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COMMISSION OPINION

of 22.10.2020

pursuant to Article 20(5) of Regulation (EU) 2019/943 on the implementation plan of Italy

(ONLY THE ITALIAN VERSION IS AUTHENTIC)

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I. PROCEDURE

On 25 June 2020 the Commission received an implementation plan from Italy, prepared pursuant to Article 20(3) of Regulation (EU) 2019/943[1] (hereafter "Electricity Regulation"). Article 20(3) of the Electricity Regulation requires Member States with adequacy concerns to set out measures to eliminate regulatory distortions or market failures on their markets in an implementation plan.

Pursuant to Article 20(5) of the Electricity Regulation, the Commission is required to issue an opinion on whether the proposed measures and the timeline for their adoption are sufficient to eliminate the regulatory distortions or market failures.

II. DESCRIPTION OF THE IMPLEMENTATION PLAN

In its implementation plan, Italy proposes to implement the following measures:

1. General wholesale market conditions

By 2021, Italy commits to removing all formal or informal price caps/ floors in day ahead and intraday markets other than the technical limits currently applied within European single day-ahead and intraday coupling as set out in Article 41(1) and 54(1) of Regulation 2015/1222[2] (hereafter "Capacity Allocation and Congestion Management Guideline"). Italy indicated that there are also no formal or informal rules or requirements that limit generators' ability to freely price their offers in the wholesale markets. Italy also indicated that there are also no rules or provisions requiring the transmission system operator (hereafter "TSO") to release generation reserves based on market prices.

Italy mentions that day-ahead and intraday markets are based on a zonal approach whereby Italy is split in several internal bidding zones. Sale offers are settled at the hourly zonal price and buy offers are settled at the single national price computed as the average of zonal prices

[1] Regulation (EU) 2019/943 of the European Parliament and of the Council of 5 June 2019 on the internal market for electricity, 14.6.2019, OJ, L 158, p. 54

[2] Commission Regulation (EU) 2015/1222 of 24 July 2015 establishing a guideline on capacity allocation and congestion management

weighted according to consumption in each zone. Italy indicates that its intraday market is organised in seven sessions where bid/offers are selected under the same criterion as for the day-ahead market; contrary to the day-ahead market, accepted purchase bids are valued at the zonal price instead of the single national price. Italy explains that it is considering removing the single national price mechanism in order to expose consumers to zonal prices providing better price signals to demand.

Italy indicates that it participates in the single day ahead coupling with the day-ahead market coupled with Slovenia, France and Austria, according to the requirements set by the Capacity Allocation and Congestion Management Guideline. Italy also brings forward that it has started the implementation of further local projects, carrying out the preparatory activities for the expansion of the coupling mechanism on the border with Greece, with operating go-live currently scheduled for end 2020.

Italy also mentions that it participates in the single intraday coupling project, for which the go-live of implementation in Italy is scheduled in 2021. Italy indicates that it is also working on the implementation of complementary regional intraday auctions in relation to the Greek-Italy and Slovenia-Italy borders.

2. Balancing markets

Italy mentions that it operates a balancing market based on a central dispatch model. The TSO procures the necessary resources for managing and operating the power system. All dispatchable generation units with a minimum power and with the needed technical requirements are obliged to participate.

Italy indicates that it has joined the implementation projects under Regulation 2017/2195[3] (hereafter 'Electricity Balancing Guideline'). The implementation timelines for these projects are the following:

(a) a European platform for the exchange of balancing energy from frequency restoration reserves with automatic activation, by 2022

(b) a European platform for the exchange of balancing energy from frequency restoration reserves with manual activation, by 2022

(c) a European platform for the exchange of balancing energy from replacement reserves, by end 2020

Italy indicates that it has implemented an administrative mechanism to apply a price equal to the Value of Lost Load, which is currently set at 3,000 €/MWh to imbalances when distributed load-shedding is applied.

3. Demand side response

[3] Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing

Italy explains that demand response can participate in wholesale markets both individually and via aggregators. Italy brings forward that it has launched several initiatives since 2017 to open the balancing market to new kinds of participants and resources, such as demand response and storage.

Italy brings forward that it has carried out a full roll-out of smart meters (first generation smart meters) to all customers including household customers (currently 98% coverage of customers, including 20-40% provided with second generation smart meters). Italy is also committed to implementing a second generation of smart meters based on new specific functionalities by 2024. Second generation smart meters will allow data reading based on quarterly hours for all customers (compared to first generation smart meters which limited this option only to business customers with contractual power above 55kW).

Italy mentions that suppliers in the retail market currently offer contracts with flat rates. Italy brings forward that since 2017 it has introduced the obligation on retail suppliers to provide at least one commercial offer lined to wholesale spot market prices in addition to flat rates. The roll out of second generation smart meters could allow suppliers to implement new commercial offers based on dynamic prices contracts.

