

**REQUEST FOR AMENDMENT (RfA) OF ITALY NORTH
REGULATORY AUTHORITIES**

ON

**PROPOSAL FOR A METHODOLOGY FOR A MARKET-
BASED ALLOCATION PROCESS OF CROSS ZONAL
CAPACITY FOR THE EXCHANGE OF BALANCING
CAPACITY OR SHARING OF RESERVES IN
ACCORDANCE WITH ARTICLE 41 OF THE
COMMISSION REGULATION (EU) 2017/2195 OF 23
NOVEMBER 2017 ESTABLISHING A GUIDELINE ON
ELECTRICITY BALANCING**

15 December 2020

I. Introduction and legal context

This document elaborates an agreement of Italy North Regulatory Authorities (hereafter referred to as "NRAs") made at the Italy North Energy Regulators' Regional Forum on 15 December 2020, on the Italy North TSOs' proposal for a methodology for a market-based allocation process of cross zonal capacity for the exchange of balancing capacity or sharing of reserves, in accordance with Article 41 of the Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing (EBGL) (hereafter referred to as "MB Proposal").

The initial proposal was received by the last Regulatory Authority on 3 January 2020. On 29 June 2020, according to article 5(6) of the EBGL, NRAs unanimously agreed to issue a request for amendment.

Pursuant to article 6(1) of the EBGL, the Italy North TSOs submitted an amended version of the MB proposal, that was received by the last regulatory authority on 25 November 2020.

NRAs consulted and closely cooperated each other to reach an agreement and make decisions within two months following receipt of submissions of the last relevant Regulatory Authority concerned, according to article 6(1) of the EBGL.

This agreement of Italy North Regulatory Authorities shall provide evidence that a decision on the Proposal does not, at this stage, need to be adopted by ACER pursuant to Article 6(2) of the EBGL. However, at the same time the MB proposal is not approvable by Italy North Regulatory Authorities. Therefore, this agreement is intended to constitute the basis on which RAs will each subsequently request an amendment to the MB Proposal pursuant to Article 6(1) of the EBGL.

The legal provisions that lie at the basis of the MB proposal and this RAs' agreement on the RfA can be found in Articles 3, 38, 41 of the EBGL:

Article 3 Objectives and regulatory aspects

1. *This Regulation aims at:*

- (a) fostering effective competition, non-discrimination and transparency in balancing markets;*
- (b) enhancing efficiency of balancing as well as efficiency of European and national balancing markets;*
- (c) integrating balancing markets and promoting the possibilities for exchanges of balancing services while contributing to operational security;*
- (d) contributing to the efficient long-term operation and development of the electricity transmission system and electricity sector in the Union while facilitating the efficient and consistent functioning of day-ahead, intraday and balancing markets;*
- (e) ensuring that the procurement of balancing services is fair, objective, transparent and market-based, avoids undue barriers to entry for new entrants, fosters the liquidity of balancing markets while preventing undue distortions within the internal market in electricity;*
- (f) facilitating the participation of demand response including aggregation facilities and energy storage while ensuring they compete with other balancing services at a level playing field and, where necessary, act independently when serving a single demand facility;*
- (g) facilitating the participation of renewable energy sources and support the achievement of the European Union target for the penetration of renewable generation.*

2. When applying this Regulation, Member States, relevant regulatory authorities, and system operators shall:

- (a) apply the principles of proportionality and non-discrimination;
- (b) ensure transparency;
- (c) apply the principle of optimisation between the highest overall efficiency and lowest total costs for all parties involved;
- (d) ensure that TSOs make use of market-based mechanisms, as far as possible, in order to ensure network security and stability;
- (e) ensure that the development of the forward, day-ahead and intraday markets is not compromised;
- (f) respect the responsibility assigned to the relevant TSO in order to ensure system security, including as required by national legislation;
- (g) consult with relevant DSOs and take account of potential impacts on their system;
- (h) take into consideration agreed European standards and technical specifications.

