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Dear Mrs. Fay Geitona

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### **EDISON RESPONSE TO ERGEG PUBLIC CONSULTATION ON DRAFT FRAMEWORK GUIDELINES ON CAPACITY ALLOCATION AND CONGESTION MANAGEMENT FOR ELECTRICITY**

#### **WHO WE ARE**

Born in 1881, Edison is one of Europe's oldest energy companies. In 2009, it reported sales revenues of 8.867 mln €, and is carrying out an ambitious investment plan in the electricity and gas sectors. Edison had to diversify its business, when the national monopoly on electricity was established in Italy in 1963. Thanks to the first wave of EU Directives in 1996, it could re-focus its business on energy once again, this becoming the largest new entrant on the Italian market.

With 50,3 TWh produced in 2009, it is now Italy's second largest electricity generator. 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 12.500 MW. In the hydrocarbons business, Edison has an integrated presence in the natural gas chain, from production to importation, distribution and selling, with sales of 13.2 billion cubic meters in 2009.

In 2009 the new LNG terminal in Rovigo started to contribute to the diversification of Italy's supply sources with its regasification capacity of 8 bcm of natural gas a year, equal to 10% of Italy's demand for natural gas. The start up of Galsi and ITGI pipelines will further connect Italy to Algeria and Caspian Sea, two areas rich in hydrocarbons.



## **GENERAL REMARKS**

Edison welcomes the opportunity to answer ERGEG public consultation on draft Framework Guidelines on Capacity Allocation and Congestion Management for Electricity (CACM). The framework guidelines and the related Impact Assessment document contribute to give a clear picture of the policy options analyzed by ERGEG in the assessment of the Target Model presented in the December 2009 Florence Forum by the Project Coordination Group (PCG). Moreover, we think that ERGEG's analysis includes the significant issues related to capacity allocation and congestion management for electricity, by addressing the relevant timeframes (intraday, day-ahead and forward), the capacity calculation methods and the definition of zones.

We agree with ERGEG that the future CACM framework should be aimed to the maximization of cross-border trade value in order to achieve an optimal use of generation capacity and a consequent reduction of costs related to redispatching and countertrade actions carried out by TSOs. To this end, an effective harmonization and coordination of efficient capacity allocation and congestion management regimes across European borders surely helps to streamline the use of cross border transmission network capacity.

In our opinion, the process started by these framework guidelines and the subsequent network code will actively contribute to the achievement of the objectives of market integration, security of supply and integration of renewable generation. Therefore, it is of paramount importance that capacity allocation and congestion management regimes provide proper and reliable price signals capable of triggering adequate investments to relieve internal and cross-border congestions. For this reason, we strongly support the marginal pricing principle as the right pricing mechanism for electricity in the day-ahead market, since it enables market prices to provide clear and transparent signals on congestion costs, if any, among different zones.

Even if out of the scope of these guidelines, we wish to highlight that the optimal use of cross-border transmission capacity should be coupled with an adequate integration of electricity balancing markets. In our opinion a more efficient management of ancillary services, including cross-border exchanges, could effectively contribute to reduce balancing costs towards a maximization of the social welfare for European customers and society.

The full implementation of these guidelines and the subsequent network codes in all European countries is much needed in order to achieve the effective integration of the



European internal electricity market. Nevertheless, a better definition of the implementation process with clear interim steps for different markets seems to be the best way to guarantee a smooth process towards the final target of the integration of the internal market for electricity by 2015. Switzerland should also be fully involved in the process triggered by these Guidelines, given its central position at the crossroad of the interconnected European network

## **ANSWERS TO THE QUESTIONS**

### **GENERAL ISSUES**

#### **1. Are there any additional issues and / or objectives that should be addressed in the Capacity Allocation and Congestion Management IIA and FG?**

Edison believes that some significant issues are not properly addressed by these draft framework guidelines:

- Timescale and interim steps: further detail on implementation processes with clearly defined interim steps especially for intraday market
- Internal congestion management: reference to regulatory supervision on TSOs obligation concerning internal congestion management
- Capacity calculation: implementation of the flow based approach only if clear benefits, associated costs and operational issues are carefully evaluated and regulatory supervision on the coordinated ATC approach.
- Forward markets: auction rules harmonization and creation of auction platforms, development of common nomination platforms, regulatory supervision on capacity calculation



**2. Is the vision of the enduring EU-wide target model transparently established in the IIA and FG and well suited to address all the issues and objectives of the CACM?**

The definition of the enduring EU-wide target model established in these guidelines is sufficiently clear. Nonetheless, we think that a roadmap should be set out in more detail in order to guarantee an effective EU-wide implementation of the target model with interim steps explicitly factored in. This would allow less advanced market to participate to the process led by regions with higher market standards.

**3. Should any of the timeframes (forward, day-ahead, intraday) be addressed in more detail?**

As far as the intraday market is concerned, we believe that the identification of continuous implicit trading as target model should be more explicitly combined with the provision of alternative interim solutions (e.g. implicit auction) for regions where continuous trade is not immediately applicable.

