



Dear Ms. Natalie McCoy  
CEER – Council of European Energy Regulators  
Brussels

Milan, 27th September 2011

**EDISON’S RESPONSE TO CEER PUBLIC CONSULTATION PAPER ON A  
“DRAFT VISION FOR A EUROPEAN GAS TARGET MODEL”**

Edison welcomes the opportunity to respond to CEER’s consultation on a “*Draft vision for a European Gas Target Model*” and shares CEER’s conviction that a target model is needed as a reference framework to implement the future regulatory acts (Framework Guidelines, Network codes, etc) that will be produced at European level as required by the Third Energy Package.

**1. What are stakeholders’ views on this definition of a “functioning wholesale market”?**

Edison agrees with CEER’s consideration that the creation of functioning national/regional wholesale markets is the first step to realize the completion of the internal European market and therefore supports measures aimed at increasing liquidity on hubs and market interconnection. Only after national markets have started to function in a proper way, different options to connect and integrate them could be tested.

Given the importance of this step, which should prevent the introduction of further regulation in markets which are considered “well-functioning”, the definition should not be based on a restricted series of indicators: in facts, the identification of functioning markets by means of a limited number of specific quantitative indicators could result into misvaluations. For this reasons, we are in favor of a flexible use of these indicators, which should furthermore be part of a wider range of parameters, both quantitative and qualitative, to determine if a wholesale market is well functioning: the presence of barriers to entry and the level of liquidity on markets may, for instance, represent important indicators to assess the competitiveness of different gas markets.



**2. What are stakeholders' views on the three options identified to enable functioning wholesale markets, i.e. (i) creating market areas at national level for Member States able to meet the criteria of a functioning wholesale market; (ii) creating a trading region covering more than one country; or (iii) creating cross-border market areas?**

As stated in answer to question 1, Edison believes that the creation of single functioning national wholesale markets should represent the priority and is a prerequisite for the subsequent integration of these areas into a single European market. On the basis of this consideration, we recommend that all steps to foster the process of integration, and in particular the full implementation of the Third Package, are quickly delivered on a national level.

Only after the creation of single functioning markets, or at least after that all Member States have implemented the Third Package provisions, further steps towards markets' enlargement and integration could be undertaken and the options identified by CEER could represent viable solutions to be adopted in accordance to the characteristics of the different markets. Nevertheless, we believe that the choice of which option should be implemented, as well as the implementation timing, should be market-driven and follow the changes deriving from the adoption of European Network Codes. Both the creation of trading regions and the merger of cross-border zones should be subject to consultation with all involved stakeholders (TSOs, shippers, DSOs, etc) and take into account that the definition of the optimal size may depend on the existence of internal congestions, which could prevent the efficient functioning of the market. Detailed impact assessments should be carried out to ensure that the costs (in terms of operations, adaptation of IT systems, etc) of adopting any of these alternatives do not overcome benefits. The realization of pilot projects within the framework of the Gas Regional Initiatives could represent a valid tool to test the viability of the proposed options in different market areas.

**3. What are stakeholders' views on the proposed steps until 2014 for enabling functioning wholesale markets?**

Edison agrees with CEER that the implementation of entry-exit systems (and, more in general, of the Third Package) in all Member States is a prerequisite for having functioning market and for any attempt of integration.

We have some doubts on the feasibility of the second step proposed by CEER: we consider the identification and implementation of cross-border market-areas or trading regions by 2013 unrealistic, since papers do not provide clear elements to transpose the theoretical market models at a more operational level.



More in general, given that the implementation of Network Codes (on CAM and Balancing in particular) will considerably change the current market structure towards more harmonization and optimization of network management, we think that any assessment on the need to integrate adjacent market areas should be postponed once the NC will produce their effects.

**4. What are stakeholders' views on the full implementation of the CAM network code and the CMP guideline at all interconnection points by 2014 at the latest?**

Edison fully supports the implementation of the CAM Network Code by 2014: the adoption of harmonized rules for the allocation of cross-border capacity will certainly contribute to decrease the existing barriers to entry new markets that European shippers are currently facing due to the existence of different regulatory regimes to access capacity.

