

# Vattenfall's views on the targeted EU power market reform

## Policy Paper

February 2023

The last year has shown that accelerating the move away from fossil fuels is more important than ever. Decarbonization has become important for both security of supply and climate change mitigation goals. It has also shown that the EU can quickly respond to protect customers and to alleviate burden on those that otherwise could not finance their essential energy needs. It has also made it obvious that the situation in each of the EU countries differs – be it a different degree of decarbonization of the power system, a different preference for technologies or a different industry landscape.

This is no surprise, since EU legislation ensures an internal market in which energy is traded freely between markets in a competitive energy sector. Decision on the energy mix and specific implementation of retail market rules and taxation are left to the Member States by design of the EU framework legislation. However, this creates a major challenge for the announced power market reform. How to unite this diversity?

In our opinion, this can only be accomplished by **creation a flexible framework that provides a toolbox with clear guidelines that leaves the choice of policy instrument to the Member States.**

Policy tools are to be used to enable investments, incentivizing energy savings and shifting demand:

### **The reform should enable investments, rather than hamper them**

Vattenfall is prepared to invest extensively in fossil free energy. We need the prerequisites and market conditions to do so. This includes a reliable and efficient market design as well as fast, efficient, and reliable permitting processes. Grid development needs to be stepped up in tandem.

### **Choice of long-term contract should remain voluntary**

Three different long-term contract instruments are currently prominently discussed to drive investments and reduce exposure to short-term volatility of prices: contracts for difference (CfD), power purchase agreements (PPAs) and forward market contracts. It is important to look at the three instruments holistically and in relation to each other as they all have different merits and can influence each other as well as short-term markets. Generally speaking, the strong use of one instrument decreases the demand for the others.

Design details matter and need careful consideration. Rightly designed each of them can deliver reduction of consumer exposure to short-term market volatility & effective investment signals. While still leaving incentives to respond to price signals e.g. by shifting or reducing demand.

All three hedging tools should be available to market participants in the future and the choice for one or the other should remain with the market participants. Likewise, governments should remain free to decide if they want to provide public support measures in line with their needs and EU competition rules.

### **Limiting the revenue of inframarginal units creates uncertainty for investors**

Investors in fossil free capacity have helped drive rapid decarbonization of the EU's electricity system, while delivering significant reductions in technology costs.

Emergency measures such as the revenue cap for electricity producers create uncertainty that increases costs and hampers the rollout: if investors do not know how they will get paid, investors will hesitate or look elsewhere. Doing so could damage long-term investor confidence needed to deliver the projects that will enable the decarbonization of the EU's electricity system.

It is vital that retrospective changes to the market do not negatively impact assets built in good faith. The revenue cap therefore should remain an emergency measure and not become permanent.

## Consumers should be protected and empowered

The hardships caused by high prices do not go unnoticed. We share the interest of consumers and decision makers to make our energy system future proof and ensure mechanisms are in place to protect (vulnerable) customers from sustained periods of soaring prices as seen in the crisis. Unfortunately, there is no quick fix to the energy crisis - after all, the fundamental problem is not that the market is not working, but that the gap between supply and demand has sharply increased caused by the disruption of gas supplies. However, providing new capacity at the scale needed will not happen overnight. Nor in six months or a year. It will happen continuously over several years. That is why prices most probably will continue to be volatile.

- We have seen that the high prices have led to unprecedented consumer reaction to prices, and that more flexible demand has proven to be the quickest way to reduce high electricity prices. This shows that it remains important to have visibility on prices to allow customers to react to them.
- Public intervention in the price setting for the supply of electricity e.g. by defining an obligation to offer fixed price contracts at certain price levels, should be targeted to energy poor and vulnerable households as foreseen already today in EU energy legislation. Only essential energy needs shall be covered by such measure.
- All customers should have all necessary information on their contracts, including the risks attached to them prior to contract entering. In competitive retail markets, this will allow customers to choose the appropriate contracts for their engagement levels.
- Suppliers should advise customers on variable tariffs how to avoid “bill shocks” in case prices increase – e.g. by advising consumers without a smart meter to increase their monthly payment to avoid too high overall cost levels at settlement.
- We need a plan to adjust demand in case of supply shocks. To create a safeguard, the demand reduction measures from the emergency regulation should be put into EU legislation and accompanied with a trigger level for when to activate the demand reduction measures. The need for such safeguard could decrease with increasing consumer responsiveness to prices.

## The only long-term way to overcome the current situation and solve Europe’s energy crisis is to reduce dependence on natural gas, oil, and coal imports and to move away from fossil fuels.

Providing prerequisites for new fossil free capacity and grid build out while incentivizing a more flexible demand is the most effective and sustainable way to reduce high electricity prices.

The reform proposals therefore should:

- **Ensure a technology-neutral approach** e.g. by ensuring easier access to different revenue-stabilizing instruments for all fossil free technologies
- **Put more emphasis on demand flexibility** by ensuring that customers can be responsive to prices. Demand response might be a niche today, but we are convinced that it will be an integral part of the future electricity system. The electrification of transport and industrial processes proves this: In our Hybrit project, since processes had to be planned from scratch, the process will now have hydrogen storage that can deliver / store up to one week of intermittent renewable energy.
- **Foster cross-border trade** and an increase of transmission capacity as we need to be able freely move electricity throughout Europe.

The way out of the energy crisis is through investments in fossil free energy and grid build out. A decarbonized power system is also a system more resilient to external shocks. Finding the right balance within the market reform will be key to keeping the transformation at high speed.

Vattenfall is a European energy company with approximately 19,000 employees. For more than 100 years we have electrified industries, supplied energy to people’s homes and modernized our way of living through innovation and cooperation. Our goal is to make fossil-free living possible within one generation. Everything we do and the decisions we take shall lead to this goal. This is the basis of Vattenfall’s strategy, and we advocate for a regulatory environment that makes this transition possible – in the energy sector and beyond in transport, industry etc

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