

Consultation Document 02/2012

GME'S CONSULTATION ABOUT PROPOSED CHANGES TO PAYMENT TIME LIMITS IN THE ELECTRICITY MARKET

1. Introduction

The European Union is completing the definition of its market model (Target Model), which is aimed at creating a really integrated internal energy market.

The process, which has been going on for various years, began with the approval of the Third Energy Package by the European Parliament and the Council. Among the main legislative/regulatory measures concerning the electricity sector, it is worth mentioning Directive 2009/73/EC (approved on 13 Jul. 2009) and Regulation (EC) No 713/2009, which set forth, among others, the requirements that Member States must meet in order to ensure access to the power grid and to cross-border trade within the EU.

Moreover, to coordinate the activities associated with the above process, the Third Energy Package formally established two new EU-wide institutions: the Agency for the Cooperation of Energy Regulators (ACER) and the ENTSO-E (European Network of Transmission System Operators).

The process continued with ACER's publication of "Framework Guidelines on Capacity Allocation and Congestion Management" on 29 Jul. 2011. The document gave guidance to ENTSO-E for the drafting of the corresponding Network Code, i.e. the technical document at EU level which lays down the operational procedures that all European network operators are held to follow in the allocation of cross-border capacity in the different timeframes and in cross-border congestion management. In particular ACER's Framework Guidelines identify the Price Coupling mechanism as the reference Target Model to be applied to the implicit allocation of interconnection capacity available in the Day-Ahead Market timeframe.

Also the conclusions of the 21st Florence Forum (22-23 May 2012), chaired by the EU DG-Tren, confirmed that the Target Model should be operationally implemented across all European borders by 2014.

Therefore, to meet the above deadline, GME is actively contributing to the process of creation and implementation of Europe's internal energy market, both directly within Europex (European Association of Energy Exchanges) and through relations with its partners in the PCR¹ project. The latter project has, among others, the purpose of establishing cooperation relations among European PXs, with a view to adopting a single market algorithm for the resolution of European wholesale markets, in accordance with the general principles of Price Coupling and taking into account the various forms of governance existing in each Member State.

Nevertheless, implementing market coupling across all Italian borders (whatever the algorithmic solutions and the information flows identified within the PCR) requires harmonising (or ensuring the compatibility) of some distinctive features of the Italian market with the design of the other European markets.

A preliminary analysis of the current design of the Italian market with respect to the one of the other European markets shows that payment time limits are among the key aspects to be harmonised.

¹ The PCR (Price Coupling of Regions) is the project of creation of a European market coupling mechanism. The PCR was established by the following power exchanges: GME, OMIE, APX-ENDEX, BELPEX, EPEX and NordPool.

The payment time limits adopted in the Italian market (15th working day of the second month following the closing of the market session - hereafter abbreviated m+2) are different from those of the most part of foreign markets (2nd working day following the closing of the market session - hereafter abbreviated d+2). Failing other measures, this difference requires the Italian market and the shipping agent² to procure financial liquidity in order to cover the payment of the value of imported energy (paid in the Italian market within the m+2 time limit) to foreign markets within the d+2 time limit.

At present, within the project of market coupling between Italy and Slovenia (the only one which is now operational on Italian borders), the role of the shipping agent is played provisionally (until the end of 2012³) by TSOs. The latter advance the liquidity which is necessary to make the different payment time limits of the Italian market (m+2) and of the Slovenian one (d+2) compatible with each other.

However, this solution (imposing costs on shipping agents) is not sustainable in the medium-long term, when (based on EU's indications) the market coupling mechanism is planned to be extended to other Italian borders. At that time, the liquidity that the Italian shipping agent will need to settle payments - in respect of imports resulting from market coupling - with foreign countries will be significantly higher⁴, given the present payment time limits applicable in the Italian market.

Consequently, GME has identified three possible solutions (alternative between them) for managing payments in the market, to be submitted for consultation to interested parties and to be implemented from 2013.

The following paragraphs describe the details of the three solutions covered by the consultation. All the proposed solutions apply to both the Day-Ahead Market (MGP) and the Intra-Day Market (MI).

Interested parties are invited to send in their comments about the operational procedures described in the document and, in particular, their answers to questions from S.1 to S.4.

Please send your comments in writing to GME's Legal & Regulatory Office ("Unità Legale e Regolazione") by 23 July 2012 at the latest (end date of the consultation) in one of the following ways:

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If you want us to keep all or part of your comments confidential, please specify which parts of your document are to be kept confidential.

² In this document, "shipping agent" means the party who/which, in a market coupling context and with reference to a national market, acts as commercial counterpart of other markets, with a view to settling payments in respect of energy imported and exported as a result of market coupling.