Article 38 General requirements

1. Two or more TSOs may at their initiative or at the request of their relevant regulatory authorities in accordance with Article 37 of Directive 2009/72/EC set up a proposal for the application of one of the following processes:

- (a) co-optimised allocation process pursuant to Article 40;
- (b) market-based allocation process pursuant to Article 41;
- (c) allocation process based on economic efficiency analysis pursuant to Article 42.

Cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves before the entry into force of this Regulation may continue to be used for that purpose until the expiry of the contracting period.

2. The proposal for the application of the allocation process shall include:

- (a) the bidding zone borders, the market timeframe, the duration of application and the methodology to be applied;
- (b) in case of allocation process based on economic efficiency analysis, the volume of allocated cross zonal capacity and the actual economic efficiency analysis justifying the efficiency of such allocation.

3. By five years after entry into force of this Regulation, all TSOs shall develop a proposal to harmonise the methodology for the allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves per timeframe pursuant to Article 40 and, where relevant, pursuant to Articles 41 and 42.

4. Cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves shall be used exclusively for frequency restoration reserves with manual activation, for frequency restoration reserves with automatic activation and for replacement reserves. The reliability margin calculated pursuant to Regulation (EU) 2015/1222 shall be used for operating and exchanging frequency containment reserves, except on Direct Current ('DC') interconnectors for which cross-zonal capacity for operating and exchanging frequency containment reserves may also be allocated in accordance with paragraph 1.

5. TSOs may allocate cross-zonal capacity for the exchange of balancing capacity or sharing of reserves only if cross-zonal capacity is calculated in accordance with the capacity calculation methodologies developed pursuant to Regulation (EU) 2015/1222 and (EU) 2016/1719.

6. TSOs shall include cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves as already allocated cross-zonal capacity in the calculations of cross-zonal capacity.

7. If physical transmission right holders use cross-zonal capacity for the exchange of balancing capacity, the capacity shall be considered as nominated solely for the purpose of excluding it from the application of the use-it-or-sell-it ('UIOSI') principle.

8. All TSOs exchanging balancing capacity or sharing of reserves shall regularly assess whether the cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves is still needed for that purpose. Where the allocation process based on economic efficiency analysis is applied, this assessment shall be done at least every year. When cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves is no longer needed, it shall be released as soon as possible and returned in the subsequent capacity allocation timeframes. Such cross-zonal capacity shall no longer be included as already allocated cross-zonal capacity in the calculations of cross-zonal capacity.

9. When cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves has not been used for the associated exchange of balancing energy, it shall be released for the exchange of balancing energy with shorter activation times or for operating the imbalance netting process.

Article 41 Market-based allocation process

1. By two years after entry into force of this Regulation, all TSOs of a capacity calculation region may develop a proposal for a methodology for a market-based allocation process of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves. This methodology shall apply for the exchange of balancing capacity or sharing of reserves with a contracting period of not more than one day and where the contracting is done not more than one week in advance of the provision of the balancing capacity. The methodology shall include:

(a) the notification process for the use of the market-based allocation process;

(b) a detailed description of how to determine 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, and if applicable the actual market value of cross-zonal capacity for exchanges of energy and the forecasted market value of cross-zonal capacity for the exchange of balancing capacity or sharing of reserves;

(c) a detailed description of the pricing method, the firmness regime and the sharing of congestion income for the cross-zonal capacity that has been allocated to bids for the exchange of balancing capacity or sharing of reserves via the market-based allocation process;

(d) the process to define the maximum volume of allocated cross-zonal capacity for the exchange of balancing capacity or sharing of reserves pursuant to paragraph 2.

2. Cross-zonal capacity allocated on a market-based 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. This volume limitation 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 cooptimised allocation process is harmonised at Union level pursuant to Article 38(3).

3. This methodology shall be 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, or 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.

