



– Position Paper –

## Europex assessment of the EMD review proposal

Brussels, 27 April 2023 | The Commission’s legislative proposal to review the EU Electricity Market Design (EMD) published on 14 March 2023 aims to respond to the ongoing energy crisis and act as a tool to accelerate the pace of the energy transition.

Europex welcomes that this proposal generally builds on the achievements of 25 years of successful electricity market integration, preserving the fundamentals of well-functioning short- and long-term markets, further incentivising the deployment of flexibility and improving consumers’ rights and engagement. However, we are concerned that some amendments seek to seriously alter parts of the existing short- and long-term markets with possible negative consequences for market efficiency and its ability to incentivise decarbonisation at least cost. We urge lawmakers to carefully assess these proposals to ensure that the EMD package is beneficial to the functioning of short-term markets, the liquidity of long-term markets and the deployment of flexibility assets.

In the following, we assess several crucial proposals and suggest improvements where appropriate.

### 1) Single legal entity for market coupling

**Article 7.** The proposed amendments to Article 7, paragraph 1, mandating a single legal entity (hereafter the “entity”) to organise the management of day-ahead and intraday markets should be entirely removed.

The proposed change would entail a profound disruption of the existing market coupling system, directly affecting its governance and operational arrangements. Neither the Commission proposal nor the accompanying staff working document provide any justification for drastically rearranging the organisation of short-term markets. The governance of the Single Day-Ahead Coupling (SDAC) and Single Intraday Coupling (SIDC) had not been identified as a shortcoming of the existing market design. On the contrary, Recital 7 indicates that “short-term markets and the pricing mechanism based on marginal pricing should be preserved, as they function well and provide the right price signals. Short-term (day-ahead and intraday) markets are well-developed, and they result from years of implementation of EU energy legislation”.

Since the adoption of the Capacity Calculation and Congestion Management Guideline (CACM GL) in 2015, NEMOs and TSOs have been successfully cooperating to organise market coupling and drive innovation across the Internal Energy Market. There is no factual evidence to suggest that a centralised structure would increase the efficiency of EU market coupling or

have a positive impact on electricity prices. Furthermore, as the future energy system will be characterised by a high share of decentralised renewable energy, a greater degree of centralisation may hamper the markets' ability to respond to the related challenges. The possible establishment and implementation of a single legal entity would take several years, involve significant cost and complexity, divert scarce resources from important ongoing and future projects, and limit the ability to bring innovative solutions to the market at a crucial phase of the energy transition. Any eventual centralisation of the existing operational, clearing and settlement frameworks would create a single point of failure, which is not the case today in the existing decentralised market coupling structure.

This concept was not discussed as part of the public consultation and, thus, no stakeholders have had the opportunity to provide feedback ahead of the proposal. In addition, no cost-benefit analysis or impact assessment has been conducted to demonstrate the efficiency and added value of a single legal entity. Both of which make it very difficult to provide a proper evaluation at this stage.

As a consequence of the abovementioned issues, the proposed amendments to Articles 7 and 59 are in breach of the fundamental principle of "proportionality" as defined under Article 5(4) of the Treaty on the Functioning of the European Union (TFEU).

**Article 59.** The introduction of a single legal entity for market coupling is also referenced in Article 59. As explained above, this drastic change to the market coupling structure would severely disrupt the well-functioning of short-term markets and the existing EU market coupling arrangements. Hence, we suggest removing the amendments to Articles 7 and 59.

## **2) Peak shaving products**

**Article 7a.** Europex welcomes the Commission's acknowledgment of the positive contribution of flexibility resources (i.e., demand response, storage) to reducing Europe's dependency on gas-based power generation and related gas price volatility. It is of absolute importance that demand response and storage solutions are further integrated in the wholesale electricity market. The Clean Energy for All Europeans package adopted in 2019 already set useful rules to develop more flexibility. Still, in many Member States the actual implementation of these rules is lagging behind. National governments should comprehensively apply Article 32 of the Electricity Directive ((EU) 2019/944) which mandates DSOs to consider market-based flexibility procurement. These local flexibility markets should be linked to wholesale electricity markets which, together, can help TSOs and DSOs handle congestion and cover grid investments while improving the profitability of flexibility assets to guarantee the incentive for their development.

However, the suggested peak shaving products, which would be procured by TSOs after SDAC but before the balancing market start, are not the best approach to foster the development of flexibility assets. The activation of demand reduction by TSOs before the balancing timeframe would certainly distort the intraday market prices, which should rather remain the main signal for the efficient development of flexibility solutions. The proposed new Article 7a should therefore be entirely removed.

