

Electricity market reform, beyond the gas crisis

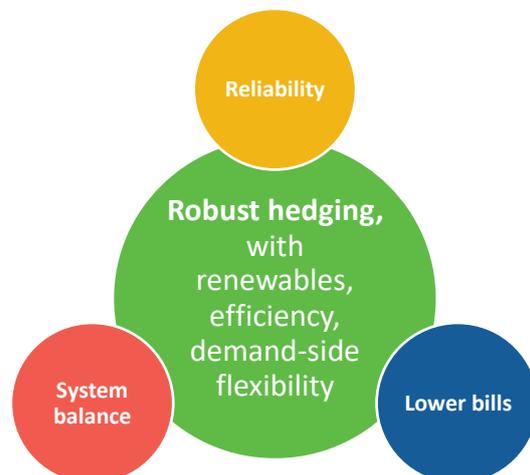
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December 2022

The European Union finds itself on the eve of a new round of electricity market reforms. This brief paper lays out where new market regulation would usefully tackle the **root causes** of the ongoing energy crisis, meet immediate **consumer needs** and help Europe move **away from fossil fuels**.

In the past, power market reform happened to increase efficiency, to reduce greenhouse gas emissions, or improve reliability and security of supply. Today in Europe, the interest in reform stems from the ongoing energy crisis. In light of the series of emergency measures that European regulators have put in place to (more or less successfully) mitigate the crisis, there is merit in analysing whether more fundamental market reforms are warranted.¹ Any reform in response to the crisis should be based on a common understanding of what caused the current crisis in the first place: It's a gas crisis, following the Russian invasion of Ukraine, exacerbated by unavailability, as well as decommissioning of nuclear capacity and low hydro output. Hedging strategies by energy suppliers and consumers meant the unprecedented wholesale market prices for fossil gas found their way to some consumer gas and electricity bills quicker than for others.

Therefore, it is logical to focus any reform induced by this crisis on improving hedging in the market to alleviate the remainder of the ongoing crisis and prepare for the next. This requires boosting a new portfolio of longer-term market features. It will mean replacing the role of fossil gas with renewables, demand-side flexibility and energy efficiency.



Translating this into more actionable goals means:

- Demand-sides resources must be recognised and promoted as a vital system resource.
- Building out more solar and wind, and to do so better and faster.
- Basic consumer needs have to be much better protected.

But it is paramount, first of all, to require Member States to prioritise the full **implementation of the Clean Energy for All Europeans and REPowerEU packages** before resorting to new market interventions. Member States may also impose appropriate efficiency or flexibility obligations on energy users and producers seeking aid.

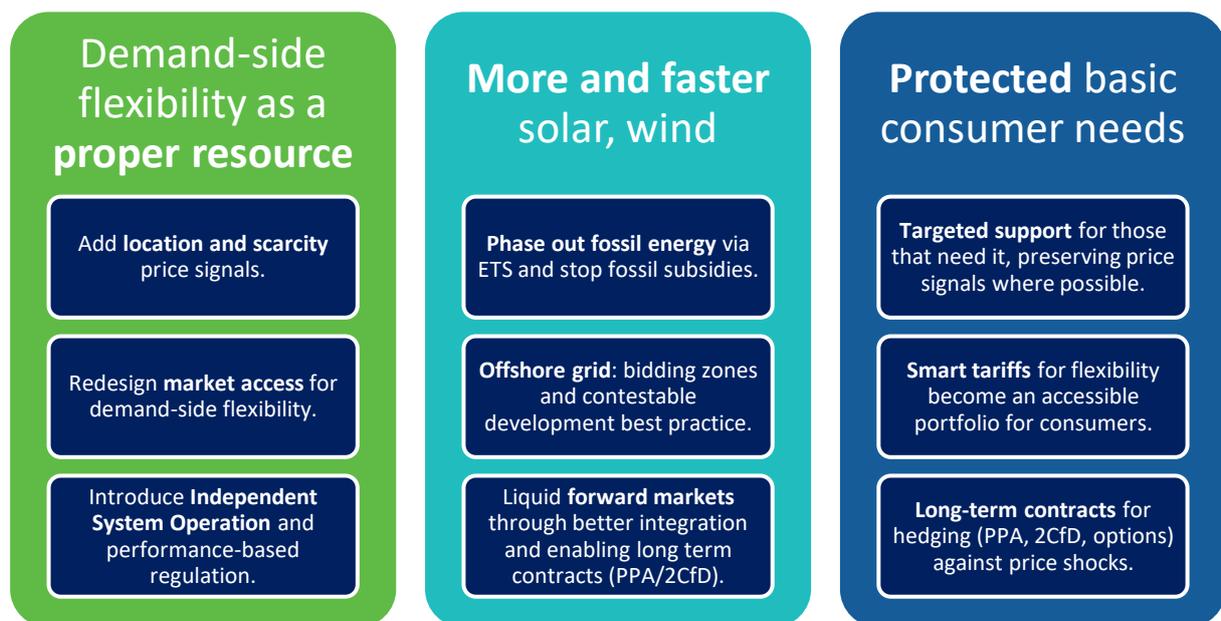
¹ This was a task for the Agency for the Cooperation of Energy Regulators (ACER) in the Spring of 2022. ACER identified 13 possible market improvements but stopped short of calling for deep reform. Agency for the Cooperation of Energy Regulators. (2022, 29 April). *ACER publishes its final assessment of the EU wholesale electricity market design* [Press release]. <https://www.acer.europa.eu/events-and-engagement/news/press-release-acer-publishes-its-final-assessment-eu-wholesale>



A true level playing field for demand-side flexibility and energy efficiency entails tackling regulatory, infrastructure and communication bottlenecks. Price signals need to include **locational** information. Demand-side flexibility and energy efficiency need to be able to participate in all markets designed to be technology-inclusive, for example, by reducing the minimum bid size to 100kW or under for all markets. They also need to facilitate value-stacking by market actors and energy communities.

Evolving towards **independent system operation** enables demand-side flexibility and lower consumer bills. It's important, but will take time, so regulators need to start the process now. A regional power system operator, independent from network ownership, effects better investment decisions and more efficient operation as there are no conflicts of interest to compete with efficiency and a technology-neutral system.

A lack of hedging exacerbated the energy crisis. Therefore, if anything, the new market reform exercise should institutionalise better hedging. **Double-sided contracts for difference** (CfD) for new capital-intensive renewable energy investments are best practice as they provide certainty for both investors and consumers. They can also provide a source of revenue for governments to support vulnerable consumers in times of peaking energy prices. Finally, they lower the cost of capital and support accelerated investment in renewables. It is important that governments carefully design auctions for new CfDs to make sure these sources are exposed to short-term market prices. The presence of **windfall profit taxation** can be an incentive to participate in CfD auctions.



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