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The European Commission

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The Danish Chamber of Commerce contribution to the European Commission's Public Consultation on the initiative: "Reform of the EU's electricity market design"

The Danish Chamber of Commerce welcomes the opportunity to provide input to the public consultation on the Commissions initiative "Reform of the EU's electricity market design".

General remarks

The EU's electricity market has served Europe well for over 20 years. It ensures that the cheapest electricity producing assets are always utilized first and sends a clear price signal to increase supply when demand is high, and electricity is scarce. These features have created enormous benefits for the European consumers over the years, as the embedded investment signals have resulted in increasing renewable which have secured low prices and a stable supply of electricity. For example, in 2021 alone cross-border border trade delivered a system benefit of 34 bn€ according to The European Union Agency for the Cooperation of Energy Regulators (ACER).

Europe's current energy challenges stems from insufficient supply due to dependence on Russian gas and lack of cheap renewable energy. The energy supply and price crises does not stem from structural failures in the market design.

The Danish Chamber of Commerce strongly warns against an overly hurried reform of the European electricity market design not based on thorough analyses and impact assessment, and which alter the fundamentals of the market design.

Structural reforms of the market design entail the risk of worsening the current energy crises by reducing the incentives to invest in new power generating capacity, particularly renewable energy (RE). This would result in higher prices for consumers as well as serious negative consequences for the green transition of the European energy sector.

The European Commission's consultation paper covers a flurry of different policy proposals. Several of the proposals in the consultation will have serious negative consequences for the electricity market if enacted and would result in a de-facto unwinding of the power market liberalization introduced in the 1990s. E.g., fixed prices and revenue curbing as well as a permanent revenue cap for inframarginal generators will not change the power price dependence on the price setting unit. Instead, such measures will only distort trade across market segments and reduce incentives for investments in RE as well as flexibility options on both the supply and demand side.

Therefore, if these very intervening proposals are enacted, they risk aggravating current challenges in the electricity markets and lead to long-term market distortions negatively impacting consumers.

Instead of distorting the design of the electricity market, the Danish Chamber of Commerce encourages the Commission to focus on how to build upon and strengthen the already existing, well-functioning design.

Firstly, this can be done by ensuring that the European electricity market is moving towards a more granular locational pricing. Such an effort could lead to better bidding zones where the market price is closer to the true cost of the electricity.

Secondly, the market for power purchasing agreements (PPAs) and traded long-term contracts should be strengthened. The possibility to enter PPA's bring benefits to both consumers and developers, as it shields consumers from rising prices as well as ensures a stable revenue stream for investments in new wind or solar power projects, thereby increasing certainty for investors.

Lastly, the deployment of renewables in Europe should be accelerated through the elimination of administrative barriers for the approval of new solar and wind power projects.

More granular location prizing, strengthening of the PPA-market and the removal of administrative barriers would strengthen the existing market design, lower prices, and speed up the green transition of Europe keeping us on track to deliver on the Paris Accord.

Specific remarks

<u>*Power purchase agreements*</u>
The Danish Chamber of Commerce supports a strengthening of the market for PPAs. The accessibility of PPAs for smaller consumers should be strengthened. This can be done in a market conform manner – for example by exploring ways in which demand can be pooled. By pooling demand from multiple smaller consumers into one contract, PPA contracts could be offered to SMEs as well.

Currently, developers are incentivized to offer PPAs as they provide a stable stream of revenue. Accordingly, there is no need for public obligations requiring specific amounts of produced electricity being traded though PPAs. Such public requirements could be distorting to the market and result in developers requiring higher payments for their offered PPAs.

The Commission should also investigate how transparency in the market for PPAs could be heightened. Accordingly, the Danish Chamber of Commerce supports efforts to establish and strengthen virtual trading hubs for forward contracts such as PPAs.

The forward market provides one venue for customers and suppliers to manage risk and stabilise cash flow. But it is important to state that optimisation and hedging through forward markets should be at the discretion of the market participant. Accordingly, there should be no hedging obligations on generators, suppliers nor customers. Forced hedging through specific obligations or a similar measure will most likely be counterproductive resulting in extra costs to consumers.

<u>*Contracts for difference*</u>
The Danish Chamber of Commerce acknowledges that contracts for differences (CfDs) can be useful in situations where the necessary investments are not being made on a market basis. CfDs can provide certainty for investors as they guarantee a fixed price independent of the development on the spot markets.

Two-way CfDs guarantee investors a fixed price while any revenue above a set strike price is returned to the state. Two-way CfDs are associated with several pitfalls which should be considered before being applied. First, two-way CfDs decrease the incentive to invest in new renewables if the strike price is set low or even negative. This will lead to higher electricity prices in the medium to long term. Second, two-way CfDs mute the price signal's influence on investors' incentive to build capacity that maximize production when the value of electricity is highest, as producers do not receive higher revenue when the market price goes up. Accordingly, two-way CfDs also decreases the efficiency for short-term dispatch.