³ As per AEEG's Decision 217/2012/R/eel of 24 May 2012.

⁴ Assuming that the coupling is extended to the entire northern border and that Italy remains a chiefly importing country, at current prices and volumes, the Italian shipping agent should procure about € 700 million of liquidity in order to honour payments to foreign markets within the d+2 time limit.

2. Solution A: Payments within the d+2 time limit

Under the first option for harmonising payments in the Italian market with those in foreign markets, payments in the Italian market take place daily within the d+2⁵ time limit (d is the day on which the market session ends); it follows that payments for the MGP taking place on 1 January, in respect of energy to be generated and consumed on 2 January, will be financially settled on 3 January.

Under this solution, the payment time limits of the Italian market will be perfectly aligned with those of the other European exchanges, actually eliminating all temporal asymmetries. Moreover, the Italian shipping agent will have no financial exposure towards foreign markets, because payments in the Italian market will be settled with the same value date (d+2) as the one used in the other European markets, giving rise to a financially-neutral relationship.

As to the implementing procedures of this solution, changes will be made both to the process of invoicing and to the process of settlement of payments, which will thus occur on a daily basis.

Indeed, also the invoicing process will have to be completed on a daily basis, i.e. before payments in the market are made. It may thus be assumed that, within d+1 or at the latest by the end of the morning of d+2, GME will complete its cycle of issuing invoices and invoice notifications and of computing the balance to be settled for the market participants involved. It follows that the invoicing cycle for the MGP taking place on 1 January, in respect of energy to be generated and consumed on 2 January, will occur on 2 January.

Such a short timeframe for invoicing and settlement of payments requires both GME and participants that are active in the market to make use of automated tools and procedures, based on adequate IT systems.

3. Solution B: Optional payments within the d+2 time limit

Theoretically, solution A (payments within d+2) is the most straightforward and efficient one, because it perfectly aligns the payment time limits of the Italian market with the ones of the other EU exchanges.

Nonetheless, as this solution involves significant changes to the invoicing and payment time limits, it may - at least in the short term - cause considerable administrative and financial difficulties to market participants and to GME, who/which will have to align their operational procedures and activate all the necessary tools to support the daily management of the invoicing and payment cycle.

This is why solution B is proposed as an alternative. With respect to solution A, this solution provides market participants with the option to postpone their payments to m+2 (i.e. to keep the current payment time limit).

Hence, under solution B, market participants (whether net creditors or debtors) that are unable to align their operational procedures with the d+2 payment time limits (and the related invoicing time limit, i.e. within d+1 or at the latest within the morning of d+2) may opt for keeping the m+2 payment time limit (and the current m+2 invoicing time limit). Taking into account alignment requirements with respect to

⁵ For the purposes of this document, the invoicing and payment processes take place on d+1 (or at the latest within the morning of d+2) and on d+2, respectively (or, if these days are non-working days, on the immediately following working days).

participants not opting for payment postponement, participants opting for settling their payments within m+2 will be held to pay or receive (depending on whether they are net debtors or creditors) the interest expense or income⁶ for late payment of the amount to be settled with GME within the ordinary deadline of d+2.

On the above assumption, the Italian shipping agent will be anyway held to pay for the energy imported or exported as a result of market coupling within d+2. Therefore, if the payments received by GME within d+2 are not sufficient to cover what the Italian shipping agent owes to foreign counterparts, a financing party will have to provide the necessary liquidity to the Italian shipping agent.

In operational terms, payments will be managed in accordance with the following procedure and always after the computation of the balance to be settled.

If the market coupling mechanism gives rise to a net debit (daily net balance⁷) of GME towards the Italian shipping agent, two cases may arise:

- the net debit of participants settling payments within d+2 (i.e. not opting for payment postponement) is higher than (or equal to) the net debit that GME must pay to the Italian shipping agent. In this case, after collecting payments from net debtor participants within d+2, GME will:
 - o *in primis* pay the entire net debit resulting from market coupling to the shipping agent;
 - o use the remaining amount (i.e. the difference between what GME has collected within d+2 and what GME has paid to the shipping agent within d+2) to pay net creditor participants who/which have kept the settlement of payments within d+2⁸. As a result, on the latter deadline, net creditor participants keeping the settlement of payment within d+2 will receive⁹ a *pro quota* value equal to the minimum between their net credit and the product between:
 - their net credit;
 - the ratio of the net debit of participants opting for the settlement of payments within d+2, decreased by the net amount that GME has paid to the Italian shipping agent in respect of market-coupling transactions, to the overall net credit of participants opting for the settlement of payments within d+2¹⁰.
- The net debit of participants paying within d+2 is lower than the net debit that GME must pay to the Italian shipping agent. In this case, in order to cover the deficit, the Italian shipping agent will rely on an external financing party, who/which will pay the difference between what has been paid within d+2 by net debtor market participants and the net debit that GME must pay within d+2 to the shipping agent. In this case, GME will make no *pro quota* payment within d+2 to net creditor participants who/which have kept the settlement of payments on that deadline.

