Union’s electricity market design: Regulation

2023/0077A(COD) - 14/03/2023 - Legislative proposal

PURPOSE: to revise the Union’s electricity market design to boost renewables, better protect consumers and enhance industrial competitiveness.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: very high prices and volatility in electricity markets have been observed since September 2021. This is mainly a consequence of the high price of gas, which is used as an input to generate electricity. The Russian invasion of Ukraine has also caused uncertainty on the supply of other commodities, such as hard coal and crude oil, used by power-generating installations. This has resulted in substantial additional increases in the volatility of price levels of electricity.

The EU reacted swiftly by introducing a wide range of measures to mitigate the impact of high and volatile wholesale energy prices on households and businesses. However, the European Council has called on the Commission to work on a structural reform of the electricity market, with the dual objective of securing European energy sovereignty and achieving climate neutrality. The proposed reform forms part of the Green Deal Industrial Plan aimed to enhance the competitiveness of Europe's net-zero industry and accelerate the transition to climate neutrality.

CONTENT: the Commission proposal foresees **significant revisions to several pieces of EU legislation**, notably the Electricity Regulation, the Electricity Directive and the REMIT Regulation. It includes a set of measures aimed to make electricity bills less dependent on fossil fuel prices by creating a buffer between short-term markets and the electricity bills paid by consumers.

Proposal’s objectives

Protecting and empowering consumers

High and volatile prices, such as those seen in 2022 provoked by Russia's energy war against the EU, have put an excessive burden on consumers. To protect them from volatile prices, the proposal will provide for the right to **fixed price contacts** as well as **dynamic price contracts**, the right to **multiple contracts** and to better and clearer contract information. Consumers will be offered variety of contracts that best fits their circumstances. In this way, consumers, including small businesses, can **lock in secure, long-term prices** to mitigate the impact of sudden price shocks, and/or they may choose to have dynamic pricing contracts with suppliers if they wish to take advantage of price variability to use electricity when it is cheaper (e.g., to charge electric cars or use heat pumps). Such a combination of both dynamic and fixed pricing allows to keep market incentives for consumers to adjust their electricity demand, while providing more certainty also for those who wish to invest in renewable energy sources (rooftop solar panels for instance) and stability of costs.

The protection of **vulnerable consumers** is also significantly enhanced. Under the proposed reform, Member States will protect vulnerable consumers in arrears from being disconnected. Also, it allows Member States to extend regulated retail prices to households and SMEs in case of a crisis.

The proposal will empower consumers by creating the right to **share renewable energy directly**, without the need to create energy communities. Greater energy sharing (e.g., sharing surplus roof top solar power with a neighbour) can improve the use made of low cost renewable energy and provide greater access to direct use of renewable energy for consumers who might not otherwise have such access.

Improve competitiveness of EU industry

Over the past year, many companies have struggled with excessively volatile energy price. To enhance the competitiveness of EU industry, the reformed electricity market design would improve access to more stable longer-term contracts and markets. Power purchase agreements (**PPAs**) - long-term private contracts between a generator (typically renewable or low carbon) and a consumer - can protect against price volatility, but they are currently mostly available only to large energy consumers in very few Member States. A barrier to the growth of this market is the credit risk that a consumer will not always be able to buy the electricity over the whole period. To address this, Member States should ensure that instruments to **reduce the financial risks** associated to off-taker payment default in the framework of PPAs, including guarantee schemes at market prices, are accessible to companies that face entry barriers to the PPA market and are not in financial difficulty.

To **stabilise prices**, investment support should be structured as "two-way" (**two-way contract for difference**), which set a minimum price but also a maximum price, so any revenues above the ceiling are paid back. The proposal will apply to new investments for the generation of electricity, which include investments in new power-generating facilities.

A further means of guarding against volatile prices is to use long term contracts that lock in future prices (" **forward contracts**"). This market shows low liquidity in many Member States but could be boosted across the EU, so that more suppliers or consumers can guard against excessively volatile prices over longer periods of time. The proposal will create regional reference prices via a hub to increase price transparency and oblige system operators to allow transmission rights longer than a year, so that if a forward contract is between parties across regions or borders, they can ensure transmission of the electricity.

In addition, to ensure markets that behave competitively and prices are set transparently, regulators' ability to monitor energy market **integrity and transparency** will be enhanced.

Boost renewables and low carbon investment

The proposal seeks to boost renewable energy investment, in order to ensure that deployment triples, in line with European Green Deal goals. This will be achieved partly by improving the markets for long term contracts. **Power purchase agreements** and contracts for difference not only provide consumers with stable prices, they also give renewable energy suppliers reliable revenues. This lowers their financial risk and greatly reduces their cost of capital. This creates a virtuous circle where stable revenues lower costs and boost demand for renewable energy.

Renewable energy is also a better investment when its ability to produce power is not curtailed due to technical constraints in the system. The more flexible the system is (generation that can rapidly turn on or off, storage that can absorb or put power onto the system, or responsive consumers who can increase or decrease their demand for power) the more stable prices can be and the more renewable energy the system can integrate. For this reason, the proposal requires Member States to assess their needs for power system flexibility, establish objectives to deliver on these needs. Member States can design or redesign capacity mechanisms in order to promote low-carbon flexibility. Moreover, the proposal opens the possibility for Member States to introduce **new support schemes for non-fossil flexibility** such as demand side response and storage.