

## **EFET response to the Italy North TSOs' market-based methodology of cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves**



### **EFET response – 11 November 2019**

The European Federation of Energy Traders (EFET) welcomes the opportunity to provide comments on the Italy North TSOs' proposal of market-based methodology of cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves, in accordance with Article 41 of the Electricity Balancing Guideline (EB GL).

#### **General comments on capacity reservation by the TSOs for balancing purposes:**

Since the early stage of drafting of the Electricity Balancing network code, we have opposed the concept of reservation of cross-border transmission capacity by the TSOs for balancing purposes. Though by the time of the adoption of the EB GL, the concept was rebranded as "cross-zonal allocation of capacity", its effects remain the same.

The cross-border reservation of transmission capacity by the TSOs for balancing purposes poses a serious risk to the availability of cross-border transmission capacity in the preceding trading timeframes. By allocating transmission capacity specifically for use in the balancing timeframe, TSOs remove available capacity from the allocation in the other timeframes, thereby restricting market participants' ability to adjust their positions across borders in the most economically efficient manner, and to contribute to overall system balance.

The use of cross-border transmission capacity is a key element of European market integration in the forward, day-ahead and intraday timeframes. A major objective of integration projects such as the EU Harmonised Allocation Rules for forward transmission rights, as well as single day-ahead and intraday coupling are to improve the access and use of such transmission capacity by the market. Reserving capacity (from the forward timeframe until the intraday market) for use by the TSOs in the balancing timeframe would turn the clock back on those improvements.

**General comments on the so-called “market-based” method for capacity reservation by the TSOs for balancing purposes:**

First, the so-called “market-based” method for capacity reservation by the TSOs for balancing purposes is based on a tool optimising actual balancing capacity bids with forecasted day-ahead bids. The allocation process is based on the forecasted market value of cross-zonal capacity for energy bids. The comparison with the actual value of balancing capacity bids is therefore reliant on estimations made by TSOs based on values from the past and not for the delivery day under consideration. We therefore consider that the “market-based” designation chosen for this cross-zonal capacity reservation process is incorrect. While this process reduces complexity, notably in terms of the functioning of the Euphemia algorithm, compared to the co-optimisation method according to article 40 EB GL, it is based on a fundamental uncertainty as to the value of cross-zonal capacity in the day-ahead market. Changes in the bidding behaviour of market participants compared to what the TSOs have modelled or are expecting should not be underestimated. Besides, ignoring the intraday market in the cross-zonal capacity reservation process, in practice, forecloses opportunities for market participants to adjust their positions. Ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders and will lead to changes in the bidding process.

Second, the methodology for calculating the market value of cross-zonal capacity reserved for the exchange of balancing energy or sharing of reserves in the current proposal relies on the selection of “reference days” and possible “adjustment factors”. Neither of the two components is specified further. We therefore strongly doubt that the current proposal is in line with article 41.1(b) EB GL that explicitly requests a “detailed description on how to determine [...] the forecasted market value of cross-zonal capacity for the exchange of energy”. Referring to concepts of “reference days” and “adjustment factors” and postponing the definition of such elements to the BCC proposals is insufficient.

Third, in the context of the implementation of article 16 of the recast Electricity Regulation approved as part of the Clean Energy Package (Regulation (EU) 2019/943), the TSOs will need to allocate to the market a minimum of 70% transmission capacity respecting operational security limits after deduction of contingencies. As the transmission capacity reserved by the TSOs through the “market-based” allocation process would be used by the TSOs themselves for the exchange of balancing capacity or the sharing of reserves, we would welcome a clear statement by the TSOs that this capacity will not be counted within the minimum 70% threshold.

Finally, article 38.8 of the EB GL requires a regular assessment of the need to reserve capacity for balancing purposes. In line with the spirit of this article, we would have expected a thorough assessment of the need to reserve cross-zonal capacity for balancing purposes in the Italy North region. There was, however, no real discussion or presentation by the Italy North TSOs of the need, benefits and

drawbacks of cross-zonal capacity reservation for balancing purposes in general, let alone on the so-called “market-based” approach for such reservation. To date, we remain unconvinced of the necessity of such a market design feature. Contrary to the methodology on capacity reservation for balancing through co-optimisation according to article 40 EB GL, the development of the present methodology for a “market-based” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves proposal according to article 41 EB GL is not an obligatory requirement. Given the overall lack of justification for cross-zonal capacity reservation for balancing purposes, and the missing impact assessment regarding the effects of a so-called “market-based” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves in particular, **we invite Italy North TSOs to withdraw their proposal altogether.**

Should Italy North TSOs persist to issue this methodology, we invite individual Italy North TSOs and NRAs to refrain from implementing this cross-border capacity reservation process, or any of the two others foreseen by the EB GL (co-optimisation under article 40, and the so-called “economic efficiency” allocation method under article 42).