4. Retail markets: regulated prices

Italy indicates that households and small enterprises (with less than 50 employees and less than 10 million euro revenue) connected at low voltage level who do not choose a supplier in the free market are supplied by default suppliers which provides electricity according to a 'standard offer'. . The reference prices for the standard offer are updated quarterly by the national regulatory authority on the basis of the procurement costs borne by the single buyer "Adquirente unico" to source electricity in the spot market. Italy mentions that volumes supplied under this scheme represent 18% of total demand (of which 65% was purchased by domestic customers). Italy commits to phasing out the 'standard offer' as of 1 January 2021 for small enterprises and as of 1 January 2022 for microenterprises and household consumers. This phase-out also entails the discontinuation of the role of "Adquirente unico" as a single buyer.

In addition, Italy mentions that customers who cannot find a supplier in the free market and are not entitled to the standard offer regime, are supplied by a supplier of last resort which is selected through an open auction that establishes also the price at which the customers are supplied. Italy mentions that volumes supplied under this scheme represent 1,7% of total demand.

Italy brings forward that there has been significant switching of regulated customers to alternative suppliers over the last years. In addition it mentions that it has already implemented an independent price comparison tool which helps detecting the most competitive offers available in the market.

5. Interconnection

Italy indicates it has strong interconnections to the countries neighbouring its northern borders - France, Switzerland, Austria and Slovenia (total of 6 300 MW and 8 400 MW in imports and between 3 000 MW and 3 900 MW in exports in 2020). There are also direct current connections with Greece (500 MW) and Montenegro (600 MW).

Italy brings forward that it is committed to increasing the level of cross-border interconnection capacity with approx. 7 GW of additional cross-border by 2030, hereby contributing to the EU interconnection targets. Italy also mentions its planned cross-zonal network developments in order to increase transmission capacity and reduce congestion between its internal bidding zones.

III. COMMENTS

On the basis of the present notification the Commission has the following comments on the implementation plan.

1. Wholesale markets

The Commission welcomes the commitment of Italy to remove all formal or informal price caps/ floors in day ahead and intraday markets other than the technical limits currently applied within European single day-ahead and intraday coupling as set out in Article 41(1) and 54(1) of the Capacity Allocation and Congestion Management Guideline.

The Commission welcomes that Italy plans to remove the single national price mechanism in order to expose consumers to zonal prices providing better price signals to demand. The Commission invites Italy to introduce these adaptations by 1 January 2022. Alternatively, Italy should set out another target date in its final plan including explaining its reasons why the chosen target date would be more appropriate.

The Commission also welcomes that Italy has joined the single intraday coupling project, for which the go-live of implementation in Italy is scheduled in 2021.

2. Balancing markets

The Commission welcomes the commitment of Italy, together with other Member States in the Core region, to participate in the European platform for the exchange of balancing energy from frequency restoration reserves with manual activation, the European platform for the exchange of balancing energy from frequency restoration reserves with automatic activation, and the European platform for imbalance netting according to Articles 20, 21 and 22 of the Electricity Balancing Guideline, as well as existing initiatives for joint procurement of frequency containment reserve resources.

With regards to the settlement of imbalances it appears that Italy applies a different mechanism depending whether the units participate in the ancillary services market or not[4]. The Italian implementation plan does not provide reasons for treating units differently when settling imbalances. The Commission considers that applying different rules for different groups of participants can result in suboptimal outcomes on the balancing market. Therefore, the Commission invites Italy to review its system of multiple imbalance settlement mechanisms and consider introducing a mechanism which applies a single imbalance price for all groups of balancing market participants as from 1 January 2022. Alternatively, Italy should set out another target date in its final plan including explaining its reasons why the chosen target date would be more appropriate.

[4] While a so called ‘dual imbalance price’ is applied to units participating in the Ancillary Services Market a’ single imbalance price’ is charged to units not participating in the Ancillary Services Market

In addition, it appears that for units not participating in the ancillary services market the imbalance energy is settled against a volume-weighted price of the activated balancing energy bids. This is in contrast with the settlement approach used for units participating in the ancillary services market where imbalance energy is settled against at the marginal price of the activated balancing energy bids. The Commission considers that applying different rules for different groups of participants can result in suboptimal outcomes on the balancing market. Therefore, the Commission invites Italy to review its system of multiple imbalance pricing rules and consider introducing a mechanism which charges the marginal price of the activated energy bids to all groups of balancing market participants as from 1 January 2022. Alternatively, Italy should set out another target date in its final plan including explaining its reasons why the chosen target date would be more appropriate.

With a view to an appropriate pricing of scarcities on the electricity market, Article 20(3)(c) of the Electricity Regulation requires Member States to consider the implementation of a shortage pricing function. In its implementation plan Italy points out that it has in place an 'administrative shortage imbalance price'. This mechanism sets the imbalance price equal to the Value of Lost Load when distributed load-shedding is applied. It appears, however, that the Italian imbalance pricing mechanism does not apply any function, which would increase the imbalance prices according to the severity of the scarcity of reserves in the system. The Commission considers that the scarcity pricing function should be triggered by the scarcity of reserves in the system and it should be calibrated to increase balancing energy prices up to the Value of Lost Load when the system runs out of reserves.