Therefore, the Danish Chamber of Commerce strongly warns against mandatory CfD schemes where producers are forced to enter contracts that oblige them to receive a fixed strike price for their electricity. Such mandatory schemes will de facto remove the aligning force of the price signal and be a huge setback for the liberalized European electricity market.

Moreover, the Danish Chamber of Commerce strongly warns against any considerations to force already existing inframarginal generators on to mandatory CfDs. Such a policy would have an expropriative character and would violate basic property rights, fundamental to a free-market economy and the internal market. In practice it would unravel the existing market design and lead to a design resembling a planned economy.

Mandatory CfD-schemes also poses a threat for European taxpayers, as such schemes require member states to pay subsidies in periods where the market price of electricity is lower than the set strike price in the CfD-scheme. As more renewables are deployed across Europe the risk for public budgets would rise dramatically if CfD's are made mandatory for all RE.

Any use of CfD schemes should always be voluntarily – both for producers and member states. Furthermore, the strike prices set in CfD schemes should aim to mimic competitive market prices and be set in competitive auctions – not through ex-post price setting.

Limiting revenues of inframarginal generators
In the consultation, the European Commission asks whether the inframarginal revenue cap, which limits the realised revenues of inframarginal generators to a maximum of 180 Euros per MWh, should be maintained beyond its current expiry date. The Danish Chamber of Commerce strongly warns against such a proposal as it would provide significant design and implementation challenges that can distort the markets for years to come.

If the inframarginal revenue cap is made permanent, it would greatly hamper investments in in new renewable energy production capacity. The Danish Chamber of Commerce would like to remind the European Commission, that renewable energy is the fastest way to increase European electricity generation capacity and thereby lower energy prices, is paramount the Europe's green transition, and is essential if Europe is to become independent of Russian gas.

The revenue cap is a de facto tax on renewables. As such, it should be treated as a tax and thereby as an internal matter for the individual member states – not a mandatory European revenue cap. If a permanent European tax on renewable energy generation is to be introduced, it must be decided under article 113, and not under article 122, in the Treaty on the Functioning of the European Union.

Furthermore, the current difficulties in implementing the temporary revenue cap in member states illustrates that it is highly complex to apply a cap for realized profits as it must take contractual obligations such as existing PPA, forward contracts and over-the-counter agreements into account. The lack of harmonization in the implementation of the price cap and emergency measure in the different member states should also be a concern. The revenue cap's administrative burdens for both private and public stakeholders are therefore quite substantial.

Last, it is not clear how any possible revenues from the revenue cap is to be redistributed in the member states. This uncertainty highlights that it is not even clear that consumers will receive any compensation from the current revenue cap. In contrast, consumers may experience negative net effects due to higher electricity prices in the medium term, resulting from reduced incentives in renewable energy investments.

Offers and contracts
The Danish Chamber of Commerce believes it is necessary to review the regulation regarding fixed price contracts. In this regard it should be considered whether there is a need for a longer minimum fixed term, where the consumer is obliged to follow a contract for a given period if signed (longer than the current minimum of 6 months for green electricity contracts). A longer fixed term could possibly encourage more electricity providers to offer fixed price contracts.

Bidding zones
Bidding zones represent the geographical area within which market participants are able to exchange energy without capacity allocation. Bidding zones should be outlined to accurately reflect supply and demand distribution. Accordingly, bidding zone borders should be based on structural congestions in the transmission grid and should thereby send clear signals to transmission system operators to where investments in new grid capacity are needed.

Sadly, several of the European bidding zones do not truly reflect supply and demand distribution today. For example, there is a high level of congestion within the German bidding zone. Clearly, there is a need for more granular bidding zones within Germany.

The Danish Chamber of Commerce therefore encourages efforts to implement reflective bidding zones in all member states, e.g., Germany. The splitting of Germany into several bidding zones would contribute to more cost effective/reflective prices for all European consumers and increase efficiency in the European energy market.

Removing barriers and incentive to increase capacity is the way to solve the energy crisis
As stated, the current challenges stems from insufficient supply of energy. Accordingly, the appropriate answer to the crisis is to accelerate the deployment of RE across Europe. To accelerate deployment, the EU needs to focus on removing barriers for the deployment of new RE. Permitting processes needs to be simplified across member states, and there should be set clear and binding deadlines for the approvals of new RE projects. Therefore, both the deadlines for permitting and the characterization of RE as an overriding public interest in the EU's temporary framework to accelerate the deployment of RE should be made permanent.

Furthermore, it is essential that grid infrastructure is improved across Europe. A grid for the future is paramount if we are to fulfil the potential of electrifying the European economies. Reflective bidding zones will support incentives to invest in a cost-effective grid. Moreover, permitting processes for grid infrastructure should be characterized as being an overriding public interest, so the approval for new grid infrastructure can be accelerated.

Best regards,

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