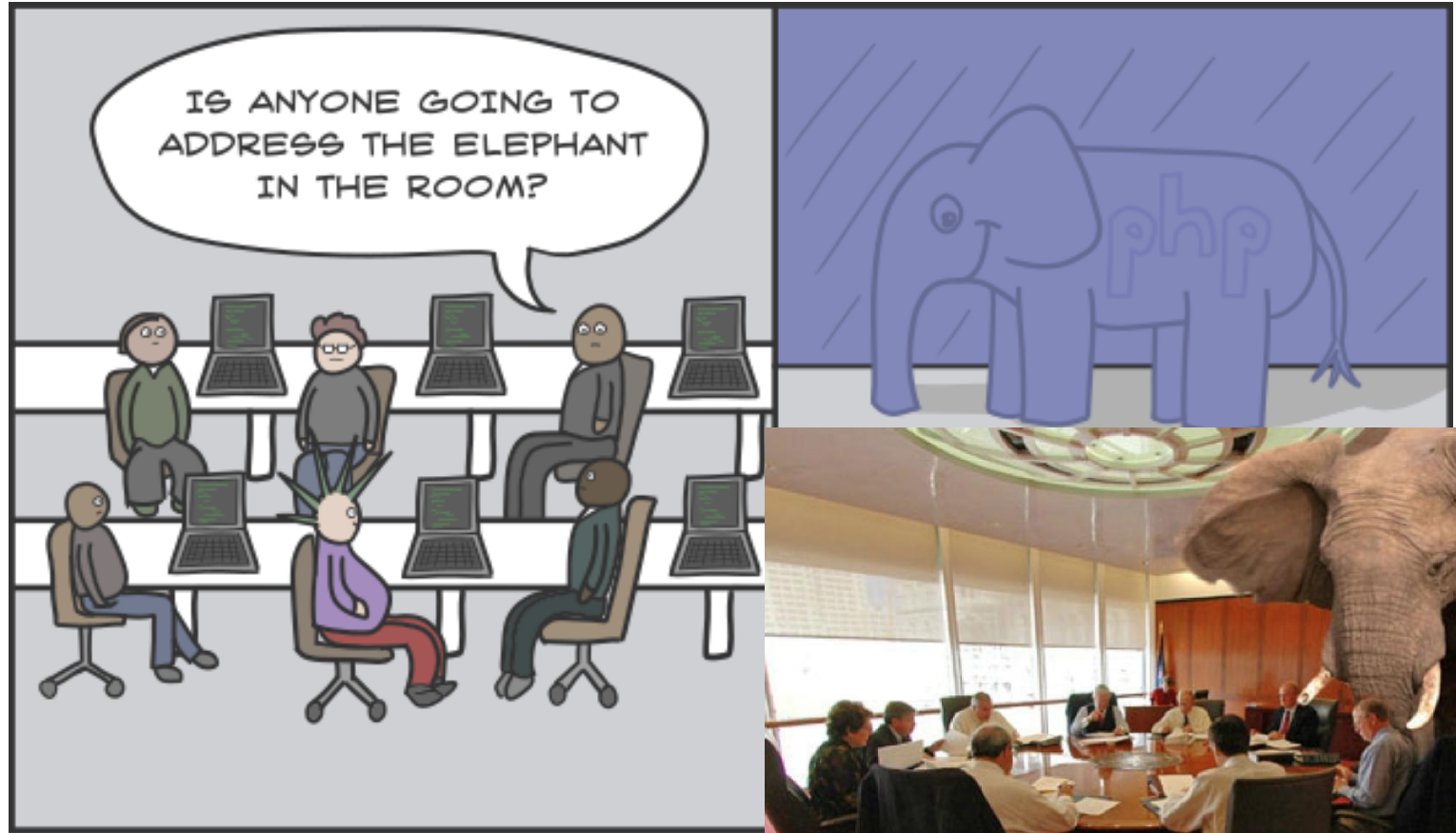


Long term contracts and EU market reform – so many elephants?

