



February 2023

## Key principles for the reform of the EU electricity market design

European businesses and households are living through the most serious energy crisis of the past decades. With energy costs skyrocketing, many businesses were forced to reduce their production output, made investment decisions for locations outside Europe or even stopped producing completely, with consequences felt across the entire economy.

**Strengthening the competitiveness of Europe through our single market while pursuing a green transition is a matter of emergency and must be the overarching core principle of the upcoming reform of the EU electricity market design.**

If anything, this energy crisis shows that access to abundant, affordable and clean energy is not a given, but is absolutely key to maintain and attract a high-performance, low-carbon industry in Europe. Businesses need the right conditions to make the necessary investments in line with the EU's climate objectives. Any revision of the European electricity market rules should treat these elements as a starting point for the reform.

There is a clear need to provide solutions to the ongoing energy crisis and to future-proof the European electricity market in order to reach the objectives of an ambitious European decarbonisation agenda. Decarbonisation of the economy will be based on an increasing use of electricity by 2050, which will need massive investments in power generation. At the same time, it is imperative that the upcoming reform is preceded by a comprehensive impact assessment to ensure that the reform is fit for purpose and builds on member states' different situations with regards to their energy mix.

Against this, the following key principles for a targeted revision of European electricity market rules in the context of the energy crisis must be prioritised:

### **Principle 1: strengthening security of supply**

The current energy crisis has brought to the core the often-overlooked security of supply. While we should continue to rely primarily on a market-based approach, most of the investments in new generation capacity in recent years have either been based on subsidies or on Power Purchase Agreements (PPAs). There is therefore a need to assess whether Europe's "energy only" market is capable of stimulating the necessary investments in power generation, and how capacity as well as flexibility should be remunerated in a future-proof, integrated European electricity market.

Different kinds of technology-neutral capacity mechanisms can be further analysed as a potential avenue to build on, which could complement the expected renewables build-up by ensuring adequate investments in backup power. It is important, however, to minimise the cost for all consumers when designing the framework. This can be partly addressed



for instance by implementing competitive bidding procedures through which beneficiaries are selected. In any case, the principle of technology-neutrality should be respected and impact on competition carefully assessed.

### **Principle 2: completing market integration through cross-border trade**

In general, and especially in a situation of potential supply shortages, we should avoid to restrict or distort cross-border trade and delay the further integration of the electricity market. According to the Agency for the Cooperation of Energy Regulators (ACER), the benefits of cross-border trade amount to €34 bn per year<sup>1</sup>.

These gains should be further exploited, such as by massively investing in all the necessary infrastructures, including grids, interconnectors and storage. Not only the cross-border trade provides monetary benefit, but it is also essential in securing the security of supply.

Given that gas is often a price maker in many European electricity markets, the market integration for gas should also be looked at, since it will have an impact on the security of electricity market for several years ahead.

### **Principle 3: limiting the impact of high gas prices on consumer electricity prices by strengthening the long-term market**

While the current pricing mechanism ensures short-term efficiency and incentivises investments in renewable and low-carbon generation, a future-proof market should provide clearer long-term signals for investments. In this light, offering more hedging opportunities for consumers through long-term contracting is a low-hanging fruit for this reform and will help to reduce the influence of gas price swings on consumers prices.

To foster long-term price signals and ensure the transfer of price stability advantages of renewables to consumers, existing barriers for Power Purchase Agreements (PPAs) should be assessed and swiftly eliminated and the right incentives to sign long-term contracts should be put in place for final consumers<sup>2</sup>.

PPAs and long-term contracts in general can contribute to de-linking the spikes in gas prices from electricity bills that consumers are exposed to, as long as the shaping costs are also mitigated for. This is achieved through decreasing the price volatility and ensuring that consumers purchase energy with profiles suitable to their needs. To promote the PPAs among industrial consumers, who could typically commit to long-term contracts of more than 5 years, it is important to offer financial instruments covering the counterparty risk, such as credit guarantees. Incentivising the development of marketplaces for PPAs which directly connect electricity producers and consumers could further promote equal access to PPAs, while making such marketplaces voluntary and

---

<sup>1</sup> European Union Agency for the Cooperation of Energy Regulators (2022). [ACER's Final Assessment of the EU Wholesale Electricity Market Design](#).

