To the attention of Energy Minister

CC: COREPER I representatives

Brussels, 14 June 2023

Subject: Electricity Market Design Review - The views of the European power sector ahead of the Energy Council on 19 June2023

Dear Minister,

The European power sector welcomes the European Commission's proposal aiming at reforming Europe's electricity market design to make clean electrification the natural choice for decarbonising Europe and reducing our **dependence on imported fossil fuels**. We are convinced that the only way out of this crisis is a truly European internal energy market.

Ahead of the General Approach to be agreed at the next Energy Council on 19th June, we share our thoughts on five areas of the reform.

1. **We strongly caution against weakening of the triggering criteria for a regional or Union-wide crisis under Article 66a and adding the inframarginal rent cap to the toolbox**

The Electricity Market Design Reform is an occasion to reinforce the integration of the internal energy market, not weaken it. **Emergency measures should only be developed to meet the specific needs of crisis situations and should always be temporary <u>time-limited and – last but not least – targeted to the customers who really need them</u>.** Across-the-board retail price regulation leads to inefficient use of energy and harms the business case for decarbonization.

Our concern is amplified by the possible extension of the price cap on inframarginal rent as currently discussed within the European Parliament. Such an approach would lead to Member States/regions ending up in a 'semi-permanent crisis mode' where disproportionate and inefficient market interventions, such as price setting below costs, with unclear compensation guidelines would become a rule.

Indeed, as outlined in a recent report by the European Commission, the benefits of the current inframarginal revenue cap would not outweigh the impact on investor certainty and the risks to the market functioning and the transition. In particular, the Commission recognises that Member States' heterogeneous implementation of the revenue cap may have affected existing power purchase agreements (PPAs) and other long-term hedging contracts as well as disincentivised the conclusion of new ones. The clear recommendation of the report is that the **<u>implementation of the infra-marginal cap should not be prolonged.</u>**

We therefore urge the European Council to adhere to the European Commission's proposal on the triggering criteria for the "electricity price crisis". Please find more details on our proposals in Annex.

2. Enhance voluntary long-term hedging and contracting opportunities

Forward hedging, power purchasing agreements, and contracts for difference (CfDs), all have a role to play to de-risk investments while mitigating exposure to severe short-term price volatility. When well designed and executed, these are the most dependable and sustainable mechanisms to ensure customers certainty for long-term power procurement and investments.

Positively, the European Council preserves the **voluntary approach** of the European Commission to long-term contracts. **Most importantly, we warmly welcome that the Council has not shown support for the use of contracts for difference at regulated strike price for existing generation plants** – such retroactive implementation would greatly compromise investor certainty.

3. Address massive grid growth and digitalisation challenge

The benefit of renewables and flexibility from consumers can be harvested only to the extent the grid deployment keeps up. Allowing System Operators to make anticipatory investment, as foreseen in the Commission's proposal, is positive. **However, we regret that the Council's proposals fail to sufficiently address this challenge in the mandate given to National Regulators in Article 18 of the recast Regulation.** In particular, the reform should ensure that network tariff design provide positive incentives to system operators and ensures a timely recognition of traditional investments in physical networks and adequate returns, with a flexible reflection of operational costs and removing all existing barriers at national level to the necessary investments in grid reinforcement.

4. Supplier resilience must be made more effective to ensure customer protection

We regret that the Council does not remove counter-productive hedging obligations on electricity suppliers in the text of Directive itself. Allowing the possibility for responsible retailers to optimize their hedging strategy is the best way to keep costs down for consumers. We welcome the Council's clarification in the recitals that stress tests and reporting requirements on suppliers could be tools used to assess supplier hedging strategies, but they should be a clear substitute for prescriptive hedging mandates instead of a top-up.

Regarding the proposed obligation for suppliers to offer fixed-term, fixed price contracts, we ask the European Council to reconsider its proposal to exempt suppliers with only dynamic prices. This approach has risks: it will greatly affect competition with a discriminatory approach, and it incentivizes suppliers to shift their offers to exclusively dynamic price types of price structure, thus further reducing customers' choice.

5. Ensure proper impact assessment of the Virtual Trading Hubs

Although in the first instance we would not recommend including such a non-tested technical instrument in a primary regulation**, we welcome the Council's cautious approach on the proposed regional virtual trading hubs by introducing an impact assessment phase**. The virtual hubs proposal would not address the root cause of the lack of forward market liquidity and can strongly disrupt markets. Please find more details on our proposals in Annex.

Next steps

The electricity industry remains committed to its goal of powering a thriving, competitive, climate neutral European economy.

We remain at your disposal for further exchanges on how best deepen and reinforce the Internal Energy Market and make it even more fit for achieving net-zero.

Yours sincerely,

Leonhard Birnbaum
President Eurelectric

Annex:

1. **Maintain a strict delineation between electricity market design reform and emergency measures**

We are indeed concerned by the proposed weakening of the triggering criteria for a regional or Union-wide electricity price crisis under Art. 66A.

More specifically, we recommend rejecting the two following proposed changes:

The proposal under paragraph 1)a) to remove the year 2022 from the average wholesale price calculation: Objectively, while indeed 2022 was indeed an exceptional year due to extreme volatility, especially for the peaks registered in the summer of 2022, if the rationale behind such a proposal is to isolate outlier years, the baseline year 2020 could also be removed due to COVID-19 exceptionally low prices.

The proposal under paragraph 1)b) to reduce/weaken the triggering criteria for the impact on retail prices from at least 6 months to at least 3 months: looking at retail prices over 6 months avoids seasonality effects that may appear if we only look at a 3 month time-window.

Eurelectric urges the European Council to build upon the European Commission's proposals to ensure that the criteria to declare "electricity price crisis" are carefully set to tackle electricity price crisis in exceptional situations that have strong and lasting impacts on consumers and the European economy. Also, the EU Commission should always be in the driving seat in declaring a EU-wide or Regional crisis, in order to avoid fragmentation. Please see our concrete proposals for more objective criteria, explicitly reflecting the actual market circumstances, activated by an EU decision (Council on a proposal from the Commission), and based on a clear situational assessment – Amendment 18.

2. **Ensure proper impact assessment of the Virtual Trading Hubs**

The establishment of administratively determined regional virtual hubs (VTH) is a fundamental change in market organization. There is no guarantee that this will increase market liquidity; on the contrary, it could significantly reduce it. Therefore, it requires an extensive impact assessment and cost-benefits analysis, both with a positive outcome. Rather than being introduced in primary regulation, we still believe that it should be addressed as part of the FCA Guidelines and subject to a thorough impact assessment by ENTSOE.

Regarding the impact assessment, we believe the following key elements should be properly addressed:

1) **For the different VTH regions, the basis risk should be studied as well as the allocation (who takes the risk) of this basis risk**
2) **The type of products (Long term transmission rights options vs obligations) should also be carefully studied**.
3) **The possibilities for hedging across regions** (between two bidding zones located in two different VTH regions)