

Remarks by the ACER Director at the Informal Ministerial meeting in Stockholm on 27-28 February 2023 hosted by the Swedish Presidency of the Council of the EU

Session 1: Electricity market design

Thank you for the invitation, Mrs. President, Deputy Prime Minister Busch. Good morning, ladies and gentlemen.

I have been asked to provide some words on the upcoming revision of the EU's electricity market design, complementing Commissioner Simson's remarks just now, to kick off the debate.

I will start with the possible implications of timing.

It is likely that for a reform launched in March of this year, *'timing may be driving content'*, so to speak, whereas later on, when the EU political calendar is more conducive to longer and more in-depth negotiations, *'content may be driving timing'*, at least to a greater extent than seems possible in the coming months.

This would seem to have certain implications.

First and foremost, it suggests a need to focus on what I would call *'close to no-regrets'* – i.e. those elements that in all likelihood most Member States and the European Parliament could rally around in the course of an accelerated legislative negotiation.

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What might constitute such *'close to no-regrets'*?

I will start from an unusual place perhaps, namely from that of price volatility.

Most will probably recognise that price volatility is likely here to stay for electricity markets.

This is due in part to more intermittent generation coming online given wind and solar very often are cost competitive vis-à-vis their alternatives. And, as more sectors of the economy turn to electricity to decarbonise, the current 'seasonality' of gas demand in winter for heating – to name but one example – is likely to be gradually transferred to electricity, at least to some extent.

This brings the question how best to tackle such price volatility going forward.

Part of the response will be via more longer-term contracting, complementing current short-term markets.

Longer-term contracts aim to protect against price risk. They mitigate price volatility by providing a contract at an average cost of production plus a profit margin and an insurance premium. In turn, the contract transfers such average-cost prices to the contract recipient or beneficiary, relevant for example for bringing the benefits of, say, lower-cost renewables to end-consumers.

There are different ways to access longer-term contracts.

The most obvious is to have a well-functioning, open-access wholesale market for them. Here ideally, buyers and sellers go on an exchange with plenty of bids and offers and conclude a contract at the price and time duration agreed upon. These are called forward markets.

It is well recognised that our forward markets in the EU need improving. This is because they are not readily available or 'liquid' for timeframes up to, and definitely not beyond, three years. In a nutshell the challenge is that new investors ('the sellers') often want to sign long-term delivery contracts e.g. for 10-15 years ahead, whereas there is little interest on the consumer side ('the buyers') to enter into contracts for such a long time duration.

Hence, it would seem a ‘*close to no-regret*’ in an accelerated market design reform to target improvements to forward market liquidity – both in terms of the volume of offers and the duration of the offers available. ACER has recently put forward proposals for improvements in this respect.

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There are other ways whereby buyers can have access to longer-term contracts.

Some of these are via bilateral contracts concluded between one seller and one buyer. These are called Power Purchase Agreements - or PPAs for short.

Others are via contracts concluded with the government, e.g. a contract where a ‘buyer’ (or more accurately, the winning bid in a government-run auction) is guaranteed a certain price floor in return for the government taking excess revenue above a certain price ceiling – a so-called ‘contract for difference’, or CfDs for short.

Both of these longer-term contract options come with advantages and disadvantages.

To name a few of the disadvantages:

- PPAs are typically concluded between big companies. This is for a reason. Smaller companies are less sure their counterpart will ‘stay in business’ over the next 8 or 12 or 15 years that the PPA lasts and so the counterparty risk for smaller companies is higher. This of course carries a cost, sometimes a prohibitively high one.

Similarly, bilateral contracts often cater to the particular needs of the two parties concluding the contract – meaning those contracts are rarely standardised and so the contract rights cannot easily be traded onwards.

- By comparison, CfDs can provide very significant risk guarantees, meaning investors will easily be able to get financing for their projects. However, some CfDs contain incentives for the recipient generator not to respond to market signals.

For example, if a generator gets the same pay-out irrespective of the prices at the time, the generator may decide to schedule maintenance of its power plant in winter when electricians and materials might be cheaper, even though electricity demand here is higher and supply is more scarce.

This is what we refer to as ‘distortive effects’ on short-term markets. If short-term price signals are distorted by virtue of the approach to CfDs, there is a risk that new flexible assets like e.g. storage will not be incentivised to come into the market at the scale and speed needed. This means either that these assets will stay out or that they will need subsidies to come in; if the latter, thereby risking cascading rounds of subsidies.

This would seem to be the wrong way to go, as we seek to keep an eye on overall affordability of the energy transition ahead.

More importantly, in the context of an accelerated legislative negotiation soon to be launched, it would seem rather far from a ‘*close to no-regret*’ solution.

Suffice it to say then, that for longer-term markets and longer-term contracting, ‘*the devil inevitably lies in the details*’.

This implies a need therefore to balance the headline goals to be targeted with **detailed guidance** at EU level on how these should be pursued – and conversely, what should be avoided.

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There are other trade-offs, too, associated with greater use of government-underpinned long-term contracts.

One example is that the more one opts for government-underpinned contracts, the more one risks to dilute the forward market available for those private entities seeking to manage their price risk on market terms, leaving consumer bills to be largely fixed by tariffs and levies.

This would suggest a role for governments, if choosing to pursue CfDs at scale, to look for ways to sell the contractual rights ‘obtained’ under such CfDs on forward markets – thereby stimulating the liquidity of those markets.

This is something we as ACER with the National Regulatory Authorities for energy have devoted attention to in our extensive contribution to the European Commission’s market design consultation ([available on our website](#)).

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There are obviously several other issues relevant for market reforms in the near-term.

Some revolve around consumer protection, striking the right balance between protection against excessive price spikes and the incentive to reduce at least parts of demand when supply is scarce.

Other issues concern the need to counter market manipulation efforts by increasingly sophisticated, big and also non-EU-based market players – this within the framework we refer to as REMIT, making sure this framework is fully fit for purpose.

Hopefully, also here, it will be possible to settle on certain ‘*close to no-regret*’ options to advance and future-proof our common market framework.

Needless to say, we as ACER stand ready to engage further in such or other discussions should there be an interest.

Thank you for your attention.

Further information is available in the ACER and CEER joint response to the European Commission’s public consultation on electricity market design.

