

Italian power market: towards the achievement of the EU Target Model

EFET position paper - Executive Summary, 16 October 2014

WHO WE ARE

EFET is an organisation designed to improve the conditions of energy trading in Europe and to promote the development of a sustainable and liquid European wholesale market.

We foresee sustainable energy markets throughout Europe, in which traders efficiently intermediate in the value chain on the basis of clear wholesale price signals, thereby optimising supply and demand and enhancing security of supply, to the overall long-term benefit of the economy and of society. Within our organisation, Task Forces dedicated to specific countries operate. The present document is prepared by the group following the Italian gas and electricity markets.

SCOPE OF THE DOCUMENT

The scope of this document is to identify the main differences between the current Italian electricity market design and the European electricity Target Model presented during the 17th Florence Forum in December 2009. ACER and ENTSO-E through the Framework Guidelines and Network Codes respectively should by the end of 2014 have implemented the electricity Target Model. There are delays and legal challenges, but EFET expects the European Commission, ACER and ENTSO-E in combination to continue setting the rules for the establishment of a European integrated internal electricity market.

Our gap analysis should contribute to identify the electricity market design elements for each timeframe which need to be amended or further developed in Italy. The object is firstly better to align the Italian electricity market design with the EU Target Model and secondly to accelerate the integration of the Italian wholesale market in the wider European one. The Italian electricity market is one of the biggest markets in Europe and in order to achieve a secure, efficient and competitive European internal market, its integration is of high importance.

FORWARD MARKETS

Forward markets should be complemented by the development of forward transmission capacity markets able to provide market participants with the long-term hedging solutions necessary to manage their exposure to both volume (liquidity) and price (cross-border price differentials) risks. EFET believes that all TSOs should offer forward (i.e. longer than day-ahead) transmission rights between all bidding zones: market participants need these hedging instruments to achieve efficient cross-border competition along the whole electricity value chain and for all timeframes. Where market participants hold transmission rights, they can compete in neighbouring forward wholesale markets while managing their geographical exposure to volumes and price risks. Therefore EFET is in favour of the definition of a common market design at European level for the long-term timeframe with the extension of PTRs and FTRs issued by TSOs on all European borders.

We advocate for the harmonisation of nomination timing, format and aggregation rules (i.e. the methods for the nomination of capacity allocated in different timeframes) and for the creation of a centralised nomination platform.

EFET believes that, if applied across Europe, the adherence by TSOs to the following principles would promote an efficient market design and facilitate cross-border electricity competition:

- TSOs shall auction physical transmission rights or financial rights with equivalent effects (subject to successful experimentation)
- TSOs shall auction the maximum of available capacity over appropriate timeframes
- Transparency should be ensured by the TSO on the methodology and data used to carry out capacity calculation. Stakeholders should be informed and involved in the definition of the capacity calculation methodology
- Transmission rights must be firm
- TSOs must not discriminate against holders of transmission rights purchased in advance of day-ahead and intra-day timeframes (implementation of Use It Or Sell It principle)

As for the Italian case, we believe that for a full implementation of the FCA Network Code provisions, the Italian Authorities should take steps in order to solve some key issues with a matter of urgency:

- Integration of CASC rules on firmness and compensation of PTRs: compensation on Italian borders, except for the Italian-Slovenian border, is now set at day-ahead allocation price, but as soon as market coupling is implemented compensation shall be set at day-ahead spot market spread without any caps, as envisaged by ACER Framework Guidelines
- Maximisation of the allocation of available cross-border capacity through base-load products
- Harmonisation of nomination rules and operational procedures on all the Italian borders on which PTRs are offered and in all directions

We also propose Terna to evaluate the introduction of periodic buy-back auctions which would allow the TSO to buy back in the market any proportion of rights it has oversold in advance. This could help decreasing capacity holders' exposure in case of a reduction of available capacity, allowing them to receive

a compensation which reflects the actual market conditions. However, liquid secondary markets are a pre-condition: transmission rights should be exchangeable on a secondary trading platforms, as already envisaged, and traders should be given the opportunity to “slice and dice” the available yearly and monthly rights.

DAY-AHEAD MARKET

EFET looks forward to the prompt achievement of fully harmonised price coupling of the day-ahead markets of Italy and Slovenia with the NWE area. We acknowledge the efforts towards the implementation of day-ahead market coupling at the Italian borders, now foreseen to go-live by February 2015.