Prof dr L Hancher





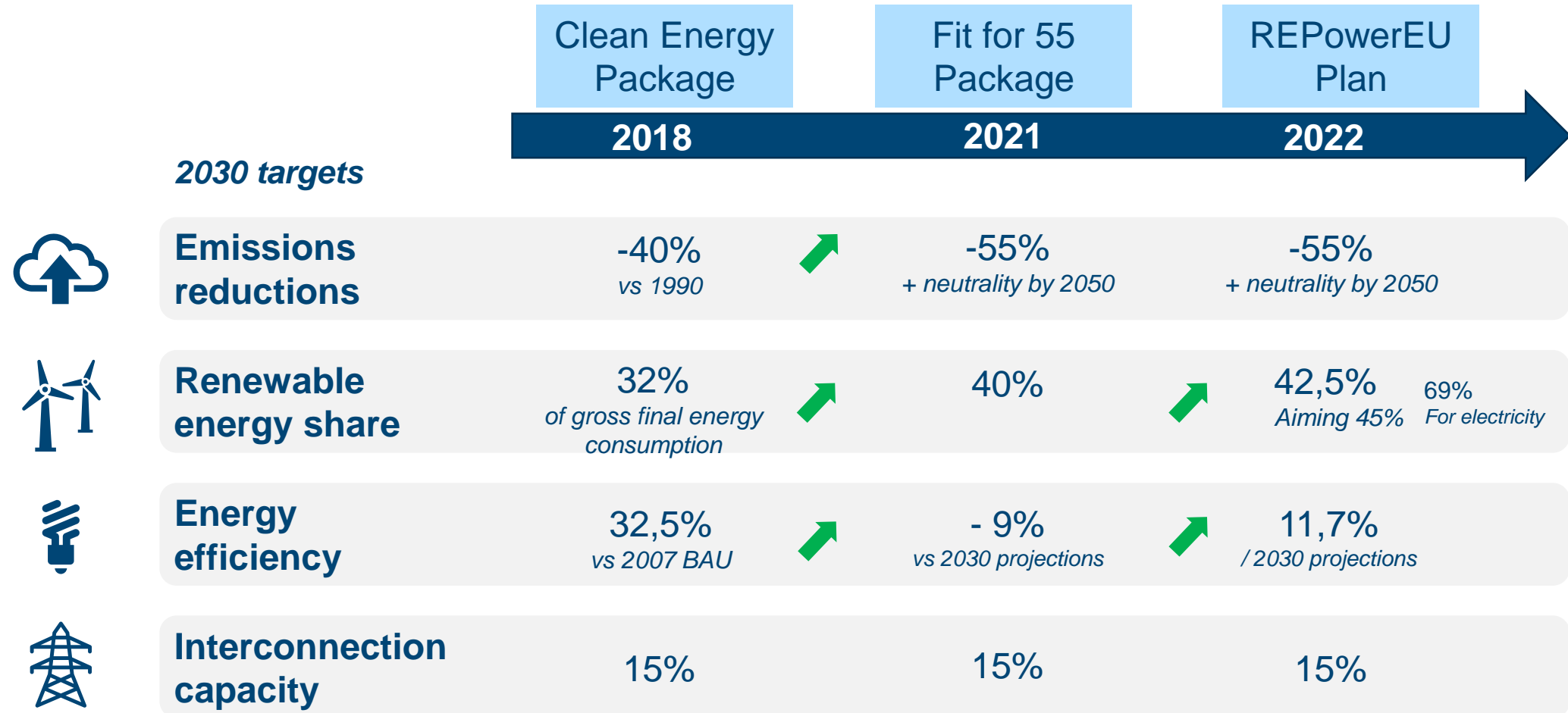