4. The pricing method, the firmness regime and the sharing of congestion income for cross-zonal capacity that has been allocated for the exchange of balancing capacity or sharing of reserves via the market-based process shall ensure equal treatment with the cross-zonal capacity allocated for the exchange of energy.

5. Cross-zonal capacity allocated for the exchange of balancing capacity or sharing of reserves via the market-based allocation process shall be used only for the exchange of balancing capacity or sharing of reserves and associated exchange of balancing energy.

II. All TSOs' proposal

Italy North TSOs amended the MB Proposal, with the intention to fulfil all the requests for amended approved by NRAs. The final version of the MB Proposal was received by the last Regulatory Authority on 25 November 2020.

III. All RAs assessment

NRAs acknowledge that TSOs amended and improved the content of the MB Proposal, in line with the request for amendment. Nonetheless, the MB Proposal does not fulfil all the NRAs requirements and it is deemed not approvable. NRAs request Italy North TSOs to further amend the MB Proposal, taking into account the following assessment. The additional requests of this document are grouped according to the subject they are referring, when they are not referring to a specific article.

Wording improvement

NRAs ask TSOs to improve the wording of the MB Proposal and ensure consistency in the usage of terms and definitions all over the document. In particular:

- NRAs consider better to refer to the “methodology for a market-based allocation process of cross zonal capacity for the exchange of balancing capacity or sharing of reserves” as the “MB CZCA methodology”, instead of as “...Proposal” and to replace the term in the MB Proposal. This would ensure a correct reading of the text;
- Both the terms “methodology” and “approach” are used to indicate the market based or inverted market based procedure. There is not consistency in the document: In art. 2 TSOs define “market based method” that includes market based and inverted market based approaches, while in art. 1 market based and inverted market based are referred to as “methodology”. NRAs ask TSOs to respect the definition provided and ensure a coherent usage of the terms “approach”, “process”, “method” and “methodology” in the proposal. Also the definition of market based method itself needs a rewording, as it is defined as a “methodology”. While addressing this wording improvement, TSOs are requested to take into account a general alignment with the co-optimized CZCA methodology, as discussed in the next paragraph.

General alignment with the co-optimized CZCA methodology

NRAs ask TSOs to further align the MB Proposal to the final methodology for the co-optimized CZCA, both in terms of layout and content, where relevant. In particular NRAs ask to further align the headlines and content of paragraphs in articles 1, 3, 6,7, 10. In particular:

- in art. 1 paragraphs 2 and 7 shall be removed;
- in articles 6 and 7 the chronological steps in sub-paragraph (2) shall be aligned as much as possible with the final methodology for the co-optimized CZCA, without prejudice to differences in the processes (market based, inverted market based, co-optimized) and subjects involved in the processes;
- article 10 seems to have the same scope of article 7 in the methodology for the co-optimized CZCA. NRAs ask TSOs to further align the content of the article in the MB Proposal;

Moreover, the term “balancing capacity cooperation” is used all over the document. TSOs shall consider alignment with co-optimized CZCA methodology where it was removed.

Implementation and application of methodology

NRAs acknowledge that TSOs fulfilled the request to include the implementation timeline, by adding article 18 in the TM Proposal. Nonetheless NRAs consider that there is still a wrong use of the terms “implementation” and “application”. The implementation of the methodology is mandatory and shall be done by all TSOs submitting the MB Proposal. On the other hand, the application is a voluntary process to actually use the CZCA method on pre-defined bidding zone borders. Not all TSOs shall be part of the application of the methodology, pursuant to article 38(1).

