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To: ERGEG European Regulator's
group for electricity and gas

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OBJECT: answer to ERGEG public consultation on “Pilot Framework Guideline on capacity allocation”.

WHO WE ARE

Born in 1881, Edison, one of the oldest energy companies in Europe. When the national monopoly on electricity was established in Italy in 1963, Edison had to diversify its business, but thanks to the first wave of EU Directives in 1996, it could re-focus its business on energy once again. Today Edison is the leading new entrant in the Italian energy market, with 50,2 billions kWh produced in 2008 and a market share of 16,4% of national output. Thanks to 7.000 MW of new highly efficient and low emission plants (CCGT thermo plants, as well as hydro and wind power plants), the Company has now a total installed capacity of more than 12.000 MW. In 2008, Edison reported revenues of 11.066 mln €.

Thanks to one of the most ambitious investment plans in Europe, Edison aims at becoming the second largest electricity company in Greece through the recently established joint venture with Hellenic Petroleum. As shown by the recently approved Business Plan (2009 – 2014), Edison will invest 7.2 billion euro in natural gas (exploration and production activities, in major gas import infrastructures, such as the Rovigo LNG offshore re-gasification terminal and the ITGI-Poseidon and GALSI pipelines) and in power generation sector, with a particular focus on renewable energy sources (hydro and wind power allow the Group to cover over 40% of the green certificate requirement with its own production). Other investments will constitute strategic developments in fast-growing markets, such as Greece, Romania and Turkey. As from 2009 the new offshore LNG terminal in Rovigo will contribute to the diversification of the country's supply sources with its re-gasification capacity of 8 bcm of natural gas a year, equal to 10% of Italy's demand for natural gas. In 2012 there will be the start up of Galsi and ITGI pipelines, which will connect Italy and European markets to Algeria and Caspian Sea, two areas rich in hydrocarbons.



GENERAL REMARKS

Edison agrees with the European Commission, GTE+ and ERGEG who identified capacity allocation as the main priority to be addressed by Pilot Framework Guidelines. Assuring an easier and more transparent access to transport capacity through the harmonisation of capacity products and allocation procedures at all interconnection points (IPs) is a fundamental step towards the integration of European markets. Furthermore, some of the proposed measures would allow network users to optimise the management of their capacity, and consequently gas, portfolios.

Nevertheless, we believe that Capacity Allocation Mechanism (CAM) and Congestion Management Principles (CMP), although part of two different processes, have a high level of interdependency. As a consequence, the results of the CMP process should be taken into account in the final design of the Capacity Allocation Mechanism.

As correctly highlighted by DG Competition Energy Sector Inquiry, difficulties faced by shippers in accessing transport capacity are among the foremost obstacles for the development of an appropriate level of competition within gas markets.

The implementation of different procedures at IPs of adjacent networks (different allocation sessions, different capacity products, different booking systems, etc) has the final effect of increasing users' efforts and transaction costs. In addition, shippers do not always have the certainty to be allocated the same amount of capacity at each side of an IP.

The above-mentioned situations, together with TSOs' difficulty in maximising firm commercially available capacity, have particular impact on new entrants and smaller operators' ability to access capacity and become relevant players in the market. For this reason, and positively evaluating the benefits arising for the market, Edison supports ERGEG's intention to increase TSOs cooperation and apply compatible rules on both sides of every IP.

On the other hand, when defining new rules for capacity allocation, ERGEG should take into consideration further aspects, such as the impact that a re-definition of capacity rights could have on security of supply and on the rights already enjoyed by shippers in compliance with the current legal framework of the country. Indeed, long term supply contracts are currently the main instrument that importing countries have to grant security of gas supply, which is going to gain increasing importance within the debate on the evolution of gas market's structure. Therefore, the presence of upstream long term supply agreements and the aim not to challenge them should be duly taken into account when defining new allocation rules.

On the basis of these considerations, Edison supports ERGEG's Target Model approach, which foresees the possibility to keep, where applicable and subject to national law requirements, pro-rata allocation during an interim period in cases when market conditions would not guarantee a fair and efficient auctions' result.



Indeed, only when market will have reached a lower level of concentration and a higher degree of liquidity, auctions would not lead to distorted results.

During the first period of implementation of new rules, pro-rata would allow all shippers interested in capacity to have access to it (in particular if applied to long-term capacity products), avoiding an artificial price increase.

For the same reason to preserve shippers' capability to comply with existing supply contracts, Edison believes that existing capacity contracts shall be amended only in their operational clauses, with no amendments to commercial clauses (i.e. prices, booked capacity and duration). Any such change would cause problems for shippers to secure the transport of contracted gas volumes, endangering their capability to respect existing contractual obligations with upstream suppliers and discouraging the development of new infrastructures, which is often based on the presence of long term supply agreements between users and producers.

