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Orgalim Position on Revised Electricity Market Design

Executive summary

Orgalim, Europe's Technology Industries, welcomes the European Commission's proposal for a revision of the internal electricity market rules which was adopted on 14 March 2023.¹ The proposal maintains the market logic that has underpinned the successes of the common electricity market by retaining the marginal pricing model and thereby preserving incentives to pursue energy efficiency and renewable expansion goals. At the same time, it introduces important adjustments that will be necessary to ensure that prices remain predictable and sustainable, thereby enabling the continued competitiveness of European industry and preserving social stability by reducing pressures on private consumers. It should be the ambition of the Commission, and the co-legislators in the European Parliament and the Council, to conclude this reform swiftly – ideally before the end of the legislative period in 2024.

However, to fully deliver on its ambitions certain adjustments must be made to the Commission proposal; in particular, it must be ensured that the foreseen tools – especially Power Purchasing Agreements (PPAs) and Contracts for Difference (CfDs) – are voluntarily and efficiently deployed and do not inadvertently undermine the market mechanism and unbalance the liquidity in the short- and long-term markets. Furthermore, there should be stronger links with initiatives to incentivise energy savings and promote electrification, including through significant improvements to the technological state of European electricity grids. Orgalim is further concerned about the proposed crisis mechanism, which is vague and therefore risks undermining the stability and predictability that is needed for investing in renewable and low-carbon energy.

In particular, Orgalim seeks to comment on the following:

- Maintain the market-based pricing mechanism
- Improve the accessibility of Power Purchasing Agreements
- Caution on Contracts for Difference
- Use available tools to boost demand-side flexibility
- Kickstart investment in grid technology
- Extension of energy sharing
- Peak shaving products
- Energy crisis mechanism
- Greater focus on improving energy efficiency

¹ Concretely, the reform consists of a revision of Regulation (EU) 2019/943 on the internal market for electricity (Electricity Regulation), Directive (EU) 2019/944 on common rules for the internal market for electricity (Electricity Directive), Directive (EU) 2018/2001 on the promotion of the use of energy from renewable sources (recast) (RED II), Regulation (EU) 2019/942 establishing a European Union Agency for the Cooperation of Energy Regulators (ACER Regulation).

General remarks

Electricity prices in the European Union have significantly exceeded sustainable levels in recent years. In particular, the substantial and immediate reduction in the supply of natural gas to the bloc following the Russian invasion of Ukraine has led to extraordinary energy prices and the risk of disruption in the European energy supply. Both industrial and private energy users have faced enormous challenges in the face of these higher prices, putting the competitiveness and social stability of the EU under strain. As such, the crisis presents the EU with the need to strengthen and increase the resilience of the present market design and to incentivise the build-out of green energy to reduce the dependency on fossil fuels and increase energy independence in the EU.

While the market has stabilised in the short term due to improvements in the energy supply that have mitigated the soaring energy prices, it is to be expected that price spikes of the kind seen in 2022 could possibly happen again in the near future and will therefore continue to pose a risk to electricity consumers in the years to come; even as the Union progresses steadily on the path to decarbonisation, it is currently not realistic to assume that it will be able to fully avoid the use of fossil fuels in electricity production in the coming decade. Consequently, it is vital to adjust the electricity market to ensure that prices remain stable and competitive, while continuing to encourage decarbonisation and energy savings. The large investments needed in the electricity system in view of electrification – both in relation to production and infrastructure – must be done in a cost-efficient manner, bearing in mind the long-term competitiveness of European industry. The security of supply for end customers and the preservation of Europe as a business location through competitive electricity prices must be at the centre of the priorities. In this context, it is particularly regrettable that the present Commission proposal is not accompanied by an impact assessment.

The best means to ensure this is a rapid-roll out of renewables and low-carbon electricity capacities, as well as a carefully calibrated combination of different measures, ranging from greater accessibility to Power Purchasing Agreements (PPAs) and a limited deployment of Contracts for Difference (CfDs) to promote the smart upgrade of electricity grids and improvements in energy efficiency. Market-based pricing must remain the foundation of the EU electricity market. The proposed revision of the EU Electricity Market Design (henceforth “EMD revision proposal”) addresses these challenges for the most part, but not to their full extent.

Electricity market design change on its own will not solve the current energy price crisis, which can be defined as a energy supply bottleneck. The Commission itself indeed recognises this in its EMD revision proposal. The main focus of action for the EU and its Member States therefore has to be to increase the production and importation of renewable and low-carbon electricity along with investments in electricity grids.

Orgalim comments

Maintain the market-based pricing mechanism

Orgalim welcomes that the Commission has opted to maintain the marginal pricing system based on merit order in the EMD revision proposal. It is fundamentally important that electricity prices continue to realistically reflect the state of play on the market, as this is the best guarantee to incentivise the expansion of renewable and low-carbon energy capacities and efforts to boost greater energy efficiency and savings. It is also important to emphasise that any measure taken at European level to alleviate price spikes respects and maintains the basic market logic underpinning the price formation system (see “Energy crisis mechanism”).

