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Pitfalls of the EU electricity market reform

A commentary by Markus W. Voigt, CEO of the aream Group

The EU electricity market reform aims to enhance the stability and affordability of electricity supply, but could lead to new challenges for small and medium-sized enterprises (SMEs) in particular. The reform introduces new market dynamics that could limit the free market in favour of regulated capacity payments and make PPAs (Power Purchase Agreements) less attractive. In particular, SMEs that use long-term PPAs as a hedge against price fluctuations could be restricted in their room for manoeuvre. The current measures create uncertainty for SMEs that rely on stable and predictable energy costs.

In response to skyrocketing electricity prices in 2022, following the war in Ukraine, the EU launched a reform of the electricity market designed to create a more stable, affordable and sustainable environment. The reform has now been adopted and the EU member states must implement it. The German government currently favours capacity payments combined with a production-based refinancing contribution. This is intended to incentivise investment in this area. At the same time, a repayment mechanism (‘claw-back’) ensures that excessive profits are skimmed off when market prices are high. However, it is not yet clear exactly what ‘excessive’ means.

While capacity payments can enhance electricity supply security, they also carry risks of inefficiency and increased system costs. Operators could be incentivised to work less efficiently, as in future availability will be rewarded more than optimisation. Capacity payments could increase system costs and impair competitiveness. Planning will also become more complex, as operators will have to take market prices and repayment mechanisms into account. The way banks evaluate the economic landscape will also play a crucial row.

At the same time, the reform intensifies the pressure on Power Purchase Agreements (PPAs), long-term electricity supply contracts between buyers and producers. This is because contracts for difference (CfD), long-term contracts between governments and electricity producers, are becoming increasingly important. They guarantee electricity producers who make investments fixed prices within a corridor plus a payment independent of production. This could reduce the incentive to enter into long-term PPAs. This is because CfDs guarantee a minimum source of income through a minimum price and capacity payment, which is considered sufficient from the banks' point of view. PPAs above the CfD corridor would be skimmed off. The resulting reduced incentive on the operator side would make it much more difficult for SMEs in particular to secure long-term electricity prices. The German government is therefore also planning to provide PPAs between industry and generators with state guarantees.

A safety net for industrial customer PPAs is therefore important. In order to ensure bankability, PPAs should be secured by state guarantees within the CfD corridor and the financial risk for generators and industrial customers should be minimised. For example, PPAs at the upper end of the corridor could still remain interesting. However, it heavily depends on what part the state guarantees. If this only covers the minimum price, a PPA would not be attractive for operators. Consequently, there is a risk that the PPA market will remain or become unattainable for small, medium-sized and even large companies.

The additional capacity remuneration mechanisms bring more uncertainty and bureaucracy to the market. It is therefore highly recommended that small and medium-sized companies are supported by a consultant with in-depth knowledge of the market. Ultimately, the reform will depend on its design and details. The German government would do well to align closely with the market.

About the aream Group

aream Group, founded in 2005, is an investment and asset manager for institutional investors and industrial clients with a focus on sustainable infrastructure in the renewable energy sector. With its three divisions Fund and Asset Management, Project Development and Operation Management, aream covers the entire value chain for renewable energy investments. With a transaction volume of more than 2.5 billion euros, aream is one of the leading asset managers in this market, and its own portfolio of plants generates around 40 million euros worth of green electricity per year. Since 2008, aream has produced more than one billion kWh of green electricity. As part of the growth strategy, several solar and wind parks are to be realized or acquired in the coming years. Through its own project development alone, aream currently has a long development pipeline with great potential. Further information: www.aream.de.

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