Therefore, NRAs ask TSOs to correct the proposal by using the right meaning of “implementation” and “application” all over the document. In particular:

- art. 1(3) provides the possibility of two or more TSOs by their voluntary initiative or at the request of their relevant regulatory authorities to implement the methodology by two years after the approval. This contradicts the meaning of “implementation” and article 18 of the same proposal. NRAs ask TSOs to remove this article;
- art. 1(5) and 1(6) use the word implementation instead of application. Moreover, the initiative to exchange balancing capacity is the voluntary process. If so, one of the 3 methods for the CZCA must be used. NRAs ask TSOs to remove these paragraphs and suggest to align article 1 with the respective one of the methodology for co-optimized CZCA, in case they want to refer to the process for application, according to art.38(1);
- the last sentence in art. 1(6) seems to link the implementation of the inverted market based approach to the implementation timescale of the methodology pursuant to art. 40 of the EBGL. This subject shall be moved to article 18 of the MB Proposal and better elaborated (see remarks about article 18);
- art. 1(7) uses the the word implementation instead of application. This paragraph can be removed, according to the remarks about the general alignment with the co-optimized CZCA methodology;
- art. 1(8) uses the the word implementation instead of application;
- art. 4 uses the the word implementation instead of (intention for) application;
- art. 18 establishes that the methodology is implemented when the NRAs approve it. NRAs consider this timeline not sufficient to fulfill the EBGL requirements, especially because the MB Proposal report a high level methodology, where specific details about the forecasted method, the CZCA process and algorithm are not included.
NRAs ask TSOs to further detail the implementation timeline by adding an obligation to submit by one year after the approval a technical document with the high level specifications and requirements of the MB CZCA method, describing inputs, outputs algorithm and processes of the CZCA optimization function and of the forecasting method.
As the inverted market based implementation is linked to the co-optimized CZCA one, art. 18 shall report a dedicated timescale explaining this correlations and whether TSOs intend to submit to NEMOs additional requirements for the implementation of the tool within the SDAC.

Justification of the inverted market based approach

In their first request for amendment, NRAs asked TSOs either to remove the inverted market-based approach or to justify the legal background and the added value, ensuring also that its implementation does not affect or preclude the implementation of the market based approach.

NRAs consider the reference to inverted market based approach made in Whereas 4(h) not sufficient to justify the legal background and the added value, compared to the complexities for its implementation. Therefore, NRAs ask TSOs to further explain the legal basis and the benefit of such approach.

NRAs understand from article 5 that the CZCA optimization function of the inverted market based approach is different from the one of the market based approach and it will share the same optimization tool of the single day ahead coupling. In case TSOs decide to keep the inverted market based approach, the MB Proposal shall explain more in detail the relationship with the tool for the co-optimized CZCA in article 5 and the implications on CZCA optimization function (article 5 and 7) and on the implementation timeline (article 18).

NRAs reiterate their request to either remove the inverted market-based approach or improve the proposal, taking into account the above remarks.

Description of forecasting method

NRAs acknowledge that in articles 9 and 12 TSOs are proposing a high level forecasting method and that further details will be provided when the methodology will be actually applied. Nonetheless NRAs ask TSOs to improve the description of this article, to make clear how the forecasting method works. The wording “shall be based” in article 9(3) and 12(2) is very vague and does not allow to understand how the inputs are processed to get the output. TSOs are requested to explain more in detail the forecasting process especially what are the steps and the calculation that provide the forecasted market value. This explanation shall include a list of the adjustment factors that will be used in the calculation.

In article 9 NRAs understand that TSOs decided to calculate the forecasted market value based on the submitted SDAC bids of selected reference day(s) instead of using the market spread value; therefore, they are requested to clarify which bids from which bidding zones will be considered and how the possible import/export with third countries is considered.

In article 12 TSOs are requested also to clarify which balancing capacity bids from which bidding zones are considered.

Finally, NRAs have doubts whether art. 39 and art. 41 allow to include the expected value of CZC related to the cross-border activation of balancing energy. If TSOs don't chose to remove this paragraph, they shall explain the legal basis of article 12(5) and provide detailed description of how this expected value is calculated.