In any case, it is paramount that clear and harmonised rules on access criteria to allocation procedures be set, such as the hold of upstream supply contracts and of sound financial guarantees, in order to avoid a speculative usage of capacity.

More in general, Edison thinks that when drafting framework Guidelines, ERGEG should consider the entire gas system as a single integrated chain, taking into account the aspects related to the upstream/downstream levels of the chain, like the flexibility of supply contracts and the seasonality of gas consumption.

ANSWERS TO ERGEG DISCUSSION POINTS

What are your main views of the proposed measures? Do you think Network codes based on these guidelines can achieve non-discriminatory and transparent capacity allocation and the fulfilment of the capacity allocation principles set out in the Third Package of Energy legislation?

Edison thinks that Network codes based on the proposed Framework Guidelines are coherent with the principles set out in the Third Package, and would in particular contribute to fulfil the aims established by art. 16 of Gas Regulation 715/2009, which are:

- the offer of the maximum capacity at all relevant IPs, taking into account system integrity and efficient network operation,
- the implementation of non-discriminatory and transparent capacity-allocation mechanisms, which shall:
 - (a) provide appropriate economic signals for the efficient and maximum use of technical capacity, facilitate investment in new infrastructure and facilitate cross-border exchanges in natural gas;



(b) be compatible with the market mechanisms including spot markets and trading hubs, while being flexible and capable of adapting to evolving market circumstances; and

(c) be compatible with the network access systems of the Member States.

Nevertheless, some of the proposed measures, i.e. the amendment of existing contracts and the introduction of a bundled product obligation thus impeding capacity booking at single IPs, do not take into proper consideration the risk arising for market participants or the limitation to shippers' ability to optimise their portfolios.

What are your views of the implications of each for the measures for sector in which you operate? In particular, we are interested to understand the nature of the implications in a qualitative way (and, if available, any quantitative evidence on costs and benefits would be extremely welcome).

See General Remarks and answers to specific points.

On the whole, Edison thinks that the introduction of a greater level of convergence of capacity allocation mechanisms, as well as the increase of TSOs cooperation will have positive effects on market functioning. However, some concerns arise from the possible implications of some measures, such as the amendment of existing contracts and the immediate introduction of auctions.

Do you support the scope of the draft framework guidelines proposed?

We appreciate ERGEG having taken into consideration shippers' requests to extend the scope of the Framework Guidelines to all the IPs between adjacent entry-exit systems, instead of limiting it to congested and potentially congested IPs. This will facilitate cross-border market harmonization and integration and allow users to reduce transaction efforts arising when managing several IPs ruled in different ways. On the contrary, reducing the scope to congested and potentially congested points would have probably led to a non-uniform application of new rules, given the difficulty to identify these kind of points.

Finally, although our understanding is that ERGEG CAM rules does not apply to TPA exempted capacity, we suggest that this should be clearly stipulated. Indeed, with reference to exempted infrastructure, Edison thinks that none of the rights acquired through Art.22 of Directive (EC) 2003/55 should be concerned by ERGEG consultation document.

What are in your views of the challenges that existing contractual arrangements create with regard to capacity allocation? What would be the possible ways to overcome those challenges?



Should relevant clauses in existing contracts be amended if they contradict the new legally binding set of rules (which will be based on the framework guideline) in order to create a level playing field for all shippers?

Edison understands ERGEG's proposal to create a level playing field for all shippers across Europe. On the other hand, it should be considered that existing capacity contracts are often linked to gas import agreements, generally based on take-or-pay clauses and that long-term supply and capacity contracts play a fundamental role in the development of infrastructures ensuring long-term security of gas supply within Europe. For this reason, we believe that amendments of existing contracts should only concern "operational clauses" (i.e. the management of communication flows with TSOs, etc), whereas the fundamental commercial pillars of contracts like duration, prices and booked capacity should be left unchanged. Any retrospective amendment concerning these elements would mean consistently increasing the risk faced by shippers.

Therefore, Edison suggests that, with reference to the more sensitive issues (i.e. duration, allocation method and prices), the new set of rules based on Framework Guidelines be applied only to capacity which will not be already contracted when Network Codes enter into force.

Experts have discussed if existing / legacy contracts should be questioned if certain conditions are met, in order to free up capacity, which would then be reallocated. Do you consider such a proposal appropriate?

See answer to the previous point.

Moreover, Edison believes that the respect of existing contracts is essential to provide a reliable framework of support to infrastructural investments. Therefore, no provisions of capacity free-up should be foreseen; on the contrary, rights enjoyed by users should be respected, while new allocation rules should progressively apply to new capacity made available by TSOs with the introduction of new capacity maximization methods and the expiration of existing contracts.

