

Joint Letter by DE, DK, EE, FI, LU, LV, NL on priorities for a targeted EU electricity market reform

The integration of the EU electricity market over the last decade has brought enormous benefits for the EU, including lower wholesale prices, greater security of supply and enabling the large-scale integration of renewable energy. The electricity market reform must be assessed against its contribution to these three key aims. It should support a transition to a decarbonised system at the lowest possible cost to our societies and ensure that security of supply is always safeguarded while transitioning to a highly efficient renewable based energy system. That will bring benefits to consumers, while at the same time protecting them against price peaks.

The EU electricity system has faced severe challenges due to an extraordinary combination of three exceptional crises in 2022: The Russian energy war on Europe as well as the low availability of nuclear and hydropower generation. These have led to a period of reduced gas supply and subsequently very high electricity prices and exceptional fluctuations, which have set European households and companies under severe pressure and created distributive challenges. However, the internal market has proven to be resilient and able to ensure security of supply across Europe, through an efficient allocation of demand and supply, and by fully leveraging the benefits of interconnection, cross-border trade and European solidarity even in times of crisis. At the same time, the crisis challenged affordability for consumers, which Europe needs to take into account when drawing the lessons from last year.

In doing so, the EU must not lose sight of what is needed to achieve the bigger aim: The ambitious medium- and long-term climate and energy targets while guaranteeing security of supply and affordable prices. This requires a well-functioning EU electricity market. In such a market, price signals ensure an efficient dispatch of generation units in Europe at lowest available cost, steering and incentivising flexibility in demand and supply to allow for efficient sector coupling, and triggering the investments needed to save energy and decarbonise the electricity sector. It is crucial that attempts to address the challenge of affordable electricity prices and security of supply do not endanger the decarbonisation efforts and well-functioning of the electricity market.

Any changes to the EU electricity market design should be targeted, based on an assessment of the impacts, and be guided by the following key principles:

- **Retaining the benefits of European electricity market integration.** By continuing to integrate EU electricity markets, through interconnection capacity, free formation of wholesale electricity prices and removing barriers to integration, we safeguard the benefits of electricity market integration for all Member States. This includes ensuring that the electricity generation units with the lowest costs available in Europe can be used to cover the specific demand, ensuring that electricity flows to where prices are highest, and ensuring security of supply. In this respect it is important to recall that the current EU market design, according to ACER estimates, has yielded a yearly EUR 34 bn in benefits over the last decade compared to a situation with no cross border flows.
- **Safeguarding and improving incentives to invest in the green transition.** To achieve climate targets, the EU needs EUR 487 bn investments in renewables annually from 2021-2030 according to REPowerEU estimates. And similar investments are needed to ensure that the roll out of renewables towards 2050. To realize those investments, we need a reliable, predictable and robust market framework that ensures investors' confidence and which addresses both renewable and secure capacity. Geopolitical challenges have made the relevance of a competitive investment environment in the EU even clearer. Therefore, we are also sceptical towards making general revenue limitations as introduced by the

temporary emergency framework a permanent function of the regular market as that could compromise investors' confidence in the needed investments.

- **Ensure efficiency of short-term markets and optimise functioning of forward-markets.** Efficient short-term markets based on marginal pricing provide a solid foundation to achieve efficient prices that provide adequate dispatch and investment incentives for a decarbonised power sector. Inframarginal rents in normal times provide important incentives to invest in cost-efficient technologies and, therefore, contribute to minimum system costs of power generation. These short-term market signals should be complemented by well-functioning forward markets that incentivize investments in renewables, but also let consumers profit sooner from the low renewable energy prices. A reform of the market design should support liquidity in forward markets. A thorough analysis of existing barriers to forward market participation is needed. Complementary financial instruments, such as financial PPAs, could be promoted.
- **Maintaining market incentives and a level playing-field.** To pass on low costs of power generation from renewable energy sources to consumers, the relevance of market-based power purchase agreements could be strengthened, barriers to PPAs should be removed and it should be explored how the uptake of PPAs can be incentivized. Depending on national circumstances private and government backed Contracts for Difference (CfD's) could play a role in long-term markets if they benefit the renewable energy transition. For CfD's it is important that they keep the market functioning, do not impair the much needed investor's confidence, and that they are designed so that reactions to current market circumstances are retained. Therefore, we have concerns applying them to dispatchable generation because producer incentives to optimise CfD revenue could then counteract system needs. Therefore, CfD's should be voluntary, should not be imposed retroactively, should focus on new renewable investments, and prices should be determined via competitive auctions or tenders in accordance with State aid guidelines, and not on regulated prices or cost-plus approaches. CfDs should also be cleverly designed so that reactions to current market circumstances are retained. We should also explore options to improve conditions for industry to access electricity at a competitive price.
- **Strengthening protection of consumers and empowering them to participate in and reap the benefits of the energy transition.** The current crisis has shown that certain consumer groups such as private households deserve better protection against unexpected electricity bill increases. This can be achieved by limiting the exposure of consumers to potential shocks on especially the wholesale market e.g. by limiting the amount of risk in portfolios of suppliers and improving hedging opportunities for them. At the same time, the financial burden imposed on suppliers should be balanced, the concentration of market power should be avoided and competitive pricing needs to be ensured. For consumers it should be possible to choose the level of exposure to short term market volatility that suits their preferences. Therefore, both variable (or even dynamic) price contracts and fixed price contracts should be available. We also need to strengthen consumer protection in cases of insolvency of electricity suppliers and against unfair practices. Additionally, it is especially important to look at those solutions which enable consumers to be protected against unexpected electricity bill increases, whilst at the same time enable and incentivize them to contribute to the green transition. For instance, via the saving of energy and the flexibilisation of their demand. This becomes increasingly important with larger shares of renewable energy production. Finally, we should also reduce barriers for the entry of new market participants, such as prosumers and energy communities, facilitate the sharing of energy and better exploit system services from distributed small scale installation, thereby contributing to reducing consumers' energy bills as well as grid/system operation.

- **Improve resilience to external shocks.** External shocks causing high or low prices may occur again in the future. The electricity market should become better prepared for such external shocks. This will better protect consumers, create trust in the market and support a stable investment environment. This could, for example, include improved financial instruments and forward markets to better handle risk exposure and increased focus on market integration. Also the relevance of market-based power Purchasing Agreements (PPAs) should be strengthened.
- **Every market reform needs to make the market fitter for renewable energy and ensure effective price signals for flexibility to develop.** As we continue to integrate more renewable energy in the European power system, flexibility sources such as energy storage and demand side response are increasingly important to maintain security of supply. For these sources of flexibility to develop in sufficient amounts, our electricity market design must ensure efficient price signals that reflect the fluctuating demand for flexibility. We should in particular make better use of demand response in the intraday and day-ahead markets, as this is underutilized in the current market design.
- **Ensuring effective cross border trade as one important element for security of supply.** An open and competitive EU-internal energy market is an important element to ensure security of supply, especially by cross-border trade and cross-border physical flows at all time and under all circumstances as far as technically feasible. Efforts must therefore continue to build upon the solid foundations of short-term markets, as also recommended by ACER.

With those principles in mind we look forward to continuing the discussions on how to improve the functioning of the EU's electricity market design in a targeted approach to ensure an efficient, well-interconnected and integrated internal electricity market for the future. Any reform going beyond targeted adjustments to the existing framework should be underpinned by an in-depth impact assessment and should not be adopted in crisis mode.