PROSPECTUS FOR A CEPS TASK FORCE ON

REFORMING THE MARKET DESIGN OF EU ELECTRICITY MARKETS

Chair: Jacques de Jong, Senior Fellow, Clingendael International Energy Programme; former Dutch Electricity Regulator

Rapporteurs: Christian Egenhofer, Associate Senior Research Fellow, Fabio Genoese, Research Fellow, Anna Dimitrova, Research Assistant, Centre for European Policy Studies (CEPS)

First meeting: 26 November 2014
Second meeting: 22 January 2015
Third meeting: 12 March 2015
Fourth and Fifth meeting (if required): TBA

(All meetings will be held from 10:30 to 16:30)

Meeting venue:
Centre for European Policy Studies (CEPS)
Place du Congrès 1, 1000 Brussels
1. Introduction

During the last decade, there was unprecedented progress towards a more common EU energy policy. This progress was essentially triggered by the formulation of a comprehensive climate change policy for the 2009 Copenhagen climate negotiations and beyond as well as the successive gas crises, which made security of energy supply a priority again. The milestones on this way were 2007 European Council meeting that led to the 2007-08 Climate and Energy Package and the entry into force of the Lisbon Treaty, which established a European Union competence for energy. This was accompanied by the so-called ‘third (energy) package’ of legislative proposals for an internal gas and electricity market. Many thought that an EU energy policy for Europe was within reach.

The belief has been that especially two mechanisms, the Directives on the internal market for electricity and gas, together with the EU Emissions Trading System (ETS), would lead to a convergence of member states’ energy policies or at least better cooperation. In reality member states energy policies have diverged, and cooperation did not materialize, at least not on an EU-wide basis. In the absence of an effective ETS the internal energy market on its own was not enough to forge a European energy policy. While there is a general lack of co-ordination of different member states’ policies, it also become apparent that the current ‘market design’ of EU’s electricity markets may not be the most appropriate to ensure low-carbon development.

But what is probably the most worrying development from an EU perspective is that all of these support schemes have one thing in common: they are designed as national policy instruments. Therefore, they are another nail in the coffin for the idea of having a single energy market, which – one might recall – holds the promise of delivering cost-effective (low-carbon) solutions. Already today, the internal electricity market is far from completed due to a high share of national taxes and levies in end-consumer prices. With a growing number of national subsidy mechanisms and depressed wholesale prices, the share of (national) taxes and levies in the overall price can only increase.

Faced with this situation, a need for action on a European level arises. Textbooks on economics suggest that overcapacity will reduce itself and, as a result, wholesale prices will recover. Furthermore, investments in low-carbon technologies will be made once the CO2 price will have risen to such a level that carbon-intensive power plants have to be taken offline because of economic reasons. This holds true only for competitive markets without state interventions. This is not the case for today’s electricity markets. In some markets, power producers are not even allowed to decommission power plants without prior consent by the regulator. But even assuming a highly competitive and undistorted power market, investments in capital-intensive energy technologies such as renewables, carbon capture and storage or nuclear require a high situation of supply and demand, further adding supply to an already saturated system will further depress wholesale power prices. The current approach is comparable to trying to accommodate a growing number of elephants in a shrinking room.

Furthermore, demand response (i.e. consumers reacting to price signals) – often mentioned as a key element of the future energy system – will not evolve under the current market conditions. The value of decreasing consumption in times of overcapacity is close to zero, simply because there will be no price spikes. And in some markets, the regulator has set price caps and does therefore not allow for price spikes, which would encourage consumers to adapt their consumption pattern.

2. Why reforming the electricity market design?

Under the current market conditions, there will not be any market-driven investments in any technologies, let alone low-carbon ones. Market-driven investments are made when market prices are likely to remunerate an investment. This is not the case right now. Any investment decision taken today is backed up by dedicated support mechanisms – be it feed-in tariffs for renewables (and possibly in the future also for nuclear) or capacity payments for conventional power. Not being market-driven, i.e. not reflecting the actual
and relatively stable CO2 price. Empirical evidence shows that political uncertainty will lead to a higher risk premium on the capital employed, which significantly affects total costs of capital-intensive investments. The crucial question therefore is whether policymakers can credibly guarantee a high and stable CO2 price for the upcoming decades. It remains to be seen whether the Stability Reserve Mechanism for the Emissions Trading System can guarantee all that. Serious doubts remain.