Effective scarcity pricing encourages market participants to react to market signals and to be available when the market most needs them. It also ensures that market participants recover their full costs in the wholesale market. Therefore, in the Commission's view, it is important that the scarcity pricing mechanism is well designed. In this sense, it should not only provide incentives for short term flexibility but also send appropriate signals for investments to maintain system adequacy. In this context, the Commission invites Italy to consider whether the price adder which the referred function creates in times of scarcity should not only apply to balance responsible parties but also to balance service providers which provide balancing energy to the TSO. The Commission invites Italy to consider introducing these adaptations by 1 January 2022.

With regards to the level of the Value of Lost Load, the Commission notes that it is lower than both the technical price limit of 9,999 €/MWh as applied in the EU's intra-day market, and the level of Value of Lost Load calculated for a number of other EU Member States as referred in a recent study prepared for ACER[5]. Applying a relatively low Value of Lost Load to settle shortages encourages market participants to rely on the TSO's balancing resources instead of seeking to establish a balanced position on wholesale markets (day ahead or intra-

5 https://www.acer.europa.eu/en/Electricity/Infrastructure_and_network%20development/Infrastructure/Documents/CEPA%20study%20on%20the%20Value%20of%20Lost%20Load%20in%20the%20electricity%20supply.pdf

day). This in turn creates 'missing money' on wholesale markets and results in generators not being able to recover their full costs. The Commission therefore invites Italy to review the level of its Value of Lost Load in line with the methodology as referred in Article 23(6) of the Electricity Regulation and to set its value at least above the intra-day technical price limit, as soon as the referred methodology becomes available[6] and no later than 1 January 2021.

3. Demand side response

The Commission welcomes that demand response is allowed to participate in a number of markets, including via aggregators. The Commission also understands that in the balancing market currently demand can only participate in the context of pilot projects. The Commission recommends that Italy opens up the balancing market to demand response by way of adapting its established regulatory framework for balancing.

In addition, it appears that currently demand side aggregators can only access customers' flexibility with the consent of the existing supplier. The Commission would like to recall that with 1 January 2021 Article 13(2) of Directive (EU) 2019/944[7] on common rules for the internal market for electricity requires that aggregators should be able to contract with customers without the consent of the existing supplier. The Commission therefore invites Italy to prepare adjusting its domestic rules for the timely compliance with this requirement.

4. Retail markets: regulated prices

The Commission welcomes Italy's commitment to phase out the 'standard offer' as of 1 January 2021 for small enterprises and as of 1 January 2022 for microenterprises and household consumers.

The Commission also welcomes that Italy has implemented an independent price comparison tool which helps detecting the most competitive offers available in the market. The Commission is of the view that Italy should take further measures to ensure effective competition in the retail market (e.g. an information campaign).

5. Interconnection

The Commission welcomes Italy's commitment to build a number of lines and other developments (e.g. voltage upgrade of circuits) to strengthen the domestic network and address existing constraints between regions. However, the Plan does not include any information about the consideration of operational measures to increase network capacity, such as dynamic line rating. More attention should be given to solutions beyond building

[6] The methodology for setting the Value of Lost Load is currently being reviewed by ACER.

[7] Directive (EU) 2019/944 of the European Parliament and of the Council of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU

networks to achieve the goal of increasing domestic network capacity in a more cost efficient way.

6. Capacity mechanism

The Commission invites Italy to make sure that the design of its capacity mechanism complies with the requirements of the Electricity Regulation and adapt its mechanism, where necessary, as required by Article 22(5) of the regulation. The measure shall also comply with Article 107 of the Treaty on the Functioning of the European Union.

7. Other recommendations

The Commission recommends that Italy together with the other Member States in the Core region strive for establishing a regional coordination centre in accordance with Article 34 to 47 of the Electricity Regulation. The regional coordination centre should be operational by July 2022. Regional coordination centres support the increasingly integrated operation of electricity systems across the EU, thereby ensuring their efficient and secure performance.

IV. CONCLUSION

Pursuant to Article 20.5 of the Electricity Regulation, the Commission invites Italy to amend its implementation plan to take utmost account of the above comments of the Commission. Italy is invited to publish its amended plan within three months and inform the Commission.

Pursuant to Article 20.6 of the Electricity Regulation, Italy shall monitor the application of their implementation plan and shall publish the results of the monitoring in an annual report and submit that report to the Commission. In this report, Italy is invited to explain whether and to what extent the market reforms have been implemented according to the planned timeline, and if not explain the reasons why.

The Commission's position on this particular notification is without prejudice to any position it may take on the compatibility of any national implementing measure with EU law.

The Commission will publish this document on its website. The Commission does not consider the information contained therein to be confidential. Italy is invited to inform the Commission within ten working days following receipt whether and why they consider that, in accordance with EU and national rules on business confidentiality, this document contains confidential information which they wish to have deleted prior to such publication.

Done at Brussels, 22.10.2020

For the Commission
Ms Kadri Simson
Member of the Commission