#### Comments on individual articles:

- *Recital 5.d: The MB CZCA methodology ensures that the development of the day-ahead market is not compromised in accordance with article 3(2)(e) of the EBGL. It is specified in Articles 3, 5 and 11 of this MB CZCA methodology, that not used CZA allocated to the exchange of balancing capacity or sharing of reserves shall be released for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process according to article 38(9) of the EBGL.*

We challenge the assertion of the TSOs that cross-zonal capacity reservation in general, and this methodology for a “market-based” method of cross-zonal capacity reservation, would not compromise the efficiency of the day-ahead market (article 3.2.e EB GL). By allocating transmission capacity specifically for use in the balancing timeframe, TSOs remove available capacity from the allocation in the other timeframes, thereby restricting market participants’ ability to adjust their positions across borders in the most economically efficient manner, and to contribute to overall system balance.

In addition, article 3.1.d of the EB GL also foresees that the implementation of the Guideline should facilitate “the efficient and consistent functioning of day-ahead, intraday and balancing markets”. Besides the fact that cross-zonal capacity reservation by the TSOs removes available capacity from the market – i.e. opportunities to trade and hedge across borders – it also fails to take account of the value of that capacity in the intraday timeframe. Ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders.

The TSOs have not provided evidence that the present methodology would actually not violate the principles of articles 3.1.d and 3.2.e EB GL.

This recital actually calls for TSOs to perform and publish a cost-benefit analysis (CBA) before implementing a balancing capacity cooperation (BCC). The performance of a CBA is actually foreseen in the CORE TSOs' methodology proposal on the same subject (article 3.1 of the CORE TSOs' proposal). We request the inclusion of the following requirements in the main body of the Italy North TSOs' proposal:

- the Italy North TSOs that want to establish a BCC shall share with Italy North TSOs the cost-benefit analysis of such a BCC
- the CBA shall also be distributed to Italy North NRAs and market participants
- the decision to establish a BCC shall be excluded unless the CBA is positive
- the relevant NRAs' decision to approve or not a BCC shall take account of the results of the CBA

Finally, we miss in this methodology the regular assessment to be performed by TSOs with regard to the continued necessity or not of a BCC according to article 38.8 EB GL. This provision is actually included in the CORE TSOs' draft methodology for the "economic efficiency" method of cross-zonal capacity reservation for balancing, at the article 3.9 of that methodology. We would like to see a similar provision (complemented with a precise timing for the regularity of the checks and an obligation to disclose these assessments to the relevant NRAs and market participants).

- ***Article 1.4: The implementation of the allocation of CZC applying the inverted market-based methodology is a voluntary initiative by two or more TSOs or at the request of their relevant regulatory authorities in accordance with Article 38(1) of the EBGL and Article 37 of Directive 2009/72/EC and is therefore not mandatory.***

The "inverted market-based" method for the reservation of cross-zonal capacity by TSOs for balancing purposes is not foreseen in the EB GL. We request a full assessment by the TSOs of the effects of this method, and a clarification by the NRAs, ACER and the European Commission whether this methodology is compliant with the EB GL.

- ***Article 1.8: According to Article 38(4) of the EBGL, CZC allocated for the exchange of balancing capacity or sharing of reserves shall be used exclusively for the product where it was reserved for, being aFRR, mFRR, or RR. The reliability margin calculated pursuant to CACM shall be used for operating and exchanging frequency containment reserves, except on Direct Current ('DC') interconnectors for which CZC for operating and exchanging***

*frequency containment reserves may also be allocated in accordance with Article 38(1) of the EBGL.*

We welcome the clarification that cross-zonal capacity reserved for a specific product shall not be used for other processes, and that if the capacity is not used for this process, it shall be made available again for the exchange of balancing energy in processes with shorter timeframes, in accordance with articles 38.4 and 38.9 EB GL.

This paragraph is, however, partially repeated in article 3.9 and 15.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- *Article 3.9: The CZC allocated for the exchange of balancing capacity or sharing of reserves that has not been used for the associated exchange of balancing energy, shall be released for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process pursuant to Article 38.9 of the EBGL. Released CZC may be used by all TSOs which are using respective balancing platforms exchanging balancing energy with shorter activation times or operating imbalance netting.*

We welcome the clarification that cross-zonal capacity reserved for a specific product that was not used for this process shall be made available again for the exchange of balancing energy in processes with shorter timeframes, in accordance with article 38.9 EB GL.

