

Electricity Market Design
Commission consultation on reform to support a clean and affordable energy transition

IFIEC Europe general considerations

IFIEC Europe thanks the European Commission for this consultation, which comes timely given the ongoing energy crisis in Europe caused by the Russian invasion in Ukraine and the subsequent drastic reduction of Russian gas exports to Europe. European industry is struggling under soaring energy prices and this crisis poses an existential threat to the competitiveness of the EU's industrial base. Industries are the backbone of the economy and provide the materials and products needed for the transition towards a climate-neutral economy.

IFIEC Europe clearly recognizes the benefits of the (still ongoing) liberalization and integration process of the EU electricity markets. As has been proven in this sector and in other markets, fair competition and free trade outperform government-driven regulation in terms of prices, security of supply and innovation. IFIEC Europe therefore continues to support the liberalization process, but at the same time underlines the vital importance of ensuring access for industrial consumers to competitive energy prices both in view of global competitiveness as in order to facilitate the energy transition toward a climate-neutral economy.

In the current electricity market design, day-ahead markets (DAMs) play a crucial role, both as a market platform and as a dispatching mechanism to ensure that the assets with the lowest cost in the merit order are activated first, which (provided there is enough competition in the market) incites generators to bid in at or close to their marginal costs. Marginal pricing and the “paid-as-cleared” mechanism have proven to be an efficient way of organizing commodity markets, although they might come with certain disadvantages:

- In electricity DAMs, marginal pricing combined with a high CO₂-price (ETS) leads to substantial windfall profits for non-fossil generators caused by additional costs for fossil plants whenever these deliver the marginal unit. This issue is not addressed by the Commission's consultation (though the Commission has the powers to bring more balance in the ETS mechanism), but results in high extra-costs for consumers.
- In case of extraordinary circumstances and excessively high fuel prices for some generation units (as is the case today with high gas prices), marginal pricing leads to extremely high electricity prices and thus to very high (or even excessive) inframarginal rents for generators that don't experience the high gas prices.

In the consultation, the Commission does not analyze in detail the possible alternatives for marginal pricing and the “paid-as-cleared” principle. Though these alternatives have advantages and disadvantages of their own, IFIEC Europe invites the Commission and regulatory authorities to continue to assess the potential of alternatives with the ability to cope with the extreme circumstances the markets are currently experiencing, and with increasing penetration of intermittent RES in the system.

Inframarginal rents provide generators with additional resources to invest in new, more performing assets. IFIEC Europe therefore suggests the Commission also thoroughly assesses the impact of high inframarginal rents on the need for Capacity Remuneration Mechanisms (CRMs) to compensate generators for “missing money”. Most CRMs in the EU today only look at individual assets' viability without taking into account the overall return of generators with a broad portfolio of assets. If inframarginal rents are judged as excessive by society, they could be creamed off by taxes without, however, creating distortionary effects in the internal energy market, and in a way that does not bias investment signals.

Any possible electricity market design reform should also look at the increasing share of (often intermittent) renewable energy sources (RES) in the electricity generation mix. In that respect, IFIEC Europe would like to underline the following elements:

- The EU Emission Trading System (ETS) is a cornerstone instrument for climate policy designed to reduce carbon emissions in the power sector and concerned industrial sectors. ETS pushes electricity generators to gradually reduce their emissions, while fully respecting technology neutrality. However, deployment of RES has been driven mainly by subsidies and support schemes in the past years (almost 450bn euros between 2015 and 2020). IFIEC Europe therefore calls upon the Commission:
 - to reduce intervention in the ETS mechanism and allow the inherent market mechanism and gradual reduction of available rights to reduce emissions within the eligible sectors at the lowest possible cost, while continuing to protect industry against the negative impact on its global competitiveness;
 - to respect technology neutrality in the electricity market and limit support to specific technologies to innovation, research & development and demo projects. IFIEC Europe insists on the need to reduce market distortions rather than introducing new ones;
 - to fully recognize that other technologies (CCS/CCU, nuclear, ...) can also contribute to reducing carbon emissions in the power sector, possibly at a lower cost.
- High penetration of RES leads to higher peak production at some moments. These peaks can partly be absorbed by system flexibility (storage) or energy conversion to molecules. These technologies have technical limitations and are still relatively expensive. It is therefore preferable to support (technologic end economic) improvements in these technologies in order to allow the system to absorb more RES energy when available.
- Demand response can also contribute to cope with high or low availability of power, but this requires price volatility with prices high or low enough to justify the economic and technical costs. This might be in conflict with the aim for price stability expressed in the consultation document. Here too, market-based solutions should be promoted, to activate the most cost-efficient solutions across the economy. To that end, regulatory barriers should be lifted and regulatory conflicts should be resolved (e.g. between demand response vs. energy efficiency).

Organized forward markets offers a market place of hedging instruments, but there are concerns about market transparency and liquidity and the duration of the available products are relatively short (<3yrs). IFIEC Europe welcomes initiatives to explore improvements in forward markets. We recognize that organised forward markets is in competition with bilateral contracts (OTC). The potential trade-off between a large extent of long-term contracts and liquidity in the short term markets should be investigated. Different consumers have different characteristics, different capabilities, different consumption and risk profiles, so any mechanism must allow for diverse hedging opportunities and be on a voluntary basis. Long-term contracts negotiated directly between generators and consumers should be adaptable to these differences. At the same time they enable investments for producers as they reduce the cost of capital and facilitate financing.

13 February 2023