Specific requirements on articles

Article 2

NRAs ask TSOs to further refine the list of definitions, removing what can be easily described in the Article where it is used and adding other definitions that are missing. In particular:

- definition 2(b) shall be removed, as already provided in article 2 of the EBGL;
- in case TSOs remove the term “balancing capacity cooperation”, according to the request to align the MB proposal to the co-optimized CZCA methodology, definition 2(c) shall be removed;
- definition 2(d) shall be removed, as already provided in article 3 of the SOGL;
- definition 2(e) can be removed, as the description of the MB method and its approaches (market based and inverted market based) is already provided in article 5;
- definition 2(f) can be removed, as the description can be provided in article 10, in the same way as the actual market value of CZC for the exchange of balancing capacity or sharing of reserves is described in article 11;
- definition 2(g) can be removed, as the description is already provided in article 11;
- NRAs ask TSOs to include a definition of the economic surplus from the exchange of balancing capacity or sharing of reserves, in line with the co-optimized CZCA methodology;

Article 6

Article 6 refers to “nominated balancing capacity market operator”; NRAs ask TSOs to define this subject or to remove it from the document.

Article 7

NRAs ask TSOs to clarify the step of article 7(2)(d) and better describe how it is organized.

Article 8

NRAs request that the term 'new interconnector' in Art 8(3) of the MB Proposal corresponds to the term as defined in Article 2(5) of the Electricity Regulation (2019/943).

NRAs believe that the second sentence in Article 8(3) of the MB Proposal may not correspond to the meaning of 'total installed technical capacity' in Article 41(2) of the EB Regulation. NRAs are of the opinion that the reliability margin reserves part of the total installed technical capacity to cover for uncertainties with the capacity calculation, but that it does not reduce the total installed technical capacity itself. NRAs require TSOs to either refer to existing legal definitions to support the TSOs' definition of 'total installed technical capacity' in the second sentence in Article 8(3), or to state in Article 8(3) that the installed technical capacity is equal to the nominal capacity, which is equal to the active power capacity of an interconnector. Such wording does not prohibit TSOs from applying necessary security constraints if needed for securely operating the system in real time.

Article 11

NRAs have doubts whether art. 39 and art. 41 allow to include the expected value of CZC related to the cross-border activation of balancing energy. If TSOs don't chose to remove this paragraph, they shall explain the legal basis of article 11(3) and provide detailed description of how this expected value is calculated.

Article 12

For Art 12(5) consider the comment on Art 11 above,

Article 13

NRAs ask TSOs to further improve the wording and the explanation in article 13, representing in a systematic way the process of the cross-zonal capacity allocation optimization function: what are the inputs, what is the objective function, what are the constraints, what are the output.

NRAs consider that a separate description for market based and inverted market based increases the clarity of the article, while in the current text the two processes are mixed.

Moreover, NRAs ask TSOs to clarify why and how the allocation of CZC for the exchange of balancing capacity or sharing of reserves can be determined before the capacity procurement optimization function, while the NRAs understanding is that the two actions will be simultaneous.

Article 16

NRAs ask TSOs to clarify the congestion income calculation described in art. 16(2), because the current text does not explain how it is performed and simply reports elements that affect the congestion income. NRAs invite TSOs to refer to the volumes of cross-zonal capacity allocated to the exchange of balancing capacity or sharing of reserves and to the price of cross-zonal capacity determined in article 14.

III. Conclusion

NRAs have assessed, consulted and closely cooperated and coordinated to reach the agreement that the MB Proposal according to Article 41 of the EBGL cannot be approved by all NRAs.

According to Article 6(1) of the EBGL, NRAs hereby request an amendment to the MB Proposal. The amended proposal shall take into account the NRAs' assessment stated above and shall be submitted by Italy North TSOs no later than two months after receiving the NRA's RfA in accordance with Article 6(1) of the EBGL.

NRAs must make their decision to request an amendment to the proposal on the basis of this agreement by **25 January 2020**.