⁶ The unit amount of interest expense or income will be identical, as explained in the following paragraphs.

⁷ The net balance arising from market coupling (net debit or net credit) is the net balance of the value of imports (debit for GME) and of exports (credit for GME) that GME must settle with foreign markets on all the hours of a market day and on all the borders on which market coupling operates.

⁸ Clearly, the collection of these amounts does not depend on the net creditor participant's intent to keep the d+2 payment time limit, but rather on the existence of a possible remaining amount between what GME has collected within d+2 and what GME has paid to the shipping agent.

⁹ See note 8.

¹⁰ If the net debit settled on d+2, decreased by the net debit that GME owes to the shipping agent, is higher than or equal to the overall net credit of participants opting for the settlement of payments on d-2, these participants will receive an amount equal to their net credit within d+2. No payment will thus be made to them on the m+2 deadline.

In both of the above-described cases, on the m+2 deadline, GME will:

- collect receivables from net debtor participants that have opted for the settlement of payments on that deadline. These net debits will be increased by interest expense calculated on the period from m+2 to d+2¹¹;
- pay:
 - o to each net creditor participant that has not exercised the option and has kept the settlement of payments within d+2, the amount not yet paid on that deadline. This amount will be increased by interest income calculated on the period from m+2 to d+2¹²;
 - o to each net creditor that has opted for the settlement of payments within m+2, the overall amount of his/her/its net credit. This amount will anyway be increased by interest income calculated on the period from m+2 to d+2¹³;
 - o to the Italian shipping agent, the amount possibly advanced by the external financing party to honour payments to foreign markets on d+2. This amount will be increased by interest income calculated on the period from m+2 to d+2¹⁴.

In the opposite case, i.e. if the market coupling mechanism gives rise to a net credit¹⁵ of GME towards the foreign shipping agent:

- on the d+2 deadline, GME will:
 - o collect its net credit from the foreign shipping agent;
 - o collect the net debit of participants keeping the settlement of payments within d+2;
 - o pay to each net creditor participant keeping the settlement of payments within d+2, a *pro quota* amount equal to the minimum between his/her/its net credit and the product between:
 - his/her/its net credit;
 - the ratio of the net debit of participants keeping the settlement of payments within d+2, increased by the net amount received from the foreign shipping agent, to the overall net credit of participants keeping the settlement of payments within d+2¹⁶.
- Then, on the m+2 deadline, GME will:
 - o collect receivables from net debtor participants opting for the settlement of payments on that deadline. These net debits will be increased by interest expense calculated on the period from m+2 to d+2¹⁷;

¹¹ Depending on the yearly calendar, this period may range from 50 to 80 days, i.e. with an average delay in the settlement of due amounts equal to approximately 70 days.

¹² See previous note.

¹³ See note 11.

¹⁴ See note 11.

¹⁵ For the definition of "net credit", see previous note⁵.

¹⁶ If the net debit settled within d+2, increased by the net credit that GME has towards the shipping agent, is higher than or equal to the overall net credit of participants opting for the settlement of payments within d+2, these participants will receive an amount equal to their net credit within d+2. No payment will thus be made to them on the m+2 deadline.

¹⁷ See note 11.

- pay to:
 - each net creditor participant keeping the settlement of payments within d+2, the remaining amount not yet settled on that deadline. This amount will be increased by interest income calculated on the period from m+2 to d+2¹⁸;
 - each net creditor participant opting for the settlement of payments within m+2, the amount of his/her/its overall net credit. This amount will be increased by interest income calculated on the period from m+2 to d+2¹⁹.

This solution supposes that the interest (interest expense/income) rate applied on the amounts settled within m+2 has a single value; in particular, it should be equal to the interest rate applied by the financing party to whom/which the Italian shipping agent resorts to cover the deficit of liquidity and honour his/her/its net debit towards foreign markets.

Finally, in terms of management, this solution implies that each participant may or may not exercise the option of settling payments within m+2 not upon each payment cycle but at pre-determined (e.g. yearly) time intervals beginning in the following period (e.g. year+1). This choice will streamline operational procedures and thus ensure efficient processes of invoicing and settlement of payments.