As concerns the adoption and implementation of the CMP Guideline, we think that the introduction of further measures to free unused capacity are important to make short term capacity available to the market. Nonetheless, the introduction of any measure implying a restriction of re-nomination rights should be carefully evaluated. As Edison highlighted in its response to the Commission's consultation, emphasis should be placed on the development of transparent and well-functioning secondary markets (which should be directly enclosed to the CMP Guidelines and there recognized as congestion management measures) and on UIOSI mechanisms, to be preferred to UIOLI that implies a restriction of users' rights to make a flexible use of the capacity they purchased.

**5. What are the stakeholders' views on the proposed pilot projects to design and trial an implicit capacity allocation mechanism between at least two entry-exit zones in different Member States by 2014?**

Edison is in favor of further analysis on the possibility to apply "market coupling" mechanisms to integrate adjacent gas systems, provided that market coupling proved to be an effective mechanism on electricity markets, leading to a "dynamic/bottom-up" integration of neighboring systems, ensuring an efficient allocation of cross-border capacity and allowing clear investment signals to arise where congestions exist.

Nonetheless, we believe that any pilot project should be based on a clear and shared definition of what market coupling means for gas markets, which is now missing in CEER's proposal. When working on this definition, the main differences



between electricity and gas markets should be carefully taken into consideration in order to adapt the design of market coupling to the peculiar characteristics of gas markets. In particular, the consequences of the introduction of a “gate closure” after which shippers cannot re-nominate capacity to let the “auction office” run the coupling algorithm, should be assessed taking into account that the implementation of a market-based balancing mechanism (as foreseen by ACER’s FG on Balancing) requires users to have the maximum amount of flexibility available.

Moreover, it should be clearly set that the available capacity considered by the Central Office to run the coupling algorithm shall be limited to free capacity, i.e. capacity which is not object of previous contractual obligations or that is progressively freed up by congestion management measures.

On the basis of the considerations listed above, we think that the study of pilot projects based on the voluntary involvement of stakeholders should be encouraged, as it could positively contribute to test the functioning of different models of market coupling, but the focus should be on a specific and limited number of projects between functioning markets, to be implemented only after having carried out a detailed cost/benefit analysis.

## **6. What are stakeholders’ views on the need for explicit long-term capacity allocation?**

Edison is convinced that long-term capacity will keep playing a crucial role on European gas markets as the key instrument to ensure security of supply. For this reasons, it is important that both the mechanisms to allocate existing long-term capacity and to identify the amount of new capacity requested by the market are designed in a way that does not undermine the possibility for users to comply with their supply obligations and for TSOs to recover the costs incurred in to realize new investments in capacity.

As concerns the allocation of existing long-term capacity, although supporting the harmonised introduction of coordinated auctions on all EU cross-border interconnection points - that will follow the implementation of the Network code on CAM – we asked ENTSOG to consider the introduction of yearly capacity products among the standard capacity products that will be offered. In our opinion, limiting long-term products to quarters, that could be subsequently combined to form longer periods only if shippers succeed in all the independent auctions, would imply for network users the risk of not being able to purchase the amount of capacity they need to comply with supply contracts’ obligations.



**7. How should economically-viable projects for cross-border capacity investments be determined?**

Edison agrees with the consideration that cross-border capacity investments should be identified on the basis of market-driven instruments. This may entail the use of open seasons, which proved to be an efficient tool to identify the need of new cross-border capacity and to allocate it. Alternatively, the application of further market driven instruments, such as the UK investment trigger mechanism, could be better explored to assess costs and benefits of their implementation in a cross-border context. For this reason, we call for the realization of an analysis by Regulators to compare the different implications of the open season, the UK investment trigger model and any further option to test the demand for incremental capacity.

