

NON-PAPER ON ELECTRICITY, GAS AND ETS MARKETS

On 21 October, the European Council addressed the recent spike in energy prices and considered the impact of these price rises on citizens, households and businesses, especially those striving to recover from the COVID-19 pandemic.

The European Council invited the Commission to study the functioning of the gas and electricity markets, as well as the EU ETS market with the assessment of the European Securities Markets Authority (ESMA). Subsequently, the Commission will assess whether certain trading behaviours require further regulatory action.

In order to enrich the necessary debate on the functioning of energy markets, this non-paper reflects specific proposals to face sharp spikes in energy and carbon prices while maintaining the focus on the green economic recovery and carbon neutrality.

1. Avoiding the “contagion effect” on electricity market

A common European approach is our preference for the whole European energy internal market. This is the most efficient and reasonable to avoid additional distortion at the same time. However, in absence of such European response, the Commission could provide Member States flexibilities to adopt measures in that sense in extraordinary situation.

The current surge of natural gas prices has shown a ‘contagion effect’ on electricity markets making prices unjustifiably more expensive, as pointed out in the Commission's Communication on 13th October, with negative effects on the economy and the ecological transition and distorting the price signal for the demand.

Exceptional times call for exceptional measures as a matter of urgency. Each +1 EUR/MWh increase in the natural gas price represents 2.7 billion euros per year in additional electricity costs for all European consumers, diverting resources from the energy transition and economic recovery and every day it gets worse.

This price distortion cannot be passed on to consumers, especially, in times of economic recovery. European action is needed to avoid asymmetries and ensure that Member States work in the same direction averting different measures that could cause additional distortions.

In exceptional situations, Member States have to be allowed to adapt the electricity price formation to their specific situations (mix, resources, level of interconnections).

Considering the above, the following proposals must be explored in the short term:

1. Decoupling Electricity Market Prices

The marginal price affects electricity futures signals and have a high impact on inflation reducing the effectiveness of hedging mechanism. In these

extraordinary circumstances, instead of the pure marginal price signal (contaminated by the spikes in gas prices), the electricity price would be obtained as an average price with reference as well to the cost of 'inframarginal' clean technologies (particularly renewables).

The electricity price would be directly linked to the national production mixes, while at the same time protecting consumers from excessive volatilities and allowing them to participate in the benefits provided by a cheaper generation mix.

2. Setting a price cap on natural gas

Set a price cap on the price of bids from electricity produced by natural gas. This measure requires a subsequent compensation to be recovered at a later stage.

2. A centralised European platform to purchase natural gas, facilitating the build-up of strategic gas reserves.

The current 'energy crisis' unveiled a number of market failures: neighbouring gas producers were not committed to supply gas to the spot market (due to technical or commercial reasons) while EU gas shippers were not able to anticipate the supply shortage.

Considering the above, the following proposal must be explored:

1. Portfolio of "option contracts"

A joint EU portfolio of 'option contracts', available to national gas TSOs, to be activated by Member States competent authorities when energy security is threatened, in form of unaffordable gas prices or gas supply disruptions. These 'option contracts' may be allocated to gas producers in third countries, by competitive auctions at EU level. The aim is ensuring additional volumes of gas to be available at affordable prices, taking into account specificities of national gas systems.

This 'gas buffer' will be increasingly necessary during the energy transition to complement renewables deployment.

3. Measures to prevent financial speculation in EU ETS markets

The sharp increase that the emission allowance price of the EU ETS has experienced this year is a matter of concern, as well as the high volatility that is observed in the market almost every week. Growing volatility and unpredictability of carbon prices can dampen the economic signal and ultimately reduce the effectiveness of the EU ETS.

In this context, the ongoing legislative reform of Directive 2003/87/CE is an excellent opportunity to introduce the necessary adjustments and put in place an effective mechanism of price control. Different options must be explored, including restricting the participation of financial entities and modifying the circumstances that can trigger an

increase of EU allowances supply (through the modification, among others, of article 29.a of the Directive). The assessment of ESMA of the European carbon market, announced in the Commission Communication on tackling rising energy prices, will constitute a valuable input to decide what the best suited measures are.

Considering the above, the following proposals must be explored:

1. Limiting the number of excess emission allowances that can be purchased, as done in the Swiss and Californian Emission Trading System.
2. Excluding speculative players from participating in the EU ETS market.
3. Limiting the validity period of emission allowances purchased, to avoid their use for speculative reasons.
4. Introducing price targeting into the EU ETS, reinforcing the existing mechanisms to build a swifter adjustment to price fluctuations. This price target/range could be modified gradually and predictably over time, following a trajectory that is compatible with the EU's emission reduction objectives.