Finally, we would like to highlight that any provision of capacity free-up, being a typical issue concerning Congestion Management, should not be dealt with by Capacity Allocation Framework Guidelines.

Is the scope of the identified areas for TSO cooperation appropriate to ensure efficient allocation of cross-border capacity in order to foster cross-border trade and efficient network access?

Cooperation between TSOs is essential to secure shippers a simple and fast access to transport capacity. The scope of TSOs cooperation identified by ERGEG is appropriate and allows shippers to diminish their efforts in booking procedures. Particular attention should be paid to the harmonisation of maintenance, which often represents an obstacle to cross-border trade.



Furthermore, Edison agrees with the idea that cooperation is to be affected by clearly assigned responsibility. This will not only facilitate the Regulators' function of monitoring compliance with the requirements, but will also assure that all TSOs take the necessary steps to co-operate.

We think that the framework provided by ERGEG Gas Regional Initiatives could represent a valuable tool to improve cooperation among TSOs and for this reason, should be enhanced.

Should a European network code on capacity allocation define a harmonised content of transportation contracts and conditions of access to capacity?

The definition of harmonised contents and access conditions for all cross-border IPs should surely be part of a European network code on capacity allocation, with the aim to foster markets' integration. Nonetheless, Edison believes that following the introduction of an European network code on capacity allocation, the harmonization of capacity contracts will come as a consequence.

Should a European network code on capacity allocation standardise communication procedures that are applied by transmission system operators to exchange information between themselves and with their users?

Standardisation of communication procedures would contribute to enhance transparency and reduce transaction efforts for users.

***What are your views of our proposals regarding capacity products?
Do you agree with the idea of defining a small set of standardised capacity products that do not overlap?***

Should TSOs offer day-ahead and within-day capacity products?

The idea of defining a small set of standardised products that do not overlap is appreciable, because it allows having a simple range of compatible products on each IP. However, users should be consulted and market needs taken into duly consideration when defining these products, in order to allow shippers to fully exploit existing contractual flexibilities and to provide the most suitable (and therefore price value) product for each type of final customer. Moreover, products should be in line with the requirements of balancing markets.

Edison is in favour of the development of an increasing role for day-ahead and within-day capacity products. Nevertheless the possibility to fully exploit this kind of short term products should be further explored, analyzing their compatibility with upstream supply contracts. Indeed, the scarce flexibility provided by gas suppliers could not allow using capacity on an intra-day basis. Therefore, the possibility to take advantage of short term capacity products depends on the existence of a liquid gas exchange, which would make gas available on a short time horizon.



Should European TSOs offer the same capacity products at every interconnection point across Europe?

See answer to previous point.

Should TSOs offer interruptible capacity also in cases where sufficient firm capacity is available?

Although interruptible capacity cannot be considered the ideal tool for liberalising European gas market, due to its scarce usability, still it could play an important role for the optimization of network use, provided that rules and times of interruption are fully harmonised across different IPs.

Should a reasonable percentage of the available capacity be set aside for firm short term capacity products?

In general, setting aside a percentage of capacity for firm short term products would have the positive effect to increase the liquidity of capacity markets and facilitate new users (usually having shorter term supply contracts) to enter the market. Yet, capacity reservation for short-term products should not question contracted capacity and the ability of shippers to comply with existing contractual obligations, in particular hindering the respect of take-or-pay clauses. Therefore, we suggest that the quantification of the reasonable amount of reserved capacity be left to NRAs, in consultation with users, also on the basis of an analysis of the Member States' dependence on long term supply contracts and with the aim not to hinder access to capacity for holders of long-term upstream contracts. A high level of coordination among NRAs should be foreseen, in order to ensure a reasonable level of harmonization within the EU market.

Recital 19 of Regulation (EC) 715/2009 states that gas shall be traded independently of its location in the system. Do you think that cross-border products will facilitate the exchange of gas between virtual hubs of adjacent markets?

In principle, the introduction of cross-border products, as intended within ERGEG consultation, should have the effect of facilitating the exchange of gas between virtual hubs, thus contributing to market integration and to boost liquidity on specific markets. Nevertheless, fully bundled products and a one-stop-shop mechanism should be foreseen as a possible (and not the only) option, in order to grant the maximum level of flexibility to network users.

Do you support full bundling of cross-border capacity into one single capacity product, including a limitation of the possibility to trade at the border so that gas is traded at virtual hubs only in order to boost their liquidity?



Edison supports the introduction of bundling products, but only as additional to the possibility to book capacity on single IPs. Limiting border trade would reduce shippers' ability to optimize their portfolios and would also have a negative impact on the cross-border trading activity, consistently reducing its operational scope.

