Executive Summary - European Commission consultation on market design

A Eurelectric response paper

February 2023

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powering people

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:
- A vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- A smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

Dépôt légal:

Markets & Investments Committee
Customers & Retail Services Committee
Working Group Wholesale Markets & Investment Frameworks

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Executive summary

On the 13th of February 2023, Eurelectric responded to the European Commission Public Consultation on Electricity Market Design outlining its priorities for the forthcoming revision seeking to deliver a market in line with consumers' needs and that supports the decarbonisation of the electricity system.

We need an evolution, not a revolution

We are pleased to see that the EC consultation **does not fundamentally question the current electricity market design based on short-term marginal pricing and its key features** (cost-efficiency, cross-border exchanges, and competition between market players). In this regard, it is essential to stress that **the current market design is not the cause of high electricity prices, and the forthcoming revision must preserve the underlying features and benefits of the current Internal Energy Market.**

Having said that, we fully support the aim of the reform to accelerate investment into renewable energy sources (RES) and other low-carbon technologies, to **reduce our dependence on fossil fuels** and reach net-zero. This, all while **fostering customer engagement and ensuring the affordability of the energy transition** by bringing the benefit of RES and low-carbon generation more directly to all consumers.

The Electricity Market Design Reform is an occasion to reinforce the integration of the internal energy market. **Emergency measures should be developed on an ad-hoc basis to meet the specific needs of crisis situations and should always be targeted, temporary, and time-limited**. We therefore strongly caution against institutionalising exceptional interventions such as market revenue limitation, regulated prices or revenues.

Enhancing hedging opportunities and long-term contracting to enable needed investments while ensuring consumer affordability

The best way to ensure affordability and protect customers against high volatility in the short-term market is to provide an **enhanced customer contracting framework** enabling sufficient possibilities to hedge and contract (especially for the long-term).

Voluntary long-term contracts such as Power Purchase Agreements (PPAs), two-way contracts for difference (allocated through centralised auctions), as well as forward hedging, canplay a critical role to support investments needed for a decarbonised power sector. If well designed, these tools may present different but complementary hedging purposes to mitigate exposure to short-term volatility for consumers (depending on their wide range of needs and preferences).

Eurelectric recognises a **large imbalance in the development of PPAs across Member States**, due to different national circumstances. Against this backdrop, we suggest mandating Member States to remove barriers preventing generators and offtakers to engage in PPAs. In addition, PPAs can be supported by:

- **Introducing public guarantees or insurance mechanisms for counterparty risks in PPAs.**
- **Developing an impact assessment on the introduction of incentives for entities** (e.g. a supplier or a PPA aggregator) to supply services to cover the balancing/shaping risk through market mechanisms.
- **Supporting standardisation and transparency,** in particular through a pan-European voluntary platform to facilitate PPA trading, or voluntary standardised PPA contracts and products at EU level.
- **Stimulating demand in PPAs through public entities' sourcing and/or incentives for larger consumers.**

Conversely, **two-way CfDs** and similar arrangements have been effective tools to ensure a minimum revenue to producers while supporting investments in new capacity where investments are not forthcoming on a market basis. However, there are **several major considerations** we must address:

- **Participation in two-way CfDs or similar arrangements - for existing and additional capacities - must be voluntary.**
- **There is no 'one size fits all' CfD** – the detailed design of CfDs or similar arrangements is key to preserve price signals, efficient short-term dispatch and liquidity of forward market.
- **Mitigating the impact of short-term markets on final electricity prices should not be considered their primary objective** as their efficiency is highly dependent on the payback design and they can be detrimental for certain types of demand that do not require the hedging they provide.
- **CfDs should be allocated in general through a competitive process** in accordance with State Aid Guidelines, and when not appropriate or possible, other specific similar arrangements should be used.

