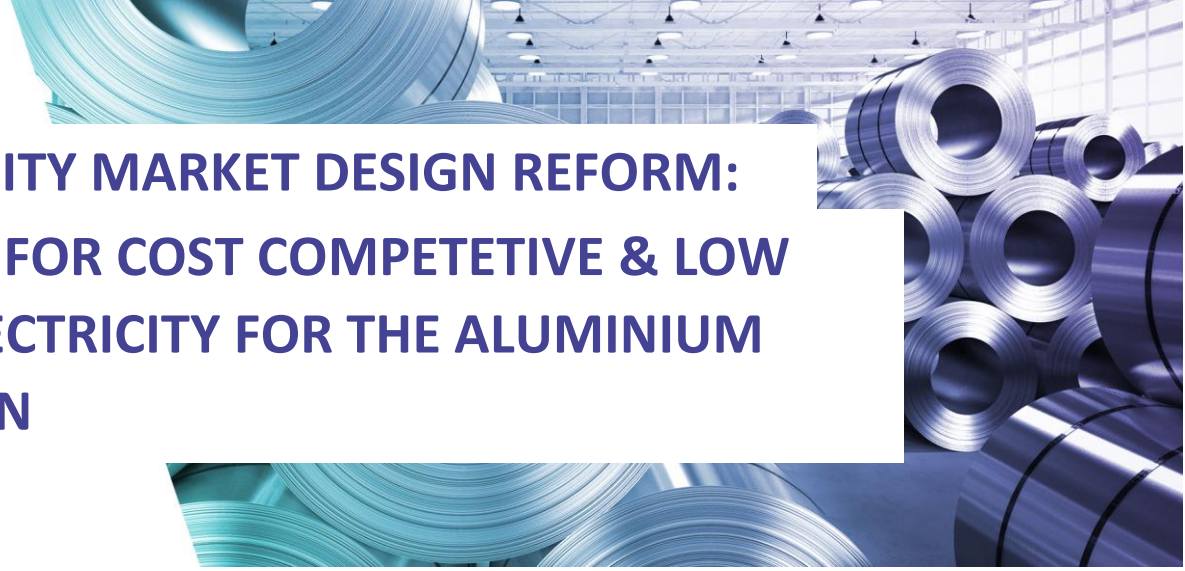

EU ELECTRICITY MARKET DESIGN REFORM: PROPOSALS FOR COST COMPETETIVE & LOW CARBON ELECTRICITY FOR THE ALUMINIUM VALUE CHAIN

Brussels, May 2023

Position Paper on draft EU Commission proposal

European Aluminium represents plants producing aluminium in Europe across the entire value chain: from alumina refining and Primary production, all the way to aluminium transformation and recycling.

Aluminium is crucial for all energy generation, transmission, and storage technologies, ranging from solar renewable power to alternative fuel cells and hydrogen production to high-voltage cables and batteries, **making it indispensable for their** uptake (see also our position on the draft Net Zero Industry Act).

The cost of electricity represents up to 40% of a primary aluminium smelter operating in Europe and the primary metal is a globally traded commodity priced on the London Metals Exchange (LME). *Producers in Europe thus cannot pass on in the product price the higher costs of electricity they face in Europe. Consequently, energy costs are THE MAIN element affecting their competitiveness on global markets.*

Europe's aluminium industry is therefore amongst the sectors most impacted by the ongoing energy crisis: **50% of EU primary aluminium capacity has been forced to curtail production in the last year**.

Electricity prices in Europe are still at a high-level compared with pre-COVID years and other regions in the world. This has a detrimental effect especially on the electro-intensive primary segment of the value chain. The temporary flexibility under EU state aid rules proposed so far by the Commission is not enough: in the last quarter, two more aluminium smelters in Slovenia and Germany have announced a complete closure.

The Commission's Electricity Market Design proposal must thus be improved to ensure access to globally competitive decarbonized electricity, while shielding EU producers from future electricity prices shocks until the proposed long-term solutions have sufficient effect.

Below a summary of our proposals touching upon three key aspects of the Regulation:

- Articles 19a and 19 b on Contracts for Difference (CfDs) and Power Purchase Agreements (PPAs).
- Articles 19e and 19f on flexibility.
- Article 66a on access to affordable energy during an electricity price crisis.

