11	280
	13.5		282
	Refe	rences	284
PAI	RTV	FORECASTING AND RISK MANAGEMENT	285
14	Price	e Modelling for Profit at Risk Management	287
Jacob Lemming			
		Introduction	287
	14.2	Electricity price modelling	289
		14.2.1 Financial models	289
		14.2.2 Fundamental models	290
		14.2.3 Combined approaches	290
	14.3	1	291
	14.4		294
		14.4.1 Electricity price modelling -	294
		14.4.2 Modelling volume risk	298
		14.4.3 Additional factors	298
	14.5	1	299
	1	Conclusions	305
	Refe	rences	305

15 Forecasting Weather Variable Densities for Weather Derivatives and

15.3 Univariate time series modelling of weather variables

307

307

308

310

**Electricity Prices** 

15.2 Weather ensemble predictions

James W. Taylor 15.1 Introduction

	Contents	XI
	15.3.1 Review of models for temperature time series	310
	15.3.2 Temperature models for the UK locations	311
	15.3.3 Wind speed models for the UK locations	313
	15.3.4 Cloud cover models for the UK locations	315
15.4	Empirical comparison of weather point forecasts	315
	15.4.1 Point forecasting methods	315
	15.4.2 Results	316
15.5	Empirical comparison of weather quantile forecasts	318
	15.5.1 Quantile regression	318
	15.5.2 Quantile forecasting methods	318
	15.5.3 Results	320
15.6	Summary of the analysis of temperature, wind speed and cloud cover	324
15.7	Forecasting the payoff density for a weather derivative	325
	15.7.1 A temperature put option	325
	15.7.2 Empirical comparison of forecasts	325
15.8	Electricity demand modelling	327
	15.8.1 Modelling weather-related demand	327
	15.8.2 Empirical comparison of forecasts	328
15.9	Concluding comments	329
Refer	rences	330
Index		331