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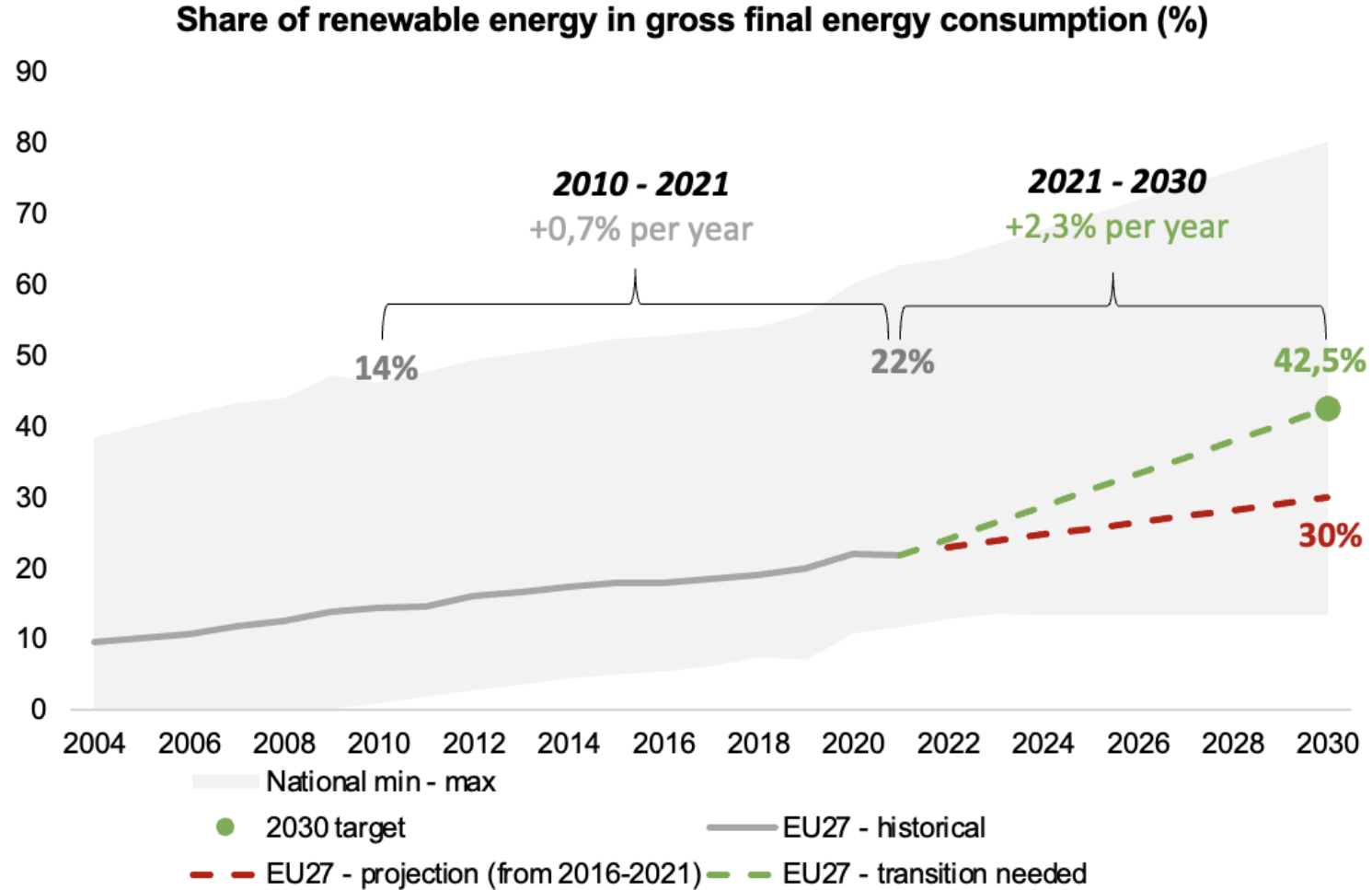
The challenges