**8. What are stakeholders' views on the proposed development of an economic test to trigger new capacity, based on market demand established through coordinated long-term auctions? If in favour, by whom and how often should such a test be conducted?**

As stated in answer to question 7, Edison is in favor of further analysis on the possible application of an economic test to trigger new cross-border capacity on the basis of market demand. Nevertheless, we think that before exporting the model applied in UK, some considerations should be done:

- So far, the "investment trigger model" has been only applied in UK, which is characterized by a peculiar gas system, being present multiple sources of gas located near to the entry points. This configuration of the system created the conditions for competition on entry points to arise: gas from different origins (national productions, import from neighbouring countries) can easily converge to an entry point and auctions consequently resulted the best mechanism to identify the need to invest in incremental capacity. The situation is often different in many States of Continental Europe, like Italy, where each entry point is generally related to a single source of gas (import route, production field) and entry capacity is consequently calibrated on the capacity of the importing infrastructure. In such systems, the costs of introducing a mechanism testing the need of incremental capacity at entry points on a yearly basis could exceed the benefits, whereas a less structured process allowing each shipper to ask the TSO to realise additional capacity when interested could turn to be more efficient.



- The “investment trigger model” was originally designed to be applied only to national capacity, which makes it easier identifying who is paying who (i.e. shippers participating to capacity auctions commits to pay the national TSO for the capacity they got allocated). When extending its application to cross-border capacity, the issue of how splitting costs arises.
- The feasibility of this mechanism is strictly related to the implementation of long-term coordinated auctions on all EU interconnection points, as foreseen by the CAM network Code. Its introduction should therefore be postponed after the new auction system will prove to be fully working.
- Any extension of the “investment trigger model” as applied in UK to European cross-border capacity should be anticipated by a clear understanding of how TSOs recover their investment costs. Our analysis of the UK model shows that TSOs shall realize the investment if the NPV test is higher than 50% of the investment costs. It means that there may be cases when shippers’ purchases of incremental capacity will only cover half a cost of the investment, whereas the remaining costs will need to be socialized. We therefore claim for a careful analysis of (1) how the specific level to pass the NPV test should be defined and (2) how long the time scale used to calculate the NPV is (provided that the longer the shorter the time scale, the lower the costs to be socialized in case the allocation of incremental capacity only covers a minimum percentage of the NPV).

**9. What are your views on the pricing of cross-border transmission capacity?**

As we stated in our response to ENTSOG’s consultation on the CAM network code, we think that a reserve price should be applied to all capacity and we believe that it should be equal to the regulated tariff, adequately proportionated according to the duration of each standard capacity product. The absence of a reserve price on short term capacity could have as main consequence the shift of the demand from long term to short term capacity, as it happened in UK, decreasing market signals for TSOs to invest in new capacity.

As concerns the management of over-recovery, we think that the decision of using it to invest in incremental capacity or to lower the tariff of the following year should be left to each NRA, in consultation with involved TSOs and market participants, since this issue is strictly related to the way how tariffs are designed in each national system. However, our general preference is for using over-recovery to lower the reserve price of the following year. Both in case of under and over-



recovery, we think that the impact on the tariffs of the following year should be limited to the reserve price of the capacity of the specific IP where under/over-recovery took place and not widespread to all the IPs of the system.

**10. Do you think that the elements of the target model provide a good framework for the integration of renewable energy?**

**11. Are there elements missing in the target model that are necessary for the integration of renewable energy on a European level, maybe with a view beyond 2014?**

Edison appreciates that CEER introduced an entire chapter dedicated to the integration of renewable energy and the role that will be played by gas in this process, thus recognizing the increasing importance of gas in power generation, in particular as back-up for the intermittency that characterizes power generation from RES.

We think that the implications of the integration of renewable energy should be carefully taken into consideration when designing a harmonised balancing regime, that should reflect power generators' need of larger flexibility. For this reason Edison is convinced that the imposition of within-day constraints on CCGTs, as allowed by the draft FGs on Balancing, could be detrimental for shippers serving power generators, that will be penalized for fluctuations that are not generally due to their inability to balance their portfolios.