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ANYTHING BUT BASIC

1. Reduce scarcity and improve electricity price and revenue predictability (Art 19a and 19b)

On Power Purchase Agreements (PPAs):

- **Add legislative clarity** that instruments facilitating the use of PPAs such as guarantees schemes **do not discriminate against electro-intensive consumers,** still face entry barriers to entry the PPAs market.
- **European companies severely affected** by the ongoing high energy prices crisis which is beyond their control **must not be penalized** by being excluded from accessing instruments facilitating the use of PPAs.

On Contracts for Difference:

Electricity produced from assets under this scheme is **traded at market price** – thus **all consumers remain exposed to high prices and volatility.** Financing contracts for difference (CfDs) requires either state budget funds or payment of support via surcharges placed on consumers – the latter leading to more burden and increased electricity bills for final consumers.

Furthermore, making the use of contract for differences mandatory impedes Member States' principle of subsidiarity to choose the measure that best fits their needs. The proposal also comes short of providing minimum design requirements of such tool.

We thus recommend the following improvements:

- **Use of CfDs to be voluntary** as they provide no protection to consumers from volatile electricity prices.
- **Minimum design requirements** to prevent market distortions.
- **An obligation for CfDs beneficiaries to sell a certain amount of their electricity output via PPAs** or other market-based mechanisms.

2. More flexibility is needed to ensure security of supply at affordable prices (Art 19e and 19f)

For baseload electricity consumers such as primary aluminium smelters, security of supply at affordable prices is essential. However, to achieve that, solid adequacy and flexibility assessments are needed. **The more flexible the system is**, **the more stable electricity prices become, and the more renewable energy sources (RES) the system can integrate**.

The Commission' proposal acknowledges the need for flexibility, but we consider **unnecessarily restrictive and disproportionate to limit the scope of Art 19e to only demand side response** and storage **as flexibility options**. This can be explained by the following elements:

- The volume of energy reserves required to meet the reliability standard (i.e. necessary level of security of supply of the Member State[1], is immense and **demand response and storage will only cover a fragment of it**.
- Depending on Member States' grid mix, ensuring a fast ramping of the flexibility needed to add RES online safely and massively will require combined cycle gas turbine (CCGT) and/or open cycle gas turbine (OCGT) plants in many cases.

[1] ACER, "Methodology for calculating the value of lost load, the cost of new entry and the reliability standard" (2020), available at: https://documents.acer.europa.eu/en/Electricity/Pages/European-resource-adequacy-assessment.aspx

- With the addition of ever-increasing RES to the grid, these thermal plants will be forced to actually operate less and less, encouraging operators to decommission them. Scarcity pricing alone will not suffice to keep these flexibility capacities online and to incentivise for new ones.

We would therefore propose:

- **Flexibility support scheme should not be limited to new investments (Art 19e):** Flexibility can stem from existing assets and/or new investment. Supporting existing assets is also a route to mitigate the lack of funding issue, which is inherent to new investments.
- **Transmission system operators (TSOs) should define what volume/type of electricity needed and necessary to meet the reliability standard in their flexibility and adequacy assessments.**
- **A set of Design principles for flexibility support schemes (Art 19f).**

3. Short-term measures tackling high prices during an electricity prices crisis

The European aluminium industry urgently needs a European solution to prevent further electricity price shocks (similar to 2022) in the next five years. The Commission proposal fails to address the life-threatening short-term problem for the electro-intensive industry, focusing exclusively on supporting power generation, households, and SMEs. It is imperative that the provisions securing an affordable electricity price in times of crisis also cover electro-intensive industries.

We therefore propose:

- **Improved criteria for declaring an electricity price crisis** reflecting market conditions to ensure actual relief to electro and trade intensive industries exposed to international competition and sensitive to power price increases.
- **Mandating ACER and the Commission to carry out an assessment of an emergency price shock absorber mechanism that could be activated during times of crisis for the purpose of reducing high electricity prices**.

Such a mechanism would be market-based, implemented quickly and triggered when needed. It would not change market fundamentals nor involve state aid and provide more certainty and a harmonious EU level solution instead of the patchwork of inframarginal revenue taxes.

Following this assessment, guidance should be issued on how to best design and implement this mechanism and minimum design principles should be provided in the legislation to prevent market distortions and to preserve market integrity and investment signals.

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