The forward market timeframe would require more details as regards harmonization of rules, the development of common auction and nomination platforms, secondary markets and available capacity maximization.

**4. In general, is the definition of interim steps in the framework guideline appropriate?**

As already highlighted, interim steps and implementation timescale for the target model should be further defined in order to start a smooth process towards the EU-wide final achievement of the target solutions. This is particularly important for intraday market, as we further stress in the answer to questions n. 17- 18.

**5. Is the characterization of force majeure sufficient? Should there be separate definitions for DC and AC interconnectors?**

Edison supports a harmonized European definition of force majeure as a mean to increase transparency in the management of cross border flows.



**6. Do you agree with the definition of firmness for explicit and implicitly allocated capacity as set out in the framework guideline? How prescriptive should the framework guideline be with regard to the firmness of capacity?**

We believe that firmness should be guaranteed for the day-ahead market in order to build sufficient confidence on cross-border trade.

As regards forward market, an adequate level of firmness, at least financial, should be in any case ensured. However, utmost care should be taken in the extension of the capacity firmness beyond day-ahead timeframe in order not to incentivize TSOs to reduce the overall capacity made available to the forward market to hedge the risk connected to capacity firmness provisions.

**7. Which costs and benefits do you see from introducing the proposed framework for Capacity Allocation and Congestion Management? Please provide qualitative and if applicable also quantitative evidence.**

The implementation of these framework guidelines and the related network code can bring valuable benefits to the European internal electricity market:

- Optimal management of flows and generation capacity
- Harmonization of rules and simplification of market procedures
- Higher market liquidity
- Increased market competition across European countries
- Further incentives to the development of cross border interconnections

The costs associated to the implementation of these guidelines are now difficult to assess and therefore they should be further investigated at ERGEG level.



## SECTION 1.1: CAPACITY CALCULATION

### **8. Is flow based allocation, as set out in the framework guideline, the appropriate target model? How should less meshed systems be accommodated?**

In Edison view, flow based capacity allocation seems to lead to a more efficient calculation of transmission capacity than the ATC method, since it contributes to consistently reduce TSO's arbitrary assumptions on available capacity through an ex-post capacity calculation based on actual bids and offers. Moreover, this mechanism takes into account the relevant physical properties of highly meshed transmission networks, thus optimizing the allocation of flows across borders with relevant mutual influence. Hence, clear benefits can be achieved in terms of a more transparent and market based allocation of transmission capacity. That is the reason why this method has been chosen, for instance in the development of the Central Allocation Office (CAO) in the CEE region with alleged positive results in terms of social welfare.

Nevertheless, we acknowledge that the flow based capacity calculation method would consistently increase the level of complexity of the system. For instance, its application would require stronger coordination efforts among TSOs, especially in designing a common grid model at a European level, whereas market players could run into difficulties in the calculation of flow patterns for trading purposes. Furthermore, this system risks to reduce the transparency of information on cross-border congestions, as no ATC is computed ex-ante and cross-border transits are limited by maximum available flows on critical tie lines, not always easy to attribute to a specific border.

Thus, the application of the flow based allocation method should be carefully assessed after a thorough cost-benefit analysis aimed at testing the actual value added to the transmission system. In the meanwhile the coordinated ATC method for capacity calculation can be considered a valuable solution for less developed markets with a lower level of interconnections, at least as an interim step. However, NRAs' supervision is fundamental in order to ensure the transparency and the non-discrimination of assumptions made by TSOs in order for coordination to be aimed at increasing available capacity rather than security margins.



**9. Is it appropriate to use an ATC approach for DC connected systems, islands and less meshed areas?**

As far as DC interconnections are concerned, we wish to highlight that the technical nominal capacity should be the only reference for capacity allocation purposes.

As previously mentioned, we think that a coordinated ATC approach for capacity calculation with an adequate regulatory supervision can suit the needs of less meshed areas. Yet, when market areas, such as islands, are poorly interconnected (e.g. through one single line) with other zones, further security margins could be factored in when calculating available capacity, with a careful attention to the dynamic response of the network.

**10. Is it necessary to describe in more details how to deal with flow-based and ATC approach within one control area (e.g. if TSO has flow-based capacity calculation towards some neighboring TSOs and ATC based to the others)?**

Edison thinks that coordination of different capacity calculation approaches within one single control area should be properly addressed by TSOs at both European network code and national level, given the highly technical nature of the issue. Nevertheless, an appropriate level of transparency on these methodologies should be ensured in order for market players to be able to assess price formation mechanisms on electricity markets.

**11. Is it important to re-calculate available capacity intraday? If so, on what basis should intraday capacity be recalculated?**

Edison believes that the development of a well functioning intra-day cross border electricity market would make a fundamental contribution to the overall liquidity of the internal electricity market, also facilitating the penetration of intermittent generation from renewable energy sources.

