

**DECISION OF ITALY NORTH REGULATORY
AUTHORITIES**

ON

**THE 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**

1 June 2021

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 1 June 2021, on the methodology for a market-based allocation process of cross zonal capacity for the exchange of balancing capacity or sharing of reserves (hereafter referred to as "MB Methodology"), submitted by Italy North TSOs in accordance with Article 41 of the Commission Regulation (EU) 2017/2195 of 23 November 2017 establishing a guideline on electricity balancing (EBGL).

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 proposal for the MB Methodology, that was received by the last regulatory authority on 25 November 2020.

On 15 December 2020, NRAs unanimously agreed to issue a second request for amendment. The new amended proposal was received by the last regulatory authority on 31 March 2021.

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. It is intended to constitute the basis on which the NRAs will each subsequently issue a national decision to approve the MB Methodology.

The legal provisions that lie at the basis of the MB Methodology and this NRAs' agreement can be found in Articles 3, 38, 41 of the EBGL and in Article 5 of the Regulation (EU) 2019/942 of the European Parliament and of the Council of 5 June 2019 establishing a European Union Agency for the Cooperation of Energy Regulators (recast) (in the following: Regulation 2019/942):

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 crosszonal 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.*

Regulation 2019/942

Article 5

Tasks of ACER as regards the development and implementation of network codes and guidelines

[...]

3. *Where one of the following legal acts provides for the development of proposals for terms and conditions or methodologies for the implementation of network codes and guidelines which require the approval of all the regulatory authorities of the region concerned, those regulatory authorities shall agree unanimously on the common terms and conditions or methodologies to be approved by each of those regulatory authorities:*

- (a) a legislative act of the Union adopted under the ordinary legislative procedure;*
- (b) network codes and guidelines that were adopted before 4 July 2019 and subsequent revisions of those network codes and guidelines; or*
- (c) network codes and guidelines adopted as implementing acts pursuant to Article 5 of Regulation (EU) No 182/2011.*

The proposals referred to in the first subparagraph shall be notified to ACER within one week of their submission to those regulatory authorities. The regulatory authorities may refer the proposals to ACER for approval pursuant to point (b) of the second subparagraph of Article 6(10) and shall do so pursuant to point (a) of the second subparagraph of Article 6(10) where there is no unanimous agreement as referred to in the first subparagraph.

The Director or the Board of Regulators, acting on its own initiative or on a proposal from one or more of its members, may require the regulatory authorities of the region concerned to refer the proposal to ACER for approval. Such a request shall be limited to cases in which the regionally agreed proposal would have a tangible impact on the internal energy market or on security of supply beyond the region.

[...]

6. *Before approving the terms and conditions or methodologies referred to in paragraphs 2 and 3, the regulatory authorities, or, where competent, ACER, shall revise them where necessary, after consulting the ENTSO for Electricity, the ENTSO for Gas or the EU DSO entity, in order to ensure that they are in line with the purpose of the network code or guideline and contribute to market integration, non-discrimination, effective competition and the proper functioning of the market. ACER shall take a decision on the approval within the period specified in the relevant network codes and guidelines. That period shall begin on the day following that on which the proposal was referred to ACER.*

II. Italy North TSOs' proposal

Italy North TSOs amended the proposal for a MB Methodology, with the intention to fulfil all the requests for amendment issued by NRAs. The final version of the proposal for a MB Methodology was received by the last Regulatory Authority on 31 March 2021. A decision is therefore required by 1 June 2021.

III. Italy North NRAs assessment

NRAs acknowledge that TSOs amended and improved the content of the proposal for a MB Methodology, in line with the request for amendment. In particular, the wording of the proposal has been improved and the proposal is now aligned, where relevant, to the final methodologies for the co-optimized CZCA and the market based CZCA of the Nordic region. Moreover, the methodology now properly differentiates between the implementation and the application of the methodology.

NRAs acknowledge that the proposal for a MB Methodology proposes only the market based approach, while the inverted market based has been removed, in line with the content of the RfA.

TSOs have also improved the description of the forecasting method, for what concerns the forecasted value of CZC for the exchange of energy, that is now based on the market spread of reference days. TSOs have not included further details on the adjustment factors, such as the method for calculating them and the metrics for deciding how to use them, but they committed to prepare and submit a technical document that will provide specific details, by one year after the approval of the methodology.