The energy transition – achieving the energy targets

EU energy and climate targets for 2030 have been reinforced over time



Will we meet those targets? (2)

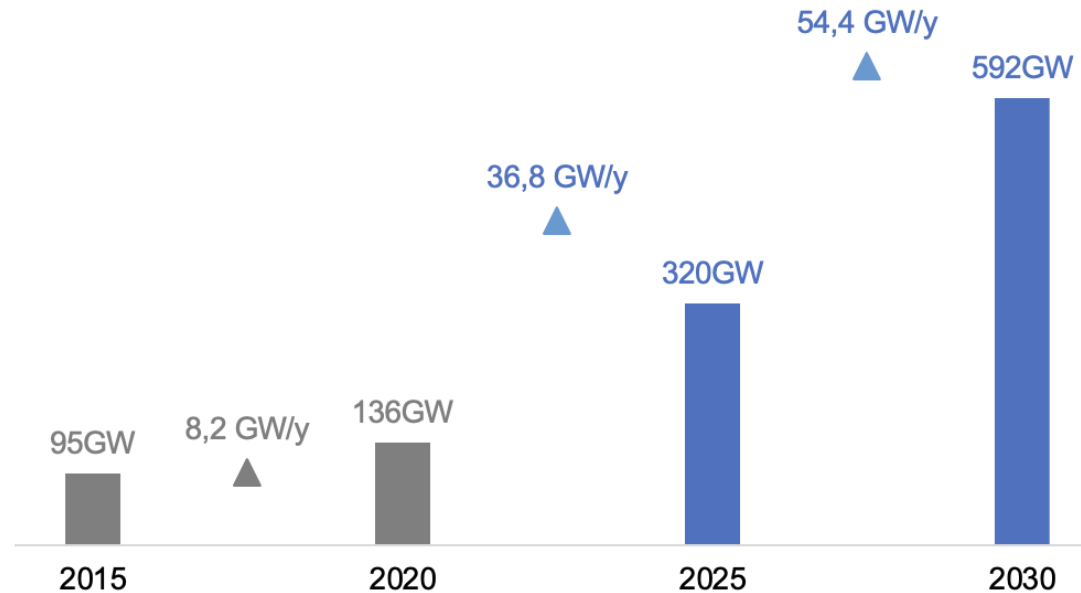


REPowerEU introduced **new and more specific targets**

Sector	2025	2030
Solar PV newly installed capacity	320 GW	Almost 600 GW
Newly installed heat pumps	10 million units by 2027	
Renewable hydrogen		10 Mt/y produced domestically 10 Mt/y imported
Biomethane production		35bcm/y

A steep implementation curve ahead of us

**Installed solar PV capacity (GW) and average annual installation rate (GW/year)
Historical vs REPowerEU objectives**



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Is the European Union on track to meet its REPowerEU goals?

This report is part of [Renewables 2022](#)

Overview

About this report
This report forms a component of Chapter 4 of [Renewables 2022](#) and addresses a key question in renewable energy markets.

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So 3 challenges going forward: those elephants!

- Decarbonization requires stepping up our game very fast in terms of (carbon neutral) power generation investment:
 - circa. EUR 800 Bns in next decade
- Decarbonisation means retiring fossil fuel generation → reducing available capacity fast
- EU industry must electrify (fuel supply switch from fossil to RES)
AND
stay competitive (energy price surge 2021 / Ukrainian crisis 2022)

Why Market Reform?



A Leap?

- Mrs. Von der Leyen at the State of the Union, on the 14th of September 2022,:
“The current electricity market design – based on merit order – is not doing justice to consumers anymore. They should reap the benefits of low-cost renewables. So, we have to decouple the dominant influence of gas on the price of electricity. This is why we will do a deep and comprehensive reform of the electricity market. (...) Not just a quick fix, but a change of paradigm, a leap into the future.”



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Why is the current electricity market not working?

Link to gas prices - gas fired plant sets the price

Short termism - price spikes

Does not price in 'externalities' fully

Does not reward/stimulate new investments in RES

EC issues Reform of Electricity Market Design (EMD), 03/2023:

Long Term Contracts revisited

Building the SEA - why were there problems with LTCs



Note context – surplus generational capacity (fossil)



No TPA (or weak access to the grid for competitors/imports)



History of vertical integration/state control -> LTCs as a means of consolidating the status quo – contrary to Art 101/102 TFEU?



->One of the main objectives is to avoid market foreclosure – i.e. keep out competitors

EU Competition law does not prohibit long term contracts

- Difference between **anticompetitive exclusion and competitive exclusion** (ECJ Unilever 19 January 2023):
 - “That said, it is not the purpose of Article 102 TFEU to prevent an undertaking from acquiring, on its own merits, on account of its skills and abilities in particular, a dominant position on a market, or to ensure that competitors less efficient than an undertaking in such a position should remain on the market. Indeed, not every exclusionary effect is necessarily detrimental to competition, since competition on the merits may, by definition, lead to the departure from the market or the marginalization of competitors that are less efficient and so less attractive to consumers from the point of view of, among other things, price, choice, quality or innovation.”
- **Competition law draws limits:**
 - 5 years for exclusivity if both parties are below 30% market shares
 - Cumulative effects (50%)