Improve the accessibility of Power Purchasing Agreements (Article 19a)

Power Purchasing Agreements (PPAs) are an effective tool to protect consumers and accelerate the deployment of renewable energy capacities, especially when concluded on a long-term basis. The prominent focus placed by the Commission on promoting their uptake through support and incentives is therefore welcome. However, certain principles must be observed as part of this initiative: first, the uptake of PPAs should stay market-based and direct market

intervention must be kept to a minimum. It is important that the instruments for increasing the use of PPAs are encouraged but remain voluntary, especially when designing tenders for renewable energy projects, as different factors can be relevant depending on the Member State. It is furthermore essential to clarify how the liquidity of the energy exchanges can be ensured in connection with the promotion of PPAs. Otherwise, PPAs could set aside considerable amounts of electricity from the electricity market. This decreasing liquidity could in turn have the effect of increasing prices on the power exchanges.

Likewise, it must be ensured that the potential offered by this instrument is fully tapped into by identifying and removing the main obstacles and barriers to the greater use of PPAs in the EU. To begin with, their accessibility for all consumers, in particularly Small and Medium-sized Enterprises (SMEs) should be improved: to them, PPAs often remain a challenging type of contract due to the strict conditions attached and their possible drawbacks considering strongly fluctuating market prices and the complexity involved in completing the contracts and including them in accounting. These challenges are exacerbated by the fact that many smaller consumers lack the resources to employ consultancy services to overcome these barriers. These issues could be addressed through a proposal to increase the level of PPA standardisation, for instance by defining a framework for accountancy standards for PPAs. It is commendable that the Commission has recognised that the principal challenges to the wider uptake of PPAs are at national, rather than European, level: while they are already more widely used in the Nordics, Germany currently has legislation in place that challenges the wider use of PPAs.

Voluntary Contracts for Difference (Article 19b)

Contracts for Difference (CfDs) can make an important difference in promoting the expansion, and thus uptake, of novel renewable and low-carbon energy technologies. They could further boost energy efficiency if Member States are encouraged to use the revenues from CfDs for corresponding measures, thereby creating a virtuous cycle.

Nevertheless, the uptake of CfDs should remain voluntary, to take account of specific situations in Member States which will be primarily responsible for designing and deploying CfDs. In certain circumstances, their obligatory introduction across the EU could undermine the market mechanism and also risk disincentivising overall electrification and energy efficiency, as businesses may no longer base their decision-making solely on the evolution of electricity market prices but rather on the expected returns from CfDs. It is essential to acknowledge the necessity for the physical electricity system always to remain in balance, across the whole system.

Using available tools to boost demand-side flexibility

Improving demand-side flexibility is key to mitigating supply challenges and high electricity prices. Action at EU level should therefore attribute great importance to this area. The proposals under Articles 19c and 19d to prepare flexibility need assessments and to set up national indicative objectives for demand-side flexibility and storage are very welcome in this regard. However, there is a need to clarify the notion of “non-fossil flexibility” as used by the Commission in this context since its meaning is unclear. It is necessary to distinguish between production-based flexibility and demand-based flexibility, where the term “non-fossil flexibility” can only meaningfully be used to describe the production side. In the future, there will be greater use of Power-to-X as flexible prosumers offering stability in the energy system. This flexibility will be the foundation for a smart and cost-efficient expansion of the grid infrastructure.

Furthermore, the actions proposed under Articles 19c and 19d are not enough on their own. Crucially, the EU and its Member States already have a powerful range of instruments at hand to increase demand-side flexibility under the existing market design, thanks to the Clean Energy Package of 2019. However, the measures adopted as part of this initiative have in many respects not yet been properly implemented by Member States and the Distribution System Operators (DSOs). This should be addressed promptly: only by using both existing and newly suggested tools for boosting demand-side flexibility will it be possible to effectively address this aspect of the electricity price crisis.

Kickstarting investment in grid technology

The electricity price crisis can only be sustainably resolved if the production and importation of renewable and low-carbon energy is sufficiently increased within the EU. However, this effort must also go hand in hand with a well-functioning and resilient electricity grid. Beyond maintaining the grid's fundamental functionality, the EU must therefore foresee an expansion of the necessary grid infrastructure. Equally as important, it must also tap into the opportunities offered – especially by digitalisation – to make European grids smarter and more efficient in the short to medium term. Smart meters and submeters are among the technological solutions that can make an important contribution to guaranteeing robust grid capacity. At present, however, there are not sufficient incentives to invest in upgraded grids and new infrastructure. While the EMD revision proposal seeks to address this in part, more should be done. In particular, the links to the Net-Zero Industry Act should be considered by co-legislators in this context. System operators play the main role when it comes to investment, but they need to be given the space for such efforts at national level. Addressing challenges related to cumbersome permitting procedures and skills shortages must also be addressed.

