NORDENERGI

Letter

25th October 2022

Nordic concern about electricity market reform pace

We must not rush the reform

Russia's effort to weaponize energy has led to soaring gas and electricity prices in Europe, putting wholesale electricity markets under pressure. We still have more demand than supply of energy, and the upcoming winter will not be easy. Neither will the coming winters.

The European Commission is expected to put forward a legislative proposal early next year regarding a reform of the electricity market model. To propose such a high-impact reform on such a rushed timeline is cause for concern for Nordenergi.

A reform of this magnitude and impact must not under any circumstance be rushed into. We therefore expect to see a thorough impact assessment, a white paper and a public consultation before the Commission moves forward with its proposal. With this letter, we hope to explain why. Even a more moderate review of the European electricity market model would require thorough preparatory work as well as careful impact assessment. A more radical shift would require years of preparation. **Currently, the proposed timeline for a thorough reform is not realistic. Hence, we need to focus on what the objectives of a reform would be.**

Even before the invasion of Ukraine, the need for rapid energy transition brought new challenges to Europe's energy markets. **We therefore acknowledge that the electricity market model needs careful revision in order to become future proof.** It should not be forgotten that the same market mechanism that now according to the Commission is broken, generated record low electricity prices in 2020. It has required a significant amount of time, effort, and collaboration to develop our current solution. Moreover, our market design has served Europe well for decades, ensuring that demand for electricity is covered at the lowest possible cost to society as well as fostered an investment environment. **When there is an imbalance between supply and demand, attention should rather be focused on resolving this imbalance**.

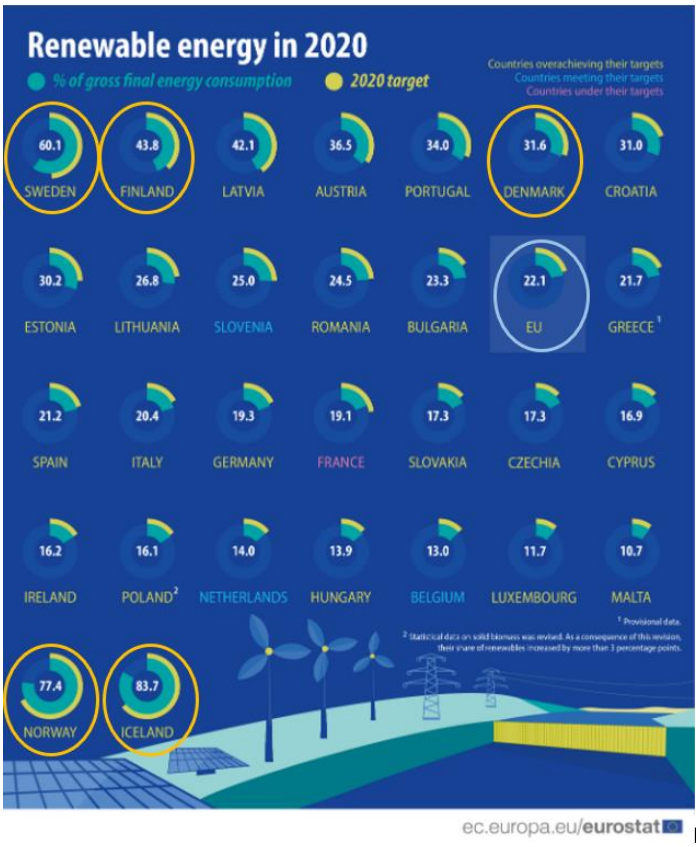
The high price level generated by the market mechanism is a symptom of the huge imbalance between supply and demand. This indicates that the market mechanism, at a fundamental level, works – this does not, however, mean that we believe the high prices we have seen are acceptable. We fully agree that prices need to come down. Whilst working toward the goal, it is imperative to remember that electricity prices work as information carriers, and the soaring level is an expression of the underlying resources situation and extraordinary circumstances. **In our view, it is therefore important to distinguish between the market mechanism per se and the exceptional price fluxes caused by the last few months extraordinary external conditions.**

Extraordinary changes to the electricity market can perhaps mitigate the effects generated by the market mechanism in the short term, but they will not solve the acute energy crisis we are facing. By regulating prices or drastically changing the market model, we cannot solve the supply-demand imbalance, but in the worst case we prolong a difficult situation, and the regulatory uncertainty slows down investment in the

solutions needed for a net zero electricity system: We strongly encourage policymakers to keep this in mind when assessing various measures.

The main objective when future-proofing the electricity market model should be to enable future investment. Electrification requires massive investment in electricity generation, electricity storage, customer electricity use, demand response flexibility and electricity networks. Eurelectric, the European electricity business association, has estimated that we will need to invest €80 billion annually in clean electricity production alone in the EU to meet the 2050 carbon neutrality targets. A robust and resilient market model with accurate price signals in the short and long term is central to enable these investments in a cost-efficient manner. This will also provide consumers with competitive and affordable prices. **In our view we have a solid foundation to build on, and the changes we need can be achieved thorough adaptations to the current energy only-based market framework. A complete make-over is not required nor advisable at this stage**.

To give an example of well-functioning markets, the Nordic countries have the highest share of renewables when looking at EU+NO+IS. Sweden had by far the highest share of renewables (60.1 % of energy consumption) in 2020, followed by Finland (43.8 %). Denmark being sixth (31,6%), whilst Iceland and Norway are playing in their own league[1], thanks to their ability to harness geothermal and hydro power to an exceptional degree. This demonstrates that the Nordic markets have functioned well in fostering an investment climate, where renewables are thriving. And all this has been done with the current market structure, which has enabled this investment to occur.

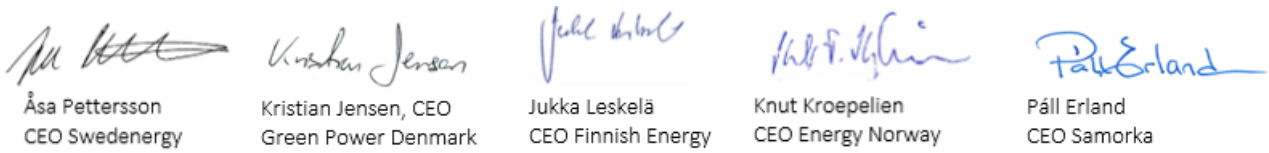


[1] Eurostat, "What is the share of renewable energy in the EU", accessed 6.10.2022, https://ec.europa.eu/eurostat/cache/infographs/energy/bloc-4c.html

We are deeply concerned that a reform of the electricity market model as expressed by the Commission and some member states is made in a rush. The future risk is that not enough investments are made in our energy system. The objective of the market reform should therefore focus on solving the future-proofing aspect instead of trying to solely address the current supply-based price shock.

The Nordics have experienced success with the existing market design, and we can proudly say that we are leading the future towards a clean energy mix. **We welcome a future-proof review of the electricity market model that promotes a market-based transition to decarbonization and electrification**. Measures must however not be rushed, and we look forward to cooperating to ensure that European electricity market regulation provides the necessary framework to deliver safe, plentiful, and ever more renewable energy to European consumers at reasonable prices.

Yours Sincerely,



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