Flexibility assets are well-suited to fully participate in SDAC and SIDC in both peak load and non-peak load situations. Before enabling a new ancillary service, the integration of demand response and storage in the existing short-term markets should be fostered. Nonetheless, if an analysis justifies the need for an additional service to ensure security of supply through demand reduction during peak hours, this should be restricted in order to avoid any negative impacts on the day-ahead and intraday markets, and preferably should include the possibility to utilise those markets for such peak shaving products.

### 3) Regional virtual trading hubs

**Article 9.** The proposed mandatory introduction of several regional virtual trading hubs should be entirely removed as it will fragment liquidity rather than help to improve it.

First, it is the market operators' role and natural interest to develop hedging products. The competitive environment in which they engage has led to many innovative cross-border hedging products, including EPAD (Electricity Price Area Differentials) contracts in the Nordics and locational spread contracts on the continent.

Secondly, the proposal to establish regional virtual trading hubs could be severely damaging in markets where well-functioning hedging possibilities are already available. This is the case, for example, in the CORE region where German power futures are combined with spread futures, and in the Nordics where a Nordic System Price (SP) contract is complemented with EPAD contracts (settled according to the difference between the SDAC bidding zone price and the SP). The forced establishment of regional virtual hubs and zone-to-hub LTTRs directly interferes with present solutions, ultimately fragmenting rather than improving liquidity.

Thirdly, in order to be properly hedged, there is no need to ensure full transmission capacity. The EPADs in Nordics and spread futures in the CORE region demonstrate that cross-border forward hedging can be done independent of transmission capacity and should not be limited to the amount of available transmission capacity. On the contrary, LTTRs issued by JAO and the TSOs are fundamentally linked to physical transmission capacity limits and the expected congestion income of TSOs. Moreover, allocating cross-border capacity sooner than necessary only leads to difficulties in forecasting transmission capacity, and hence, increased financial risk for TSOs, the costs of which will be borne by end-consumers. Furthermore, the existing market-based cross-border hedging products have the additional advantage that any market participant, not only the TSO, can be a counterparty, including market participants active in bidding zones not physically connected to the bidding zone in which they seek a cross-border hedge.

Hence, having TSOs provide cross-border related long-term products should always remain a fallback option if market-based solutions are not forthcoming or if those pre-existing are not deemed sufficiently liquid. In that case, the choice of providing LTTRs in the form of financial transmission rights (FTRs) or more directly bidding zone related hedging products (e.g., EPADs) should be free to apply as an additional measure from TSOs, in accordance with point (b) of Article 30(5) of Regulation (EU) 2016/1719 establishing a guideline on Forward Capacity Allocation (hereafter the FCA Regulation).

In addition, we firmly oppose that the proposed decision-making process for establishing virtual trading hubs, and how such prices would be calculated, is fully mandated to ENTSO-E and ACER without explicitly including NEMOs, derivatives exchanges and market participants. We also strongly disagree with the proposed introduction of an exclusive monopoly role for JAO to offer on behalf of TSOs auction trading in not only pre-existing zone-to-zone LTTRs but also zone-to-hub LTTRs.

Nevertheless, Europex recognises that regional price references can be effective in forward markets of Member States or regions with an internal zonal configuration. For instance, in the Nordic Countries the usage of a single Nordic System Price – which could be deemed to be similar to a “hub” and where future contracts are combined with EPADs – has been positively assessed. A further example is in Italy, where the existing PUN price has worked well as a virtual trading index. Both these models have been functional as they have been brought forward by market operators according to market needs and physical market fundamentals, without being vertically imposed by regulation.

If regional virtual trading hubs were to be introduced, it is of utter importance that already existing regional price references are maintained in order to avoid that Member States with an internal zonal configuration are split into different virtual trading hubs. Otherwise, this would result in market fragmentation, thus jeopardising the overall market functioning.

In addition, the virtual trading hubs proposal was already consulted by ACER last year and only received a 12% approval rating by the respondents. We are concerned that such a model is being proposed after being categorically rejected by direct stakeholders. In addition, the Electricity Regulation is not the proper framework to prescribe zone-to-hub LTTRs, which should be instead assessed in the review of the FCA Regulation involving all stakeholders. Indeed, the FCA Regulation should retain the possibility to implement other long-term cross-zonal hedging products to support the functioning of wholesale electricity markets, such as EPADs which are considered as cross-zonal hedging products as under point (b) of Article 30(5) of the FCA Regulation.