Forward markets should offer efficient and effective hedging opportunities to market participants . However, as we have seen from the emergency measures introduced in 2021 and 2022, **market-distortive regulatory interventions can lead to significant liquidity reductions in forward markets.** Thus, regulatory stability should be ensured.

While forward markets are currently sufficient to mitigate part of the exposure to short-term volatility for a limited time horizon (1 or 2 years), they **do not provide enough long-term visibility to trigger investments.** To this regard, in order to improve the liquidity of forward markets in the current and longer-term horizons, Eurelectric recommends:

- **Easing collateral requirements**, e.g., by widening the types of non-cash collateral under EMIR review, such as non-collateralised bank guarantees, or accepting underlying electricity production/ customer contracts/ ETS permits.
- **Ensuring that TSOs facilitate cross-border forward hedging** through 1) allocation of a higher volume of long-term transmission rights (LTTRs) products with longer maturities (to match at least forward market product maturities), 2) more frequent auctions 3) keeping Financial

Transmission Rights optionality, and 4) facilitating secondary trading for the exchange of LTTRs.
- **Considering voluntary mechanism for market makers** in forward markets to stimulate liquidity up to 7-10 years.

Current framework for capacity mechanisms must be improved to ensure long-term visibility

Finally, due to significant increases of low-cost variable generation in the future, **valuing flexible and firm capacity will be crucial to ensure adequate investments and guarantee system adequacy to the required level**. Well-designed, technology-neutral, and market-based capacity mechanisms will therefore play a key role in the future to complement the expected renewables build-up. Despite the need of capacity mechanisms across Europe, current legislation does not recognise this structural need and only allows them temporarily, as a last-resort solution andsubject to State aid clearance. This creates uncertainty on their stability and hence impact investors' confidence. **Therefore, the Electricity Market Design shouldconsider how to simplify and automate the approval process, and how to further foster their harmonisation along already defined key design principles**, while keeping sufficient flexibility to address national adequacy needs and specificities.

Striking the right balance between customer protection and supply offer regulation

We understand the objective of the Commission looking into solutions to ensure supplier viability so consumers can have reliable and affordable access to electricity. **However, prescribing what products suppliers must offer will not ensure prices and variety for consumers which meet their individual needs and match their risk appetite.** Rather than mandating suppliers to pursue specific hedging strategies tied to specific instruments or offer specific types of contracts, **we would recommend a principles-based, flexible resilience framework that should:**
- **Ensure strict implementation of Article 10 of the Electricity Directive** which requires suppliers to provide information to consumers on their rights and on proposed offers, including risks undertaken when signing a new contract.
- **Allow NRAs to conduct regular stress tests and establish reporting requirements** to ensure their resilience, either through hedging, financial robustness or other means. Such tests should be adapted to national specificities and take the suppliers' portfolio into account.
- **Align incentives for final customers and retailers by pairing any fixed price contracts with an adequate mitigation for contractual breach** (e.g., cost-reflective termination fees).
- **Ensure that barriers to long-term hedging and supply in forward markets are addressed** as key prerequisites.

Nevertheless, should obligations to offer fixed-price contracts be imposed on suppliers, these obligations should:
- Be paired with a right for suppliers to charge cost-reflective early termination fees.
- Remove supplier size discrimination to prevent competitive distortion (e.g. in Art. 11 of the Directive).
- Promote retail offers in parallel that include short-term incentives (e.g. offers like time-of-use tariffs, critical peak pricing, dynamic pricing, and dynamic rebates) for consumers with more elastic consumption.