3.1. Solution C: Payments of participants within the d+2 time limit only in respect of energy imported and exported under the market coupling mechanism

Under this solution, payments in the Italian market are proposed to be made within d+2 only for the value corresponding to the share of energy imported and exported as a result of market coupling, without introducing any postponement option and keeping payments - in respect of both energy generated and consumed in Italy and energy imported and exported as a result of the allocation and nomination of monthly Physical Transmission Rights (PTRs) - within the m+2 time limit.

In operational terms, every day, at the end of the MGP sitting, GME will determine the net balance of the value of energy imported and exported as a result of market coupling, i.e. the net balance that GME will - through the shipping agent - pay or receive to or from foreign markets within the d+2 time limit.

Under this solution, the balance - whether a net debit (import flow) or a net credit (export flow) towards the above foreign counterparts - will be proportionally allocated (with the consequent issuing of invoices and invoice notifications) among net debtor participants (import flow) or net creditor participants (export flow) in the MGP.

If the balance is a net debit towards foreign markets:

- within d+2, GME will:
 - receive - on a *pro quota* basis - from each net debtor participant the payment of a value equal to the product between his/her/its net debit and the ratio of the net debit of the Italian market towards foreign markets to the total net debit of all market participants²⁰;

¹⁸ See note 11.

¹⁹ See note 11.

²⁰ Considering the market day of 1 Mar. 2012, the only transit with Slovenia resulting from market coupling and valued at the price of the northern zone was equal to 4.5% of the total net debit of all market participants. If solution C had

- pay to the Italian shipping agent the net debit towards foreign markets;
- within m+2, GME will:
 - receive from each net debtor participant the payment of the difference between his/her/its net debit and the *pro quota* amount already settled within d+2;
 - pay to each net creditor participant the total value of his/her/its net credit.

If the balance is a net credit towards foreign markets,

- within d+2, GME will:
 - pay - on a *pro quota* basis - to each net creditor participant a value equal to the product between his/her/its net credit and the ratio of the net credit of the Italian market towards foreign markets to the total net credit of all market participants;
 - receive from the Italian shipping agent the net credit towards foreign markets;
- within m+2, GME will:
 - receive from each net debtor participant the total value of his/her/its net debit;
 - pay to each net creditor participant the difference between his/her/its net credit and the *pro quota* amount (already settled and advanced to net creditor participants within d+2).

Under this solution, no interest will be applied on the values settled within m+2 and GME will have no liquidity deficit or surplus. Therefore, no resort will be made to external financing parties to cover liquidity deficits, if any.

4. Questions for consultation

- S.1 In your opinion, which are the main advantages and disadvantages of each of the proposed solutions?
- S.2 Among the proposed solutions, which one may be implemented on 1 Jan. 2013?
- S.3 If solution A may not be implemented on 1 Jan. 2013, do you think that solution B or solution C may be introduced in preparation for the subsequent adoption of solution A?
- S.4 If you have answered “yes” to question S.3, which solution - B or C - is preferable in view of a transition towards solution A and within which timeframes?

been applied, all the net debtor market participants would have paid 4.5% of their net debit within d+2 and the remaining 94.5% of their net debit within m+2.

Summary of proposed solutions

	NET DEBTORS		NET CREDITORS			
	AMOUNT PAID WITHIN D+2	AMOUNT PAID WITHIN M+2	AMOUNT RECEIVED WITHIN D+2	AMOUNT RECEIVED WITHIN M+2	INTEREST	EXTERNAL PARTY TO FINANCE GME
SOLUTION A	All the value traded in the MGP	-	All the value traded in the MGP	-	No	No
SOLUTION B	<ul style="list-style-type: none"> Debtors keeping d+2: All the value traded in the MGP Debtors opting for m+2: Zero 	<ul style="list-style-type: none"> Debtors keeping d+2: Zero Debtors opting for m+2: All the value traded in the MGP 	<ul style="list-style-type: none"> Creditors keeping d+2: Proportional to what has been paid within d+2, net of payments towards foreign markets Creditors opting for m+2: Zero 	<ul style="list-style-type: none"> Creditors keeping d+2: Balance with respect to what has been received within d+2 Creditors opting for m+2: All the value traded in the MGP 	Yes, on amounts paid or received within m+2	Yes, for variable amounts, depending on the amount paid within d+2 by net debtors
SOLUTION C	<ul style="list-style-type: none"> In case of import, payment in account proportional to the import value with respect to the total net debit in the MGP In case of export, payment in account equal to zero 	<ul style="list-style-type: none"> In case of import, balance with respect to what has been paid within d+2 In case of export, all the value traded in the MGP 	<ul style="list-style-type: none"> In case of import, payment in account equal to zero In case of export, payment in account proportional to the export value with respect to the total net credit in the MGP 	<ul style="list-style-type: none"> In case of import, all the value traded in the MGP In case of export, balance with respect to what has been received within d+2 	No	No