

**Sorgenia S.p.A.**

**Consultation Paper  
of the European Commission  
on generation adequacy, capacity mechanisms  
and the internal market in electricity (11/15/2012)**

Milan, February 7<sup>th</sup>, 2013



The present paper formulates Sorgenia's comments regarding the *Consultation Paper of the European Commission on generation adequacy, capacity mechanisms and the internal market in electricity*.

Sorgenia welcomes the EC consultation on generation adequacy and capacity remuneration mechanisms as these subjects are becoming high priority in MS's energy policies.

European's Member States are facing adequacy challenges as a consequence of some market distortions due to regulatory and operational barriers which prevent the market delivering the necessary price signals to ensure the appropriate generation mix.

Sorgenia recognize the importance and the benefits of a progressive transition towards a low-carbon economy. In particular we welcome the development of the renewable energy sources as fundamental resources in an adequate energy mix. However, it should be stressed the importance of integrating the RES in the system in a smooth and secure way. The creation of highly remunerative incentive scheme (in Italy the most remunerative ones) has triggered a turbulent increase of renewable sources which has determined an imbalance between technologies (on the one side the economically supported RES and on the other side the unsupported conventional technologies) which generated the erosion of spaces for competition on energy markets and problems in terms of secure and adequate management of the grid. In this context, the most flexible thermoelectric resources become the necessary complementary resources in order to compensate sudden swings in generation due to intermittent RES. However, the fundamental traditional flexible resources, operating today in a context where the space left to the free market is reduced to about half of what it used to be, are facing a problem of "missing money". This together with high uncertainty regarding expectation on the evolution of key aspects of the market (fundamentals of the market, evolution of the Italian and European regulatory framework, future operating hours of new and existing assets, technological evolutions, future impacts of the Emission Trading Scheme) and with some remaining retail market distortions such as end-users regulated prices, undermine investment decisions and the maintenance of existing fundamental conventional generation.

The market failures previously explained justify a regulatory intervention which is urgent and must be carefully designed in order not to create unexpected distortions of the national and European energy market.

Sorgenia is convinced that an appropriate CRM should be preferably market based. However, in case of urgency, administrated mechanisms should be implemented in a way not to interfere invasively with the market. Sorgenia deems also important for a CRM to be technology neutral and ensure equal treatment of existing and new plants, take in due account interconnections, grid constraints and evolutions, be established as a stable framework and be transparent in its design and application.

At the moment in Italy is in place a form of capacity payment based on tariffs and limited to particular categories of plants and it is being developed a capacity market mechanism which, with some necessary corrections, can be a means to grant capacity adequacy. The first mentioned mechanism concern also some obsolete oil fuelled plants owned by the incumbent for which a fee is granted for the security of the gas market in case of emergency. We deem that such a fee is able to divert the competitive dynamics: in the electricity market, it reinforces the position of the incumbent and in the gas market it frustrates the necessary

investments aimed at granting the security of the system. Such a capacity payment mechanism could further reinforce these distortions.

Contrary to the mechanism just explained, Sorgenia shares the Italian Legislator's choice of introducing a market-based mechanism to sustain production capacity. However, the framework outlined by the Authority shows a level of criticality able to jeopardize the fulfilment of the objectives pursued by the national law, when it was introduced. Sorgenia, in particular, considers critical the following aspect:

- Sorgenia regards as totally unreasonable the provision concerning the return to the TSO of every revenue gained on the ancillary services market (MSD) when the market price exceeds the contract price. The current Italian system provides the definition of a unique price limit both for the day ahead market (MGP) and the ancillary services market on the basis that the contractual obligation of the operator is unique and jointly concerns both markets, but this view is totally mistaken because the obligation under the contract only consists in the supply of capacity and not - surely - in the supply of services on the ancillary services market: the participation to this market, which is made compulsory by the system, implies costs which are sensibly different from those of the mere supply of a *commodity* (electricity) on the day ahead market; therefore, it should not be subjected to the same price limit set out for the day ahead market.
- considering the right emphasis of the Commission regarding the opportunity to design the mechanism not on a specific technology in order to avoid discriminatory effects, it must be underlined that the Italian system, as described above, is based just on the less costly technology. This approach advantages the operators which manage such kind of plants (in particular, the incumbent) because they can more easily cover their costs through the mechanism;
- the proposed participation of the demand should be evaluated in comparison with similar performances to be supplied and after the renounce to other existing remuneration system for the interruptible service already in place;
- Sorgenia regards as fundamental to assure transparency and objectivity on the calculation of the target capacity to be supplied through the mechanism in order to grant adequacy of the electrical system. Market operators should be able to assess the validity of calculation and the target should be consistent with the real need, excluding any possible exercise of specific interests by the entity which calculate the target (in Italy the TSO is the entity which impose the target and select the resources to fulfil the target).