The EU’s role

As the EU Treaty leaves decisions on national fuel mixes to member states, the EU can essentially use its competencies on the internal market and competition policy as well as engaging EU member states in coordination and consensus building.

A first step towards streamlining competition policy has been made with the adoption of the new “Guidelines on State aid for environmental protection and energy 2014-2020” published on 28 June 2014\(^1\). The Guidelines constitute to date the most important and most effective tool for the European Commission to address the challenges described above. They go beyond being merely an instrument to address state aid. De facto, they are one of the European Commission’s principal tools to shape EU energy policy up to 2020 and, more importantly, will have a major impact on the 2030 Climate and Energy Framework, including the review of the Carbon Leakage list\(^2\) and the review of renewables policy\(^3\). But they are only one element of the solution.

Behind the state aid guidelines, looms the far bigger and more complicated issue of electricity market design, and how to adapt it in line with the low-carbon priority. The underlying cost structure of low carbon power sector (as well as other sectors) will see a considerable shift from variable to fixed costs. This is in stark contrast with the current power ‘market design’ where remuneration is based on variable costs. This raises two fundamental questions.

- The first is how the market can be designed in such a way that the underlying cost structure (i.e. mainly fixed costs) relates to electricity prices and the remuneration of generators.
- The second, which is politically even more significant, is how to achieve a transition from one system to another. The transition will be particularly difficult because of its very significant distributional impacts. Such impacts will come into play within the power sector, e.g. between generators, mainly but also between TSOs and DSOs, between different sectors, e.g. power sector, industries or households, between member states and even between regions, at international level between consumer and producer countries and between generations.

The central element is to de-risk investment, for example by appropriate remuneration, e.g. for full costs instead of variable costs.

Given the pressing nature of these challenges, it is expected that the new Commission will soon take up these topics and will come up with a formal set of proposals around the Internal Energy Market. A first step may already been taken in the context of the retail market communication, due very soon.

4. Objectives

Although it will be up to the CEPS Task Force to agree on the terms of reference and final agenda, we propose to explore practical solutions to the challenges identified above or any other that the Task Force may want to focus on. Generally, the Task Force is meant to:

- Assess the on-going EU policy discussions and share knowledge among stakeholders
- Think through ideas and proposals for a new ‘electricity market design’.

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\(^1\) OJC 200/1 of 28.6.2014
• Work out a set of concrete recommendations to be presented to EU and member state policy-makers.

5. Why a CEPS Task Force and how does it work?

CEPS Task Forces constitutes multi-stakeholder fora where representatives from the European Commission (DG Energy, Climate Action, Enterprise, ECFIN etc.), member states’ officials, European Parliament, business and industry, NGOs, energy consumers, International Organizations, academic experts and other stakeholders meet, discuss solution proposals and make recommendations to some of the biggest challenges for the EU.

The new CEPS Task Force will meet five times in the period of a year. All meetings will be held at CEPS, typically lasting from 10:30-16:30. Generally, speakers are recruited from the Task Force, although external speakers can be invited to tap into additional knowledge. Speakers typically speak no longer than 5 to 10 minutes to allow for sufficient discussion time. In order to ensure a broad input from external experts, it is aimed to involve Mike Hogan (RAP), Simon Skillings (E3G), Arne Mogren (Global Utmaning) and Markus Steigenberger (Agora) in the project.

It will be chaired by Jacques de Jong, Senior Fellow, Clingendael International Energy Programme, formerly Electricity Regulator in the Netherlands. The rapporteurs will be Christian Egenhofer, Associate Senior Research Fellow, Fabio Genoese, Research Fellow, and Anna Dimitrova, Research Assistant, all from CEPS. Outreach activities will be directed by Monica Alessi, Research Fellow & Programme Manager, CEPS.

At the end of the Task Force, we will publish a CEPS Task Force Report that will present policy recommendations. This Report will be circulated among EU and member state policy circles. The report will be based on discussions in the meetings, supplemented by research carried out by the rapporteurs. The Draft Task Force Report will be circulated before the fifth meeting to be discussed and approved by the Task Force and then published as a CEPS Task Force Report and circulated among EU, member states and international policy makers.