<sup>2</sup> For further details on existing barriers to PPAs development in Europe, please consult the [BusinessEurope position paper from April 2022](#).



avoiding overly restrictive conditions or that they negatively affect the liquidity on the forward market.

In addition, Contracts for Difference (CfDs), which are already used in some member states, should be further assessed as they could serve an important role in ensuring sufficient investments for decarbonised generation and for limiting the influence of short-term gas price swings on electricity prices. For instance, two-sided CfDs could also play a key role in times of high energy prices in order to allow governments to evenly support households and industrial consumers. However, CfDs also have risks and therefore their use should remain voluntary at member states' level. When assessing the effectiveness of CfDs, it is essential to consider their specific design features, impact on short-term incentives and market functioning as well as the potential crowding-out effect on the investors' interest in PPAs (e.g., due to the asymmetric exposure to counterparty risk).

The use of long-term contracts such as PPAs and voluntary CfDs should be considered first before assessing whether changes to the pricing mechanism would be necessary.

In general, in order to further limit the impact of high gas prices on consumer electricity prices, we need massive investments in renewable and low carbon generation, storage, import infrastructure, demand response, network and we need to ensure that consumer prices better reflect the benefits of these investments. These investments need to be looked at collectively to provide a good adequacy between generation infrastructure and clients' needs for different energy carriers, and further stimulated by the right policy incentives, such as good planning laws and appropriate incentives for network operators.

#### **Principle 4: incentivising investments in flexible sources**

A future-proof market with an increasing share of renewable production, will need to be complemented by growing use of dedicated storage, supply- and demand-side flexibility technologies. More investments in flexibility will be necessary to curb the impact of potential volatility of prices and to provide visibility to consumers and businesses. Furthermore, additional flexibility on the demand and supply side could be supported by appropriate market incentives.

For instance, demand-side flexibility from different sectors can be encouraged by requiring national System Operators to adopt a more 'flexible' approach to procuring demand-side resources (e.g., notice time for demand reduction, duration of reduction, number of demands drops per week). This will enable more sectors to contribute, whilst noting some sources such as heavy industry will always have limited demand elasticity.

It is also worth pointing out that smart sector integration will not only enable cost-efficient decarbonisation and electrification of the society but also provides the very needed flexibility for the electricity system.

In general, the overall aim should be to ensure a stable energy market and a reliable energy supply, without over-dependency on user flexibility. Investments in flexibility must always be economically attractive without triggering any adverse economic effects, for instance on production continuity. The industrial production curtailments experienced in



the context of the ongoing crisis should be avoided in the future by developing a more stable and reliable energy market, including by securing reliable energy supplies.

### **Principle 5: empowering consumers**

The liberalisation of the electricity market led to the increased role of the prosumers and their self-production, which is welcomed. Meeting the decarbonisation targets will require an increased role of prosumers, including industrial prosumers, in the medium- and long-term, which needs to go hand in hand with adequate infrastructure and market-based solutions.

To strengthen the role of the industrial prosumer, it is necessary to adopt measures that favour agreements between all-sized companies and to extend participation in the renewable energy communities (modifying the definition in Directive 2018/2001) to companies belonging to the same industrial cluster or value chain. This would further support the development of renewable energy sources by pooling resources and sharing risks and burdens.

At the same time, it is crucial for consumers to be able to access a wide range of supply offers, especially over the long-term markets, in order to allow them to manage their exposure to price volatility, depending on their willingness to hedge their price exposure. In this light, competition in the retail market will give customers access to best products and prices - best suited for their electricity purchase, flexibility services and hedging needs.

It is also important to thoroughly assess the challenges that the development of distributed and small-scale electricity production brings on the financing of the grid and on the overall costs. Large-scale production will still be needed in order to produce in times of low output from small-scale production. Large and small-scale production should compete on a level playing field so that costs are minimized for consumers.

\* \* \*