This paragraph is, however, a partial repetition of articles 1.8 and 15.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- *Article 3.10: In case the inverted market-based process is in place, and the allocated CZC is not needed it shall be returned for the exchange of energy in the following energy markets if any (e.g. XBID).*

We welcome the confirmation that cross-zonal capacity that is not needed in the “inverted market-based” process could be reused in the intraday timeframe.

However, we have some difficulties understanding the process and timing of when TSOs decide that cross-zonal capacity reservation is “not needed” (in the “inverted market-based” approach) or “not used” (in the standard “market-based” approach). We assume the decision about needing or not the cross-zonal capacity is actually what the optimisation tool does, i.e. that irrespective of whether this concerns the standard or inverted “market-based” approach, capacity that is not **needed** for the exchange of balancing energy or sharing of reserves (i.e. with a lower value than what it would have if used for day-ahead energy exchanges) would in any case be released to the market (day-ahead for the standard “market-based” approach, intraday for the “inverted market-based” approach). Whether the reserved cross-zonal capacity is **used** or not by the TSOs for the exchange of balancing energy or

sharing of reserves is only known after the cross-border intraday markets close, both for the standard and the inverted “market-based” approach.

We would welcome clarification from the TSOs on the points discussed above.

- **Article 4.2:** *Each balancing capacity cooperation within CCR Italy North implementing this MB CZCA proposal shall inform the relevant NRAs of the applied forecast technique to determine the forecasted market value of CZC for the exchange of energy or the forecasted market value of CZC for the exchange of balancing capacity or sharing of reserves.*
- **Article 4.3:** *Each balancing capacity cooperation within CCR Italy North implementing this MB CZCA proposal shall share the applied CZCA optimization function with all CCR Italy North TSOs for transparency purposes.*

We ask that the full methodology, including the forecast technique, is also shared with market participants and consulted upon. The forecast technique being at the heart of the MB CZCA, full transparency on the process is required.

Market participants can provide valuable input concerning issues of the market value of cross-zonal capacity and should therefore be included into the assessment of the BCC proposal, which is to be considered in the timeline of communication.

- **Article 5.1:** *The market-based allocation process pursuant to Article 41 of the EB GL consist of two CZC allocation approaches. These two differ based on the timing of the balancing capacity procurement. Either it is organized before the SDAC which is named market-based approach, or the balancing capacity procurement is performed after SDAC but before SIDC and is named the inverted market-based approach.*

The “inverted market-based” method for the reservation of cross-zonal capacity by TSOs for balancing purposes is not foreseen in the EB GL. We request a full assessment by the TSOs of the effects of this method, and a clarification by the NRAs, ACER and the European Commission whether this methodology is compliant or not with the EB GL.

- **Article 5.2:** *The market-based approach is a market-based allocation methodology to allocate CZC for the exchange of balancing capacity or sharing of reserves that is based on a comparison of the actual market value of cross zonal capacity for the exchange of balancing capacity or sharing of reserves and the forecasted market value of cross zonal capacity for the exchange of energy. The CZCA optimization is performed during the procurement of balancing capacity bids and before the SDAC.*

- **Article 5.4:** *The inverted-market based approach is a market-based allocation methodology to allocate CZC for the exchange of balancing capacity or sharing of reserves that is based on a comparison of the forecasted market value of cross zonal capacity for the exchange of balancing capacity or sharing of reserves, and the actual market value of cross zonal capacity for the exchange of energy. The CZCA optimization function is performed during the SDAC and before the procurement process of balancing capacity.*

The article enshrines that the value of capacity is only compared between the DA market and the expected value in the balancing timeframe, without taking account of the value of that capacity in the intraday timeframe. Ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions in intraday across borders. This contradicts some of the most fundamental principles in the EB GL itself:

*Recital 12 “The integration of balancing energy markets should facilitate the efficient functioning of the intraday market in order to provide the possibility for market participants to balance themselves as close as possible to real time.”*

*Article 3.2.e “When applying this Regulation, Member States, relevant regulatory authorities, and system operators shall ensure that the development of the forward, day-ahead and intraday markets is not compromised.”*

Article 39.2 EB GL explicitly requests the inclusion of the intraday timeframe into the calculation of the market value for the exchange of energy “where relevant and possible”. Presumably, the relevance is undisputable and even though it is difficult to estimate the value contribution of the intraday timeframe, an estimate of zero is just as arbitrary as any other value but certainly wrong. Furthermore, the reasoning in the Explanatory Document that the traded volumes in the intraday timeframe are small compared to SDAC is questionable, particularly given that intraday trading volumes certainly exceed volumes exchanged for balancing.