Extension of energy sharing (Article 15a)

Orgalim welcomes the Commission's proposal to expand energy sharing schemes and energy community projects. However, this initiative should be extended to cover not only Small and Medium-sized Enterprises (SMEs) and households, but businesses of all sizes. Likewise, greater consideration should be given to the benefits that can be achieved by prosumers, meaning customers that produce their own energy. It should also be borne in mind that there are significant technical challenges to energy sharing via micro-grids and smart grids.

Peak Shaving Products (Article 7a)

Under Article 7a (Electricity Regulation), the Commission proposes the introduction of "Peak Shaving Products" to incentivise a reduced use of electricity at peak demand hours as part of its proposal. As a matter of principle, however, such Peak Shaving Products must be developed by market actors rather than the Transmission System Operators (TSOs) who should focus on supplying reliable transmission of electricity on the market. Moreover, both TSOs and DSOs should be able to procure Peak Shaving Products to alleviate peaks and congestion at all levels. Furthermore, there is a need to principally underline that Peak Shaving Products do not automatically have precedence over other adaptable products such as flexible connection agreements: both instruments may involve redispatching, and in decisions concerning which flexible resources to select first for redispatch the activation of flexible connection agreements could be selected ahead of other flexible resources at a higher cost. If the system operator is obliged to activate other bids prior to flexible connection agreements, these agreements will de facto become ineffective.

Energy crisis mechanism (Article 66a)

Under Article 66a (Electricity Directive), the Commission is granted the authority to declare an EU-wide energy crisis situation should certain conditions be fulfilled. Orgalim regards these proposals as problematic in their present form: for instance, the criteria used for identifying an energy crisis are excessively vague. As a result, their invocation relies largely on the judgment of the Commission, as they cannot be effectively and precisely measured. This is especially significant as the declaration of an energy crisis, with the mandate of intervening in the electricity price and thus artificially capping it below the market price, would risk jeopardising the security of supply, as high prices are a market signal for a shortage and imbalances in the energy markets. This is counterproductive in a crisis situation. The Commission is thus granted potentially significant powers that Orgalim does not consider justified. It is also more widely questionable whether a mechanism for the declaration of an "energy crisis" should be included in market regulation. If a crisis mechanism is maintained, it should be ensured that any measures taken as part of a crisis response will not affect the market logic underlying the energy price formation system. One possible solution could be the introduction of a market-based instrument that could act as a "price shock absorber".

Greater focus on improvements in energy efficiency

The cheapest electricity is electricity that is not used. To achieve its aim of reducing the pressures of high electricity prices on industry and consumers, the EMD revision proposal must therefore further encourage initiatives dedicated to saving electricity or using it more efficiently. This includes incentivising the uptake of corresponding technological solutions such as smart meters and submeters. Accelerating the roll-out of electricity smart meters and setting new ambitious deployment targets (given that the EU's 80% target for 2020 has been missed) is a crucial element to build a more resilient and consumer-centric EU electricity market. Co-legislators should also explore possible synergies between the EMD revision proposal and the recent proposals for the Energy Performance in Buildings Directive (EPBD): in particular, the Smart Readiness Indicator that evaluates a building's ability to support the grid and the deployment of BACS (Building Automation Control Systems) may help with promoting a more efficient use of electricity and relieve pressure on the market. The possible opportunities offered by the European Parliament's proposal for a stand-alone inclusion of demand-side response and flexibility within the Energy Performance Certificate should also be assessed in this regard. Beyond the EPBD, potential connections with the revised Energy Efficiency Directive (EED) could also be considered.

Forward markets (Article 9)

Virtual hubs are a novel concept that should be thoroughly assessed by ENTSO-E before being integrated into the market framework. Introducing virtual hubs without proper impact assessment risks increasing complexity in the market while not necessarily increasing liquidity in forward markets. In this regard, it is important to underline the challenges facing forward markets in certain Member States: for instance, the Nordic forward market has been seeing low levels of liquidity due to the need to hedge against both the system price and the price difference between electricity price areas (EPADs).

Instead, the focus should remain on ensuring an expeditious implementation of already identified short-term measures to improve forward markets and auctioning of long-term transmission rights (LTTRs). Fulfilling the potential of the short-term measures must be prioritised before introducing other non-tested measures with long implementation times (five to ten years) as virtual hubs, which can have a disruptive effect.

Therefore, we suggest the further development of the current framework with recognised solutions (i.e. more frequent auctions, switch to obligations) which could alleviate most of the current market flaws within a one to two-year timeframe while allowing a realistic timeline on a proposal for, and assessment of, the introduction of regional virtual trading hubs.

Orgalim represents Europe's technology industries, comprised of 770,000 innovative companies spanning the mechanical engineering, electrical engineering, electronics, ICT and metal technology branches. Together they represent the EU's largest manufacturing sector, generating annual turnover of over €2,906 billion, manufacturing one-third of all European exports and providing 11.19 million direct jobs. Orgalim is registered under the European Union Transparency Register – ID number: 20210641335-88.