Note that the CEPS Task Force Report will contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position agreed by all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong.

6. Conditions for participation

The CEPS Task Force is primarily designed for CEPS Corporate Members but participation is open to non-members as well, albeit at a higher fee.

The fee covers participation in all workshops, documentation, lunches and three copies of all reports produced. Upon request by participants, CEPS will mail additional copies of the final CEPS Task Force Report to persons identified by participants.

Participation fees:

€ 1.000 for CEPS Corporate Members
€ 5.000 for non-members

For the detailed programme, please see the Work Programme & Agendas of Meetings.

For Registration, please return the Registration Form in the Appendix.

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4 For further information, please visit www.ceps.eu.


6 Regarding information on CEPS Corporate Membership, please contact Kerstin Born, Director for Corporate Relations (Kerstin.born@ceps.eu) at +32 2 229 3910 or ++32 475 301601.
First meeting of the CEPS Task Force on

Reforming the Market Design of EU Electricity Markets

26 November 2014

- What is wrong with the ‘electricity market design’?
- What can and should the EU do?
- Agreement on final terms of reference

**Tentative Agenda**
(Speakers still to be invited)

Big Conference Room, Ground floor,
CEPS, Place du Congrès 1, 1000 Brussels; tel.: +32 2 229 3911; [www.ceps.eu](http://www.ceps.eu), see online map

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<tr>
<th>Time</th>
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<td>10:00-10:30</td>
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| 10:30-10:35| **Welcome by CEPS**  
Christian Egenhofer, Associate Senior Research Fellow, CEPS |
| 10:35-10:45| **Introduction by the Chair of Task Force**  
Jacques de Jong, Senior Fellow, Clingendael International Energy Programme, The Hague |
| 10:45-11:00| **Short introduction to the Task Force: objectives, scope and proposed timelines**  
Christian Egenhofer, CEPS |
| 11:00-13:00| **Developing the internal electricity market further**  
Klaus-Dieter Borchardt, Director, Internal Market, DG Energy, European Commission |
|            | Q&A                                        |
|            | Comments by:  
Michael Hogan, RAP  
Graham Waele, Chief Economist, RWE AG  
Pedro Vitório, EDP  
Sylvain Lhôte, VP, Alcoa |
|            | **Discussion**                             |
| 13:00-14:00| **Light lunch at CEPS**                    |

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5-7 minutes each.
14:00-15:30 Different proposals for remuneration models

Panel with:
DG Energy
ENEL
Investment Bank
BEUC (European Consumer organization)
ThyssenKrupp
ERG (renewables producer)

Discussion

15:30-16:00 Wrap-up of meeting and agreement on the terms of reference for further work

16:30 (at latest) End of meeting

Meeting 2: 22 January 2015

• Improving the current design, e.g. balancing, intra-day etc.
• Integration or renewables into the power market: how and when?
• Capacity mechanism
• Demand-response

Meeting 3: 12 March 2015

• How to deal with overcapacities, e.g. new markets, carbon pricing, performance standards, etc.
• Who will win and who will lose and how to address this?

Meeting 4: May 2015

• What market design for Southeast Europe? A case study

Meeting 5 and final: late June 2015

Discussion and approval of the final report.

Launch of the Report in the European Parliament and selected member states, e.g. Presidency, Germany, France, Poland and Southeast Europe.
APPENDIX: Registration Form

Reforming the Market Design of EU Electricity Markets

0 I wish to participate in the CEPS Task Force

Name:..............................................................................................................................

Title:...............................................................................................................................

Company:.....................................................................................................................

Address:......................................................................................................................

Postcode:...................................................Country:..........................................

VAT N°.........................................................................................................................

Email:............................................................................................................................

0 As a corporate member of CEPS my company pays 1.000 Euro (+ 21% VAT)
0 My company is a not a corporate member of CEPS and pays 5.000 Euro (+ 21% VAT)
0 My company is interested in becoming a corporate member of CEPS.

Please return to:

Isabelle TENAERTS
CEPS
Fax: 32.2.219.41.51
isabelle.tenaerts@ceps.eu

8 Regarding information on CEPS Corporate Membership, please contact Kerstin Born, Director for Corporate Relations (Kerstin.born@ceps.eu) at +32 2 229 3910 or ++32 475 301601.