Do you consider combined products to be an appropriate interim step towards bundled products?

Should capacity at two or more points connecting the two same adjacent entry-exit systems be integrated into one single capacity product representing one single contractual interconnection point?

Combined products could be considered as an appropriate intermediate step, because they allow TSOs to maximize the available capacity, contextually reducing shippers' efforts. Again, as for bundling products, they should only be an additional alternative to the possibility to book capacity on single IPs.

Should auctions be the standard mechanism to allocate firm capacity products?

In principle, auction is the ideal market-based allocation method. Nevertheless, the adoption of auctioning as sole and standard allocation mechanism in markets which have still a high level of concentration and where a sufficient level of liquidity is not yet present, could result in market distortion. This is particularly true when dealing with long-term products, which are usually booked by incumbents and on which only a minor role can be played by new entrants.

In addition, Edison would like to remark the efficiency of Open Season as procedure to allocate Long Term capacity if physical congestion is the result of structural lack of interconnection capacity and investments in new transport infrastructures are required..

Open Seasons to allocate new capacity on Interconnectors should require an intensive cooperation of the Regulatory Authorities of the countries involved (as foreseen by art. 41.6 c of the gas directive) in order to ensure a full consistency of the regulatory framework. European Regulators have already successfully experienced such type of cooperation for example for the OS procedures for capacity allocations between France and Belgium; UK and Netherlands; Italy and Greece; and Hungary and Romania.

What would be the implications of using auctions for capacity allocation in the markets in which you operate? Is there any way in which auctions can be designed to overcome potential issues resulting from their introduction in those markets?



Do you support pro rata allocation as an interim step? If yes, should pro rata allocation only be used in given situations or market conditions?

See answer to previous point.

Given the possible distortive effects deriving from the implementation of auction in certain markets, Edison appreciates ERGEG's proposal to adopt, with reference to the choice of the allocation methodology, a Target model anticipated by possible interim steps. Indeed, this approach allows to take into due consideration the different stage of maturity which still characterizes gas markets in different Member States.

A compromise solution, which takes into account the different level of liquidity characterizing the markets of long and short term capacity products, could be reached proposing that, in case of demand exceeding offer, allocation on a pro-rata basis is foreseen for long-term products (more than one year) and allocation via auction, in case of short-term products (one year and less). In fact, whether auctions took place between hubs that are not liquid enough, which is the case of markets where the majority of traded capacity is booked to satisfy long-term supply contracts, the risk is that new entrants could not be guaranteed to have a minimum access to capacity. On the contrary, pro-rata allocation would guarantee all shippers a minimum access to capacity.

Pro-rata can also be considered a valuable tool to develop secondary markets, due to the fact that usually pro-rata may only allocate a certain share of the requested capacity to the user, who will then be incentivised to buy the remaining capacity on the secondary market. Secondary capacity trading has to be further developed and improved as the main tool to make capacity available without endangering the ability of users to comply with the obligations of up-stream contracts. Providing incentives to trade capacity on secondary markets can therefore be a valuable first step towards a more market-based capacity allocation system.

Should the network code define harmonised firm secondary capacity products and anonymous procedures for offer and allocation of secondary capacity products in line with those on the underlying primary capacity market?

The definition of harmonised and firm capacity products, as well as anonymous procedures for offer and allocation of secondary capacity products will contribute to increase the appeal of secondary markets, which are a fundamental step for the development of a liquid capacity market within EU.

Edison believes that secondary market should still be a shippers' market, where TSOs only provide a central booking platform where players meet and where OTC capacity transactions should still play a very important role. TSOs should only provide the necessary instruments to manage secondary markets, but should not be assigned the role of managing these markets. Therefore, the possibility to slice and dice offered and unsold secondary products into products of shorter duration should be left to shippers.



Do you think that all capacity connecting systems of two adjacent transmission system operators should be allocated via a joint, anonymous, web-based platform?

The adoption of joint platforms to allocate all capacity connecting adjacent systems would consistently reduce users' transaction efforts and would avoid the risk to have different capacities allocated at each side of an IP.

This is particularly true with regards to secondary capacity: indeed, organizing the trading of secondary products on an anonymous web-based platform should particularly boost liquidity on secondary markets, allowing shippers to avoid the search of shippers who have booked capacity and may be willing to sell it.

Do you agree that joint allocation of primary and secondary capacity products on these platforms would strengthen capacity markets?

Joint allocation risks being very costly and complicated to be implemented and requires further analysis on possible benefits. Therefore, Edison believes that priority should be given to the development of efficient secondary markets. Only after that, the issue of joint allocation could be further explored.