Establishing a framework to identify and satisfy the evolving system needs to maintain security of supply

An enhanced framework for assessing, in a forward looking way, the evolution of system needs in terms of firm and flexible resources is necessary to provide visibility for market participants and network operators. The current indicative network and adequacy planning exercises will need to be broadened to include flexibility and cross-sector needs, for instance:

- **Extending the time horizon to a timeframe aligned with decarbonisation objectives,** reflecting the key policy targets and milestones of 2040 and 2050.
- **Improving and apply the Economic Viability Assessment to all system needs** - not only adequacy.
- **Stress testing the resilience of the energy system through an enhanced analysis of extreme events in the system needs assessment.**
- **Improve transparency on methodologies, assumptions and justifications** - for a better inclusion of stakeholders in the system needs assessment process.
- **Improve governance and stakeholder engagement -** even though some current developments, such as the organisation of stakeholder group meetings go in the right direction.

Using the Market Design to Enhance the Development of Flexibility Assets

We welcome that the European Commission is not only looking at solutions which protect consumers against unexpected electricity bill increases but is also investigating solutions that enable and incentivise them to contribute to the green transition through the development of flexibility assets and services.

Before considering additional measures, the European Commission should:

- **Ensure proper implementation by Member States of existing provisions in the Electricity Directive related to demand-side flexibility and aggregation** (Art. 13, 15, 17, and 32), including an accelerated roll-out of smart-meters to all customers to allow market participants to provide a wider variety of flexibility offers in which more final customers may participate.
- **Address the further development of flexibility assets and services through ongoing relevant technical workstreams** (EC Smart Grids Task Force & development of the new Network Code on Demand Response) **instead of the market design reform**
- Remove obstacles at national level **to invest in the necessary and efficient growth, digitalisation, and automation of the grids.**
- **Develop harmonised capacity markets as an instrument to support the development of flexible assets.**

Overview of Eurelectric's recommendations for targeted legislative changes

To improve forward liquidity

- **Easing collateral regulations in forward markets**, by widening the types of non-cash collateral under EMIR review, such as non-collateralised bank guarantees, or accepting underlying electricity production/ customer contracts/ ETS permits as collateral.
- **Facilitating cross-border hedging opportunities offered by TSOs through allocation of higher volume of Long-Term Transmission Rights with longer maturities (beyond 1 year)** and with more frequent auctions.
- **Considering voluntary mechanism for market makers in forward markets** to stimulate liquidity beyond the current timeframe - up to 7-10 years.

To promote long-term contracts and hedging mechanisms

- **Member States must address national barriers to enter into PPAs and other long-term contracts on a voluntary basis for both for large and small consumers.**
- **Providing dynamic guidelines for an ideal contract for difference (CfD) design & settlement, as there is a wide range of system needs and national specificities between Member States.**

Introducing legislation to set up a flexible resilience framework for suppliers at national level

- **Ensuring proper implementation of Art. 10 on information to be provided by suppliers.**
- **Introducing legislation allowing termination fees** (e.g. amending Article 12.3 from a derogation right of MS to an explicit right of suppliers when consumers voluntarily terminate fixed-price contracts).
- **Introducing guidelines for a flexible resilience framework to be used by NRAs** to perform regular stress tests and introduce reporting requirements for suppliers.

Improving the regulatory framework for capacity mechanisms

- **Developing guidelines to foster harmonisation of capacity mechanisms.**
- **Simplifying and automating the approval process and remove the temporary and last resort nature**
- **Developing harmonised capacity markets to support the development of flexible assets**

Restrict flexibility of Member States to undertake unilateral actions distorting market functioning

- **Ensuring proper implementation of Art. 3 of the Electricity Regulation** listing the principles for a sound operation of electricity markets.
- **Creating an EC guideline/framework or prohibiting certain types of intervention.**
- **Removing "all obstacles" to the necessary and efficient growth,** digitalisation, and automation **of the grid infrastructure existing in national regulatory regimes.**

Introduce a framework to coordinate future system needs

- **Moving beyond the different plans that are foreseen in current legislation (TYNDP, ERAA) aiming at a global, whole-system system needs assessment,** therefore encompassing not only adequacy and network (currently covered in 2 separate exercises) but also flexibility and considering cross-sector needs.

Eurelectric pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Social Responsibility

- Transparency, ethics, accountability

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