- **Article 6.2:** *The market-based allocation process to allocate CZC for the exchange of balancing capacity or sharing of reserves shall include the following steps:*

An additional requirement to article 6.2 should be formulated, stating that the calculation of the CZCA must not take longer than selecting bids without using a BCC, which should essentially be a few minutes (if not seconds). With sequential day-ahead procurement of FCR, aFRR and mFRR, market participants will be forced to prepare bids for subsequent markets in less than one hour already. Any additional delay in the publication of accepted bids will certainly result in a loss of efficiency – which otherwise should be included in the CBA.

- **Article 8.1:** *The maximum volume (upper limit) of CZC allocated for the exchange of balancing capacity or sharing of reserves with the market-based allocation process shall be limited to 10 % of the available capacity for the exchange of energy of the previous relevant calendar year between the respective bidding zones or, in case of new interconnectors, 10 % of the total installed technical capacity of those new interconnectors.*

It should be clearly stated the 10% are applied over CZCA for all of the balancing processes, not 10% for each of aFRR, mFRR and RR, possibly summing up to 30%.

- **Article 8.4:** *The volume limitation of Article 41(2) of the EBGL may not apply where the contracting is done not more than two days in advance of the provision of the balancing capacity or for bidding zone borders connected through DC interconnectors until the co- optimized allocation process is harmonized at Union level pursuant to Article 38(3) of the EBGL.*

We deplore that the Italy North TSOs include in their methodology the possibility to deviate from the 10% maximum threshold for reservation of cross-zonal capacity. De facto, this derogation will apply to any BCC using the “inverted market-based” approach, allowing the TSOs to reserve unlimited amounts of cross-zonal capacity at the expense of the market.

- **Article 8.7:** *Italy North TSOs and NRAs of each balancing capacity cooperation may commonly apply additional limits for the maximum volume of allocated CZC for the exchange of balancing capacity or sharing of reserves within their own balancing capacity cooperation.*

We would welcome a clearer wording that individual BCCs can set only a lower threshold than the maximum 10% of available cross-zonal capacity referred to in article 41.2 EB GL.

- **Article 9.2:** *The forecasted market value of CZC for the exchange of energy between bidding zones shall be based on submitted SDAC bids of selected reference day(s) with the option to include adjustment factors to improve the forecast of the market value.*
- **Article 12.2:** *The forecasted market value of CZC for the exchange of balancing capacity or sharing of reserves between bidding zones shall be based on standard upward balancing capacity bids and of standard downward balancing capacity bids of selected reference day(s) with the option to include adjustment factors to improve the forecast of the market value.*

Articles 9.2 and 12.2 mention the application of “reference days” for the assessment of the forecasted market value of CZC It is unclear how those reference days will be

selected, especially when market participants will not be part of the consultation prior to the actual application of the methodology.

Furthermore, these articles include the possibility for TSOs to use “adjustment factors” that shall be included and justified in the “methodology for the establishment of common and harmonised rules and processes for the exchange and procurement of balancing capacity according to article 33.1 EB GL”. To us, the description of adjustment factors belongs to the MB CZCA methodology and not to the one related to article 33.1 EB GL:

- The adjustment factors are inherent to the CZC allocation mechanism that is chosen rather than to the methodology defining the BCC.
- Moreover, the concept of sharing of reserves is not covered by the article 33(1)

We strongly doubt that the reference to “reference days” or “adjustment factors” without further specification is in line with Article 41.1(b) of the EBGL that explicitly requests a “detailed description on how to determine [...] the forecasted market value of cross-zonal capacity for the exchange of energy”. Referring to the concepts of “reference days” or “adjustment factors” and postponing the definition of such elements to the BCC proposals is insufficient.

- **Article 9.4:** *The TSOs shall monitor the efficiency of the forecasting methodology, including a comparison of the forecasted and actual market values of the CZC for the energy and take appropriate actions, where needed.*
- **Article 12.3:** *The TSOs shall monitor the efficiency of the forecasting methodology, including a comparison of the forecasted and actual market values of the CZC for the balancing capacity or sharing of reserves and take appropriate actions, where needed.*

TSOs should publish the forecasted market values on a continuous basis (with as little of a delay as possible) and not only the efficiency of the forecasted market values as currently set out in articles 17.7 and 17.8

- **Article 12.4:** *In addition, the TSOs of the balancing capacity cooperation may decide to take into account the expected value of CZC allocated for the exchange of balancing capacity or sharing of reserves regarding the cross-border activation of balancing energy. If TSOs decide to use this option, they shall do so in a transparent way and regularly monitor its efficiency.*

We would welcome a clarification by the TSOs of what exactly is intended in this additional derogation. How do they differentiate “forecasted” from “expected” value of CZC. We reiterate our comment that article 41.1(b) EB GL requires a “detailed description on how to determine [...] the forecasted market value of cross-zonal

capacity for the exchange of energy" in the present methodology. Leaving such vague concepts and open derogations in the methodology for a later definition of such elements to the BCC proposals is insufficient.

