

EFET response to the Italy North TSOs' proposal for an allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves based on economic efficiency analysis



EFET response – 11 November 2019

The European Federation of Energy Traders (EFET) welcomes the opportunity to provide comments on the Italy North TSOs' proposal for an allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves based on an economic efficiency analysis, 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 “economic efficiency” method for capacity reservation by the TSOs for balancing purposes:

First, the so-called “economic efficiency” method for capacity reservation by the TSOs for balancing purposes is based on a tool optimising forecasted balancing capacity bids with forecasted day-ahead bids. 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 both the value of balancing capacity, and 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 42.1(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 “economic efficiency” 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 “economic efficiency” 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 an

“economic efficiency” cross-zonal capacity allocation for the exchange of balancing capacity or sharing of reserves proposal according to article 42 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 “economic efficiency” 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 “market-based” allocation method under article 41).

Comments on individual articles:

- ***Recital 5.d:*** *The EE 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 and 12 of this EE CZCA methodology, that not used CZC 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 an “economic efficiency” 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.

- **Recital 5.h:** *In conclusion, the EE CZCA proposal meets the objectives of the EBGL.*

This recital concludes, without any proper demonstration, that this methodology is beneficial to all market participants and electricity consumers. We challenge this assertion of the TSOs, and would welcome the publication of the factual analysis we expect them to have performed to come to such a conclusion.

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 Hansa 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
- **Article 1.7:** *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 EBGL.

This paragraph is, however, partially repeated in article 3.11 and 12.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 3.9:** *The TSOs shall regularly assess whether the CZC allocated for the exchange of balancing capacity or sharing of reserves is still needed for that purpose. The TSOs shall perform this assessment at least once per year.*

We welcome this provision foreseeing a 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. We would nonetheless like to see it complemented with an obligation to disclose the assessments to the relevant NRAs and market participants.

- **Article 3.11:** *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 1.7 and 12.2. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 4.2:** *Each balancing capacity cooperation within CCR Italy North implementing this EE 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 EE 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 EE 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 6.1.c:** *Notification to the BSPs of selected upward balancing capacity bids or downward balancing capacity bids by TSOs shall be done before the GOT of the SDAC.*

This paragraph states that the notification of selected bids shall be done before the GOT of the SDAC. However, as the TSO-BSP GCT takes place before W-1, we ask that the timing for the notification to the BSPs is set far earlier than the GOT of SADC (e.g. before D-1, in order to be able to cope with the potential daily procurement of reserves that has to be organised in accordance with the recast Electricity Regulation).

- **Article 7.1:** *The maximum volume (upper limit) of CZC allocated for the exchange of balancing capacity or sharing of reserves based on an economic efficiency analysis shall be limited to 5 % 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 5% are applied over CZCA for all of the balancing processes, not 5% for each of aFRR, mFRR and RR, possibly summing up to 15%.

- **Article 7.6:** *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 5% of available cross-zonal capacity referred to in article 42.2 EB GL.

- **Article 8.1:** *When calculating the forecasted market value of CZC in day-ahead market timeframe it shall be calculated in accordance with Methodology pursuant to Article 37(5) of the CACM based on the total welfare surplus of the SDAC consisting of consumer surplus, producer surplus and congestion income.*

This paragraph refers to article 37(2) of the CACM GL. However, the concept of “forecasted market value of CZC” is not covered in the CACM. The link to the article 37(2) of the CACM GL is therefore not straightforward. Please advise or amend.

- **Article 8.2:** *The forecasted market value of CZC for the exchange of energy between bidding zones shall be defined per MTU and shall be calculated in accordance with Article 39(5) of the EBGL.*

The article enshrines that the value of cross-zonal capacity is compared between the forecasted DA market value and the forecasted balancing capacity value, 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 EBGL 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 8.3** *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 9.2:** *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 8.3 and 9.2 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) 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 the concepts of “reference days” or “adjustment factors” and postponing the definition of such elements to the BCC proposals is insufficient.

- **Article 8.4:** *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 9.3:** *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 article 14.7.

- **Article 11.2:** *The objective for the allocation of CZC 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 contracting period.*

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 12.2:** *According to Article 38(9) of the EBGL, when CZC 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(11) of this EE 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 1.7 and 3.11. Please make sure the text of the methodology does not reiterate the same rules multiple times.

- **Article 11.4:** *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 14.1:** *Italy North TSOs of each balancing capacity cooperation shall publish the EE 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 EE CZCA proposal. We believe that a minimum three-month notice to market participants is necessary for appropriate preparation.

- **Article 14.3:** *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)(a) and 6(1)(b) of this EE 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 “economic efficiency” 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 14.6:** *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 14.7:** *Italy North TSOs of a balancing capacity cooperation applying the allocation process based on economic efficiency analysis shall publish the efficiency of the forecasted market value for the exchange of balancing capacity or sharing of reserves and 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 article 13.7.