EU Competition Policy Towards LTCs post-liberalization

- Methodology to analyze “access to customers” in LTCs when dominant players are involved emerged [Gas Natural/Endesa (2000), Synergen (2001), Repsol (2005), E.ON Ruhrgas (Bkt, 2006) and most importantly Distrigas (2007) and EDF cases (2009)]
- No cases concerned RES PPAs >> only old school bilateral & physical
- **Emphasis on foreclosure effects**

The ‘old’ case law – some flexibility?

- Distrigaz - permits contract durations as long as:
- *No contracts over 5 years (2y. for resellers)
- *70% customers must come back to market (termination of existing contract) every year
- Examples of duration flexibility management:
- 37.5% supplied under 5 year contracts and 62.5% supplied under 1 year contracts
 - 60% supplied under 2 year contracts and 40% supplied under 1 year contracts
- Commitments as long as Distrigaz market share > 40%
- Contracts with a buyer investing in new power plant exempted from duration and “market come back” remedy.

Vertical contracts – the old guidelines

- Investment depreciation constitutes a legitimate rationale for lengthening contracts
- In vertical guidelines (2010) : §140
- “In addition to the types of efficiency mentioned in paragraph (136), exclusive customer allocation may generate efficiencies where it is necessary for the distributors to invest in specific equipment, skills or know-how to meet the needs of a particular category of customers, or where such investments lead to economies of scale or scope in logistics. The depreciation period for those investments is an indication of the duration for which exclusive customer allocation may be justified.”
- Necessity: if the duration is not fixed at the correct date the investment would not even be made

Vertical guidelines (June 2022) : low carbon and RES

- European Commission recently widened the possibility to increase contract duration in particular for low carbon industry
- 316: duration of depreciation:
- “Non-compete obligations may also be used to address a hold-up problem for investments pursuing sustainability objectives. For example, a hold-up problem could arise where an energy supplier facing increased demand for renewable energy wishes to invest in a hydropower plant or wind farm. The supplier may only be willing to take that long-term investment risk if a sufficient number of buyers are willing to commit to purchase renewable energy for a longer period.

Such vertical agreements with buyers may be pro-competitive, as the long-term non-compete obligation may be necessary for the investment to take place at all, or for it to take place on the foreseen scale or within the foreseen time.

Therefore, such non-compete obligations may fulfil the conditions of Article 101(3) of the Treaty if the supplier’s investment has a long depreciation period, exceeding the 5 years set out in Article 5(1), point (a) of Regulation (EU) 2022/720.” **[VBER]**

- BUT - competition law should remain technology neutral?? What about other fuels?

Traditional remedies in EU Competition policy

Tailoring: shorten duration, tailor duration to the share of customer demand tied, termination clauses

- **Prohibiting:** delete clauses (e.g. destination clause), forbid vertical M&A for several years (Repsol)...

- **New remedies** for energy: negotiating commitments

- increasing use of Virtual Power Plants (VPPs) and gas releases, even in the context of LTC cases

- Flexible remedy mix: Dstrigaz (2007) and EDF (2009) cases

Summary - Antitrust framework for LTCs

Not a problem if market shares (on both sides) < 30% without 'hard-core' restraints (note: 5 years limit in case of de facto exclusivity in VBER)

-
- The vertical guidelines (para 316) already allow for investment in RES when backed by LTCs such as PPAs

Pro-entry bias matched so far by a general pro-generation investment bias in past decisions

Overall: limited problem if you are not dominant and/or PPA is linked to RES investment

-
- Amending the competition law framework for PPAs signed by dominant players (on their domestic market)?

- Change in analysis of geographical market (remain national, see EON/RWE asset swap case) is hard to foresee >> market coupling with 'virtual hubs' + LT transmission rights on interconnections will not change that?