Moreover, the TSOs managed to fulfil the specific comments and requests on the articles of the proposal, issued by NRAs on their RfAs.

On the specific request to either remove the inclusion of the expected value of CZC related to the cross-border activation of balancing energy or to justify the legal basis, providing also detailed description of how this expected value is calculated, NRAs consider that TSOs did not fulfil the request: the legal justification provided in the whereas 4(f) appears weak and the description of how the expected value is calculated does not allow to understand the steps of the calculation that provides this value.

Because of this specific request that has not been fulfilled, the NRAs are not able to approve the proposal for a MB methodology submitted by the TSOs. Nonetheless, NRAs consider it efficient to directly amend the proposal by exploiting the provision included in Article 5(6) of Regulation 2019/942, about the duty for regulatory authorities to revise terms and conditions and methodologies where necessary, before approving them.

In the process of amending the methodology, the NRAs coordinated with TSOs to explain the amendments and to gather their comments. For this purpose, NRAs launched also a hearing phase to collect the TSOs' feedback on the draft version of the amended methodology.

The TSOs considered the changes proposed by the NRAs as acceptable and proposed few additional changes, to correct a wrong reference and to improve the clarity of the description of the CZC price.

IV. Italy North NRAs amendments

Inclusion of the balancing energy value in the forecasted value

As already stated in their RfA, NRAs have doubt on whether art. 39 and art. 41 allow to include the expected value of CZC related to the cross-border activation of balancing energy in the actual value of CZC for the exchange of balancing capacity.

In the amended proposal for a MB Methodology, the TSOs justify the inclusion of the value of balancing energy activations in the actual value of CZC for the exchange of balancing capacity with the recital 4(f):

[...]

In line with Article 39(2) of the EBGL and in order to depict the realized total welfare surplus which results from the allocation of CZC either for the exchange of energy or for the exchange of balancing capacity or sharing of reserves, TSOs may include the expected market value of allocated CZC on subsequent markets.

NRAs are of the opinion that art. 39(2) of the EBGL, which requires to take into account, where relevant and possible, expected bids of market participants in subsequent markets, is a provision that applies to the calculation of actual market value of CZC for the exchange of energy and the subsequent market is only the intraday market, as mentioned in the article itself. Therefore, the principle cannot be extended to the calculation of the actual value of CZC for the exchange of balancing capacity or sharing of reserve. There is dedicated provision for the actual market value of CZC for the exchange of balancing capacity (paragraphs 3 and 4 of Article 39) so there is no need to draw analogies from Article 39(2). In Art 39(3) and (4) of the EBGL there is no reference to subsequent markets.

At the moment, NRAs don't see a legal basis that justifies the inclusion of the expected value of balancing energy in the actual value of CZC for the exchange of balancing capacity or sharing of reserves and therefore removed this possibility for the MB Methodology.

Therefore, NRAs decided to rephrase recital 4(f) and to delete paragraphs 9(3) to 9(6) and 15(e), to reflect their opinion.

Timeframe of the CZC allocation process

NRAs consider that paragraph 10(1) is not a mandatory requirement, thus it can be removed. In this way TSOs are free to implement the CZCA optimization function and the balancing capacity procurement optimization function to be performed either simultaneously or in separated steps.

Pricing of CZC

NRAs rephrased the description of the CZC price in art. 11(3), making reference to the marginal value of CZC coming from the CZCA optimization function, considering also the additional text proposed by the TSOs through the hearing phase. The intention is to make the description independent of the pricing method used for the settlement of balancing capacity bids, without changing the meaning of the CZC price.

Wording improvement

NRAs also take the opportunity to include further minor amendments to correct few typos and improve the clarity of the methodology.

- In art. 8, it is included a clarification of how the reference period is taken, whenever the CZC is allocated for a day which is bank holiday in one or several bidding zones;
- In Article 8(7) the right reference for the proposal for the application of the MB Methodology is article 38(1) of the EBGL;
- In art. 14(6), the right reference is Directive 2019/944 EC, instead of Directive 2009/72 EC, that is no longer valid.

V. Conclusion

NRAs have consulted, closely cooperated and coordinated to jointly agree that they amend and adopt the MB Methodology, submitted by the Italy North TSOs, pursuant to Article 41 of EBGL. The legal basis for the direct amendments by NRAs lies on Article 5(6) of Regulation 2019/942. NRAs must make their national decisions to adopt the MB Methodology, on the basis of this agreement, by 1 June 2021.