We wish to draw the attention on some key topics which should be taken into consideration for the full implementation of CACM Network Code and for the coupling of the Italian day-ahead market to NWE area:

- The cash settlement is not aligned with the common European standard: we call AEEGSI to coordinate with GME in aligning with the D+2 common rule across Europe in the outlook of the market coupling implementation.
- Firmness of cross-zonal capacity: reduction of allocated capacity shall only be used in emergency situations and *Force Majeure*, and when all other means are exhausted (reduction of allocated capacity shall be a last-resort measure).
- More transparency on capacity calculation methods: TSOs need to better coordinate in order to provide more transparency on capacity calculation methods as traders need to better understand methods, model and parameters in both NTC/ATC cases. Information about the grid model, reliability margins, operational security constraints etc. is not made public and therefore it's not possible to judge if capacity calculation is appropriately coordinated between the TSOs. The lack of relevant capacity calculation information hinders improving efficiency and competition and is not compliant with the NC CACM.
- Correct functioning of the market coupling considering the Italian zonal structure: the current Italian zonal set-up could pose challenges to market coupling in the daily calculation of PUN. The current market zonal structure should be assessed to ensure that it allows an efficient integration with the other adjacent day-ahead markets. It has to be deeply analysed whether the current bidding zone delineation can be maintained in a situation where Italy is coupled on its northern borders. We recommend that bidding zones review process by AEEGSI and TERNA should be thoroughly discussed with market participants based on a complete market analysis and taking into account of the access to liquid markets in all bidding zones.

INTRADAY MARKET

We believe that an efficient and timely intraday market is a key to allow market participants to optimise their portfolios during the day of delivery, as well as having the possibility to take into account relevant changes in fundamentals which remain unknown at the time of the gate closure of the day-ahead market session.

The target model proposed by ACER in the Capacity Allocation and Congestion Management (CACM) Framework Guidelines clearly defines implicit allocation (first-come-first-served), re-nominations till h-1 of delivery, continuous capacity allocation and bilateral trading using intraday capacities as the pillars for cross-border intraday capacity allocation.

EFET supports the development and the implementation of cross-border capacity allocation mechanisms based on continuous allocation. The key advantage of this approach is the ability to react quickly to events in this phase of the market via rapid decision-making. This is not achievable with centralised auctions with intervals of several hours where no action can be taken.

The current cross-border intraday (XBID) set-up, based on two sessions of explicit auctions, is far from a near-to-real-time continuous trading with implicit capacity allocation as stipulated in the Target Model. Although we welcome the recent proposal by GME of introduction of an additional MI session and the later closure of the MI2, the allocation of intraday capacity via two auctions per day is not sufficient and does not maximise market participants' opportunities to adjust their balances close to real time. Therefore, EFET advocates for the replacement of national intraday auctions with a continuous market.

We appreciate the good effort of GME and Terna showed in the recent proposal of an XBID continuous trading market complemented by regional auctions, as presented at the 5th ERI CSE SG Meeting. We believe that this proposal represent a step forward. However, as envisaged by the current ENTSO-E CACM Network Code, complementary regional auctions can be approved by NRAs if certain conditions are met:

- regional auctions shall not have an adverse impact on the liquidity of the pan-European Intraday solution;
- all Cross-Zonal Capacity shall be allocated through the Capacity Management Module;
- the regional auction shall not introduce any discrimination between Market Participants from adjacent regions;
- the timescales for regional auctions shall be consistent with the pan-European Intraday solution to enable the Market Participants to trade as close as possible to real-time; and
- National Regulatory Authorities shall have consulted the Stakeholder Committee.

Therefore, our recommendation is that a single introductory implicit auction is run for all the 24 hours of day D, based on the capacity available after the day-ahead spot auction. This allows capacity to be priced in case of congestion during the auction. The auction should cover capacity allocation both between the Italian zones and cross-border capacity and there should be no discrimination between domestic generation/production units and cross border units.

EFET calls for urgent and appropriate steps by AEEGSI, GME and Terna to move towards the Target Model of continuous intraday trading with implicit capacity allocation. If a regional auction is set to be organised besides, this should not introduce any discrimination between market participants from adjacent regions.

BALANCING REGIME

The European system balancing landscape is currently rather heterogeneous, with different TSOs and regulatory approaches (e.g. central dispatch vs self-dispatch, advance reserve procurement vs short term calls). Consequently, balancing products, procurement methods and imbalance settlement pricing vary

widely. As renewable penetration grows, it is important that all market participants are given the maximum incentive and opportunity to balance their positions in day-ahead and intraday markets. Therefore a clear distinction between intraday markets, balancing mechanisms and system operation actions are of utmost importance.

Balancing services should be procured only through a transparent, non-discriminatory, efficient market based method and activated/chosen depending on an economic merit order. Technical and network constraints should play the least significant role possible in the activation of balancing services and, if considered, they should be transparent enough to enable the understanding of the activation function path to Balance Service Providers (BSPs). Procurement methods should be market-based and avoid opaque bilateral balancing services contracts between the TSO and some BSPs which could have a discriminatory aspect. As a next step, regulators and TSOs need to adopt a more concerted approach to harmonised products and services. We see the improvement of harmonised and linked national balancing markets as necessary steps to improve the Italian security of supply and a primary mean to provide the flexibility services needed by the system. The Italian central dispatch model renders an exchange of balancing service across national borders more challenging. EFET recommends pursuit of efforts at a European level to harmonise balancing products and other relevant balancing market design elements, in order to improve efficiency in the internal power market close to real time and make cross-border balancing markets possible on a decentralised basis. The bottom-up approach of ENTSO-E based on pilot projects is a valuable start and we acknowledge the involvement and efforts of Terna in the "TERRE project". It is however important that the different pilot projects are coordinated and open to stakeholder involvement also in the design phase.