Summary/2 focus of analysis - duration & exclusivity



No problem with buyer size and exclusivity if contracts > 80%: threshold for de facto exclusivity



New entrant reseller trying to establish a market position: probably 5yr • For a moderately dominant supplier (Repsol): ≤ 5 yr



exclusivity: 'critical customer' concept >> important in energy



Efficiencies: investment and entry



SO: LT means over 1yr and 5yr is max. Exclusivity & duration must be analyzed together

LTCs and state aid rules (Art 107 TFEU)

CfD and CRM type state intervention primarily assessed under the EU state aid rules

In the last 10 yrs state supported LTCs have been offered...

- To renewable (RES) producers through feed-in tariffs and Contract for Differences (CFDs)
- To capacity/flexibility providers, to ensure security of supply >> ‘capacity remuneration mechanisms’ (CRMs)
- ... **but no antitrust (Art 101/102 TFEU) issues:**
- State-support schemes, sometimes with competition « for the market »
- Structural impact on wholesale markets but not a priori on (spot) liquidity so no foreclosure effects

The current electricity market design

- Short term ‘energy’ only - (gas sets the marginal price)
- Retail prices often still controlled at national level
- Wholesale market ‘ liberalised’ as Single European market
- BUT lack of sufficient investment in new RES
- AND increased ‘intermittency’ due to RES
- LTCS can stabilise prices, reduce volatility, and act as the financier of new renewable projects

NEW APPROACH TO LTCS

- **CONTRACTS FOR DIFFERENCES (CFDS)** CfDs are long-term contracts.
- CfDs include a subsidy model where a “strike price” is agreed by the counterparties for a certain volume of electricity.
- If the market price for electricity rises above the strike price, the provider pays their counterparty the difference, while if it goes lower, the energy buyer pays the counterparty the difference.
- In most CfDs – state/state entity is the counterparty

The EMD Regulation(draft)

- Through PPAs, private investors contribute to additional renewable and low carbon energy deployment while locking low and stable electricity prices over the long-term. Likewise, through two-way contracts for difference, the same objective is achieved by public entities on behalf of consumers. Both instruments are necessary to achieve the Union's decarbonisation targets through renewable and low carbon energy deployment, while bringing forward the benefits of low -cost electricity generation for consumers. (at recital 36).
- [<https://data.consilium.europa.eu/doc/document/ST-14339-2023-INIT/en/pdf>]

The EMD proposal: a ‘matrix’ change for LTCs?

- Two-way CFDs for ‘new’ public-backed investment :
- Compulsory CfDs for ‘mature’ solar, wind, geothermal, hydro and nuclear (new + repowered) + redistribution of revenues to consumers
- Mix of tech. neutrality, organization of ‘competition for the market’ for each technology and different preferences among Member States as to CFD design (and relative share of CFDs v. PPAs)
 >> subsidiarity?
- Member States must facilitate (RES) PPAs >> address remaining national regulatory barriers
 - Favour bidders in RES tenders that reserve part of electricity produced for PPAs with SMEs
 - Virtual ‘hubs’ with longer-term transmission rights on interconnections (at least 3 years)
 - Develop liquidity on ‘organized’ forward markets (across borders)
 - “subject to compliance with Union competition law”?

Amending the competition rules

Public-backed CFDs and private PPAs are complementary:

- PPAs are not fit for influx of RES / low-carbon generation investment at the scale we need
- CFDs do not address buyer efficiencies:
- investment linked to industrial customer electrification / decarbonization
- long-term hedging of electro-intensive industries (competitiveness) • ‘Competition for the market’ is difficult for certain technologies...
- Public-backed CFDs and private PPAs are also substitutes:
- BUT CFD raise risks of crowding out of private PPAs (change in contracting parties’ incentives) ?
- CFD cost for public finance is enormous

Back to the elephants

- **PHASING OUT**

- **how to finance the phase- out of fossil fuel electricity generation plants is the first elephant in the room**

->new EMD actually prolongs phase out??

- **PHASING IN**

- **full decarbonisation cannot be achieved by “more of the same”, i.e., more wind and solar PV generation capacity alone without massive deployment of storage and digitalisation - > do we need to consider role of LTCs here?**
- **AND the question about how to expand (transmission and distribution) networks fast enough to accommodate new generation capacity is the biggest elephant in the room ??**
- **Important to get the right market signals in the right locations so avoid that some types of LTCs frustrate that process**

Thank you for your attention



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