Finally, instead of the establishment of regional virtual trading hubs, we believe that forward market development would significantly benefit from a streamlining of market rules and regulations, particularly financial services regulation. Simplifying these would reduce the barriers to entry for new participants and encourage the development of new products and services. Furthermore, refraining from policies which directly intervene in the market would improve certainty and help to promote forward market liquidity. Enhancing the predictability of market design allows participants to enter more confidently into long-term hedging positions. Allowing for a broader variety of accepted collaterals by clearing houses could also help market players to mitigate their risks via financial instruments. For example, as the value of power or gas supply contracts follows the value changes of open positions, they could serve as good supplement to current solutions. In addition, enabling spread products with mandatory cross-margining between the clearing banks could also increase forward markets liquidity.

#### 4) Power Purchase Agreements

**Article 19a.** Europex welcomes the Commission’s objective to increase the deployment of Power Purchase Agreements (PPAs) to complement existing hedging solutions. Nevertheless, the proposed amendments can be further improved.

We agree that Member States should facilitate the deployment and market integration of PPAs while safeguarding competitive and liquid electricity markets. Moreover, it is of utmost importance to clearly define the term “guarantee scheme”. If not properly designed, such guarantee schemes may interfere with market-based tools to manage counterparty default risk, and, if implemented inconsistently, negatively affect market liquidity. Guarantee schemes for PPAs should apply to collateral requirements, regardless of whether PPAs are concluded bilaterally or via regulated marketplaces. Finally, the legal text should differentiate between physical and financial PPAs: particularly the latter can be an optional market-based management tool to hedge against price and volume risks in the electricity market for longer time horizons.

#### 5) Direct price support schemes for new investments in generation

**Article 19b.** Two-way contracts for difference can be complementary instruments to forward hedging and PPAs as they can respond to a wide range of customer needs and preferences.

Nonetheless, CfDs should not become the primary investment instrument for new low-carbon capacity but could act as a targeted supplement to market-based tools. Their design must ensure fair competition, enhance market liquidity and deliver long-term investment signals. In order to minimise their negative impact on spot market pricing and dispatching signals as well as on forward market liquidity, these instruments should be auctioned in an open, competitive and non-discriminatory manner. In addition, they should be designed so that they can keep a direct connection to the spot market which they reference and follow its volatility, thereby ensuring that market participants are not price indifferent.

Finally, Member States should have the possibility to choose the support schemes that suit their needs, CfDs should not be the sole option available.

#### 6) Flexibility support schemes

**Article 19e.** As with Article 7a, Europex supports the increased deployment of flexibility assets, such as demand response and storage, mainly by facilitating the integration of these resources in existing short-term markets, e.g., DA and ID, and by incentivising local flexibility markets.

Regarding capacity remuneration mechanisms (CRMs), in many Member States, the current setup is disruptive to the EU electricity wholesale market. This is because different national CRMs often support fossil-fuel based electricity production rather than incentivise the development of demand response and storage. Also, in many cases, these are not limited to peak power (MW) delivery periods but directly or indirectly give support for longer periods of energy (MWh) deliveries throughout the year. At the same time, CRMs should be permissible

only as mechanisms of last resort that are activated only when strictly necessary and eliminated once they are no longer required. Finally, CRMs should be organised as capacity markets in order to tackle adequacy concerns in the most efficient way.

**Article 19f.** Flexibility support schemes can be a valid alternative but with certain conditions, i.e., as set under points (e), (f), (g) and (h) of this article. Namely, these support schemes must be market-based and technology neutral to avoid distorting the well-functioning of electricity markets in terms of price and dispatching signals.

## **7) Access to affordable energy during an electricity price crisis**

**Article 66a.** Europex is firmly convinced that vulnerable end-consumers should always be protected from excessive price volatility. However, declaring an “electricity price crisis” does not seem to be the most appropriate tool to do so. Such declaration would undermine trust in well-functioning electricity markets, potentially eroding the confidence of market participants and investors, worsening any situation of high price volatility rather than improving it.

The proposed parameters set out in points (a), (b) and (c) of paragraph (1) are inconsistent with the price evolutions of the last few years, during which electricity prices have significantly fluctuated. We find these conditions to be too detailed and too restrictive to fully take into account the circumstances surrounding any potential future price fluctuation. Measuring current prices against historical levels should also consider external factors which influence prices.

As an alternative, it would be preferable for the Commission, ACER and Member States to jointly assess ad-hoc the level of wholesale and retail prices and their impact on the economy overall before declaring a price crisis. In addition, in case an electricity price crisis was declared, this decision should be periodically re-evaluated by the Commission and ACER to ensure the well-functioning of wholesale and retail electricity markets. Also, more flexibility should be given to those Member States where smart metering has not been fully implemented yet in setting regulated prices for end-consumers, provided that the Internal Energy Market is not distorted.