Thus, TSOs should recalculate capacity also intraday in order for market participants to have sufficient information on interconnection capacity available for their intraday flows management needs. For instance, intraday capacity could be recalculated after the notification of the day ahead market results and, in case of an intraday implicit auction



mechanism (see answer to questions n. 17-18), available capacity should be notified after the gate closure of each market session.

Moreover, when flow based capacity calculation is applied, information on critical tie lines shall be duly updated instead of ATC values.

## **SECTION 1.2: ZONE DELINEATION**

**12. Is the target model of defining bidding zones on the basis of network topology appropriate to meet the objectives?**

**13. What further criteria are important in determining the delineation of zones, beyond those elaborated in the IIA and FG?**

Edison shares ERGEG's view on the opportunity to define bidding zones on the basis of network topology, as a mean to detect internal structural congestions and to reduce the redispatching costs borne by the system. We also wish to highlight that, on the basis of the Italian experience, the presence of different bidding zones within a country doesn't prevent both the definition of a single price zone at a national level and the creation of different balancing areas overlapping bidding zones. In our opinion, this possibility could surely increase the political acceptability of this kind of solution.

In any case, once taken in due consideration the structural limits of the network, zones should be delineated as widely as possible, in order to avoid an excessive fragmentation which could be detrimental to network management and market liquidity. Furthermore, the decision of defining smaller bidding zones should be backed by a solid cost-benefit analysis including congestion and redispatching costs, combined with an accurate consultation of market stakeholders.

## **SECTION 2: FORWARD MARKETS**

**14. Are the preferred long-term capacity products as defined in the framework guideline suitable and feasible for the forward market timeframe?**

The long-term capacity products identified in the framework guidelines properly address the main objectives inherent in the implementation of the forward market timeframe.





Long term allocation of capacity rights is of paramount importance for hedging purposes since it reduces the risks associated with congestion costs in day-ahead markets.

Therefore, the introduction of PTR with UIOSI and the development of secondary markets for capacity go in the right direction towards a balance between transmission capacity allocated long-term and an appropriate level of capacity released for day-ahead and intraday electricity exchanges. To this end, the development of well-functioning secondary market platforms seems to be a primary condition.

In our opinion, also FTR, designed as options, can be a viable solution especially where day-ahead markets are coupled.

**15. Is there a need to describe in more detail the elaborated options for the organization of the long-term capacity allocation and congestion management?**

Edison believes that the following issues should be addressed by the framework guidelines as regards long-term capacity allocation and congestion management:

- Auction rules harmonization across European borders through the creation of common auction platforms, e.g. CASC-CWE
- Regulatory supervision on the maximization of cross-border capacity allocated long-term by TSOs
- Development of common nomination platforms which allow bundling capacity nominations in import and export on each cross-border interconnection.

**SECTION 3: DAY AHEAD ALLOCATION**

**16. Are there any further issues to be addressed in relation to the target model and the elaborated approach for the day-ahead allocation?**

We fully agree with the target model proposed in these framework guidelines for the day-ahead timeframe, i.e. the single price coupling implicit auction. Given the different level of market development across European countries we support a gradual



implementation of this target model starting from the most advanced regions where the physical characteristics of the system and the market structure allow a faster implementation of market coupling (e.g. the CWE region).

We agree with ERGEG when claiming that a market coupling mechanism can be implemented regardless of the existence of individual power exchanges for each European market. Nevertheless, a process of market splitting implemented at regional level (e.g. through the merger of regional PXs), such as in the Nordic market, could help to increase the overall efficiency of the system.

#### **SECTION 4: INTRADAY ALLOCATION**

**17. Are there any further issues to be addressed in relation to the target model and the elaborated approach for the intraday allocation?**

**18. Does the intraday target model provide sufficient trading flexibility close to real time to accommodate intermittent generation?**

Edison considers the development of an intraday cross-border electricity market as a further opportunity to strengthen market players' ability to balance their positions closer to real time, while facilitating the integration of intermittent generation. Therefore, we acknowledge that continuous implicit trading can guarantee the maximum flexibility close to real time and we understand why this method has been rightly chosen as a target model for European cross-border intraday electricity trade.

Nevertheless, we wish to highlight that up to now cross-border intraday electricity exchanges are not evenly developed across European borders. Hence, the immediate implementation of a continuous implicit trading on all European borders seems to be an objective too ambitious, given the peculiarities of less advanced markets. Instead, the definition of interim targets appears to be a more feasible solution.

For instance, Italian market features less meshed transmission networks with lower available capacity compared to other European markets. Therefore, the implementation of continuous implicit trading for cross-border intraday market risks to lead to internal congestions whose costs would fall on network users. For this reason, we propose the initial implementation of an intraday implicit auction system with at least three gate



closures per day which can enable market players to participate to intraday cross border trade. The system should then be developed in order to allow intraday cross-border exchanges closer to real time through an increase in the number of gate closures.

Edison also wishes to stress that the definition of interim steps should be effectively coordinated at European level in order to guarantee the interoperability of different system and the smooth development towards the final target model.