- **Article 13.3:** *The objective for the allocation of C2C between SDAC and the exchange of balancing capacity or sharing of reserves shall be the maximization of the total economic surplus for the sum of the exchange of energy and the exchange of balancing capacity or sharing of reserves per business day.*

We understand the reasoning for this objective, but changes in the bidding behaviour of market participants compared to what the TSOs have modelled or are expecting should not be underestimated. This will require time to adapt and alignment with TSOs in order to design it.

As we mentioned in earlier points, ignoring the intraday market, in practice, forecloses opportunities for market participants to adjust their positions and will lead to changes in the bidding process.

- **Article 15.2:** *According to Article 38(9) of the EBGL, when C2C allocated for the exchange of balancing capacity or sharing of reserves has not been used for the associated exchange of balancing energy, it shall proceed pursuant to article 3(9) or 3(10) of this MB CZCA proposal.*

We welcome the clarification that cross-zonal capacity reserved for a specific product that was not used for this process shall be made available again for the exchange of balancing energy in processes with shorter timeframes, in accordance with article 38.9 EB GL.

This paragraph is, however, a partial repetition of articles 1.8 and 3.9. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 15.5:** *TSOs shall not increase the reliability margin calculated pursuant to Article 21 of CACM due to the exchange of balancing capacity and or sharing of reserves for frequency restoration reserves and replacement reserves.*

We welcome this requirement that the application of cross-border capacity reservation should not increase the day-ahead or intraday reliability margins used by the TSOs.

- **Article 17.1:** *Italy North TSOs of each balancing capacity cooperation shall publish the MB CZCA proposal without undue delay after concerned NRAs have approved this proposal or a decision has been taken by the Agency for the Cooperation of Energy Regulators in accordance with Article 5(7), Article 6(1) and Article 6(2) of the EBGL.*

This article does not include any indication of the timing for the publication of the MB CZCA proposal. We believe that a minimum three-month notice to market participants is necessary for appropriate preparation.

- **Article 17.3:** *Each TSO that is part of a balancing capacity cooperation shall publish information in accordance with Article 12(3)(h) of the EBGL on the allocation of CZC for the exchange of balancing capacity or sharing of reserves pursuant to Article 38(1)(a) of the EBGL as defined in article 6(1)(b), 7(1)(d) and 7(1)(e) of this MB CZCA proposal and no later than 6 hours before the use of the allocated CZC.*

If the cross-zonal capacity allocation process for the exchange of balancing energy or sharing of reserves is completed at the time of the balancing capacity procurement process in the case of the “market-based” approach, it is unclear why Italy North TSOs participating in a BCC would wait to publish information on allocated cross-zonal capacity for the exchange of balancing energy / sharing of reserves only six hours before its use. For the sake of transparency, this information should be published together with the results of the capacity procurement process, according to the same timing as laid down in article 13.2.

- **Article 17.6:** *Subject to approval pursuant to Article 18 of the EBGL, a TSO may withhold the publication of information on offered prices and volumes of balancing capacity or balancing energy bids if justified for reasons of market abuse concerns and if not detrimental to the effective functioning of the electricity markets. A TSO shall report such withholdings at least once a year to the relevant regulatory authority in accordance with Article 37 of Directive 2009/72/EC and pursuant to Article 12(5) of the EBGL.*

It shall never be the task of a TSO to decide whether market abuse has been committed, nor to restrict market design or disclosure of price sensitive information on the basis of a fear of such market abuse materialising.

- **Article 17.7:** *Italy North TSOs of each balancing capacity cooperation applying the market-based approach shall publish the efficiency of the forecasted market value for the exchange of balancing capacity or sharing of reserves.*
- **Article 17.8:** *Italy North TSOs of each balancing capacity cooperation applying the inverted market-based approach shall publish the efficiency of the forecasted market value for the exchange of energy.*

TSOs should publish the forecasted market values on a continuous basis (with as little of a delay as possible) and not only the efficiency of the forecasted market values as currently set out in articles 17.7 and 17.8.