



Clean Energy Package – Price regulations in the retail market

In 2016, the EU Commission proposed broad reforms of EU energy legislation (the Clean Energy Package). Included was a new provision in the Electricity Directive instructing Member States to phase out government-regulated prices capped below costs, and to establish a roadmap for a five-year phase-out of all regulated prices. Negotiations in the Council and European Parliament and in trilogue ended with a much-altered provision. The result is a clear blow to the Commissions efforts to introduce market-based pricing in the retail markets.

The Commission proposal

Price regulation of retail prices was regarded by the Commission as fundamentally at odds with the core principle for efficient electricity markets, namely that prices should be formed based on demand and supply (Article 3a in the Electricity Regulation). In 2013, ACER monitoring of the Internal Energy Market showed that 12 out of 28 Member States (MS) still regulated retail prices, and moreover that prices were rising and varied significantly between MS due to non-market reasons, such as network charges, government taxes, and levies. The Commission feared that increasing non-contestable charges would reduce consumers' interest in supplier switching and weaken the competitive pressure in retail markets.

The Commission acknowledged that for many MS, price regulations were motivated by 'energy poverty', referring to households with electricity bill payment problems. Energy poverty in the EU was on the rise because of generally increasing poverty levels.

In the Clean Energy Package, the Commission proposed to separate measures towards price regulation and energy poverty;

- Article 5 (paragraph 2) stated that as a main rule, price regulations should not be used to address energy poverty: *"Member States shall ensure the protection of energy poor or vulnerable customers in a targeted manner by other means than public interventions in the price-setting for the supply of electricity."*
- Paragraphs 3 and 4 stated conditions for derogations within and after the five-year phase-out period. After this point: *"... the Member States may still apply public interventions in the price-setting for the supply of electricity for vulnerable household*

customers in so far as it is strictly necessary for reasons of extreme urgency."

To deal further with the rising levels of energy poverty, the Electricity Directive included separate articles on vulnerable customers (Article 28) and energy poverty (Article 29) and cross-referenced to the Governance Regulation. According to the Governance Regulation (Article 21), Member States should continuously monitor energy poverty and report on how they intended to solve it by other means than price regulation, through measures such as national energy action plans, benefits in social security systems, or targeted support schemes for energy efficiency improvements.

The Governance Regulation (Article 21) proposed that progress on objectives for energy poverty should be included in the biannual Integrated National Energy and Climate Progress Reports. Cross-reference was also made to the revised Energy Efficiency and Energy Performance of Buildings Directives to provide for further measures to tackle energy poverty.

The agreement after trilogue

The adopted Article 5 in the Electricity Directive differed substantially from the Commission proposal. Paragraph 2 maintained as the general principle that: *"MSs shall ensure the protection of energy poor or vulnerable household customers pursuant to Articles 28 and 29 by social policy or other means than public interventions in the price setting for the supply of electricity."*

However, paragraph 4 extended the opportunities for derogation to include not only households but also microenterprises, and to cases motivated by a lack of competitive pricing in the retail market. A set of conditions for price interventions were added: they

should be limited in time, prices should be set at a level above costs, and measures should be implemented to achieve effective competition if a lack of such was the motivation for price regulation.

The proposed end-date for price regulations was not adopted but replaced by an instruction to report on implementation of price regulations in 2022 and 2025, why these would (still) be needed and on the plans for transition to market-based prices. The Commission was instructed to report on implementation of Article 5 by the end of 2025, followed by a legislative proposal, if appropriate, which may include an end date for regulated prices.

The cross-references were maintained in the adopted Governance Regulation. Energy poverty provisions were changed to provide more detail on how MS should fight energy poverty, and obligations in the national energy and climate plan were detailed. Article 21 stated that national objectives to reduce the number of households in energy poverty should be indicative, that national progress reports should include quantitative information, and, where available, information on policies and measures. Data should be made available for the European Energy Poverty Observatory. Further details were also added to Article 3 that described the national plans in general terms.

Why the changes?

The Commission's efforts to keep price regulation and energy poverty measures apart did not succeed – the strong linking was upheld in the negotiations, both in the Council and Parliament.

The Council was deeply split on both proposals. On one side were MS who wanted energy poverty regulated by social policy [*i.e. outside scope of energy policy*]: Nordics, Austria, Germany, Netherlands. On the other side were those who wanted to maintain price regulation as an option: France, Spain, Portugal, Greece, the UK, Belgium (to some degree), and most but not all of the Central and Eastern European Countries (CEECs). Several CEECs argued for energy price regulations not only to alleviate energy poverty but as an option to mitigate imperfect competition in the retail market.

The positions of the MS largely reflected the current use of price regulations. For UK, to maintain the possibility to regulate prices was important since the country had just decided to implement price regulation. To a large extent, the positions on price regulation also reflected the level of energy poverty in the member states. Luxembourg here deviated most, taking the role as the strongest promoter of provisions on energy poverty (despite being the richest country!), at the same time clearly stating that the problem should be addressed without price intervention in the market.

The informal deal in the Council (General Approach agreed in December 2017) strongly linked the two issues and reflected a compromise to avoid strong provisions on either of them. The

Commission-proposed timeline for removing price regulation was scrapped.

The Parliament rapporteur initially supported the Commission proposal to remove price regulations. At the same time, the Parliament had the fight against energy poverty as one of its main priorities and wanted to give the EU more power in setting guidelines for energy poverty measures in the Governance Regulation. The Parliament negotiators struck a deal with the Council where the Parliament did not insist on the removal of price regulations in exchange for Council backing on EU guidelines for energy poverty measures.

External events affected the negotiations. The Yellow Vest uprising against energy charges in France strengthened the conviction of France and others that the opportunity to regulate prices should be maintained. The political atmosphere made the removal of price regulations difficult.

Assessing the outcome

The failure to remove price regulations represents a clear blow for the Commission's efforts to accelerate competitive pricing in EU retail markets. The outcome is a reminder that many MS still do not fully subscribe to the idea of market-based steering of energy policy in Europe, to the great disappointment of the Commission. Now the Commission will monitor price regulation developments and come back with an assessment and possible new regulations in 2025. This outcome is regarded as the best one could expect, given the political atmosphere.

Continued regulation of prices means that consumers will have less incentives to reduce demand and adapt consumption patterns to varying wholesale prices. This may reduce the provision of flexibility in the wholesale market and increase the value of flexibility from other sources, such as Norwegian hydro. The effect is however likely to be small. On the other hand, it could also be an early sign that the development of a competitive, integrated European electricity market must yield if it is perceived to be at odds with social and national policy concerns.

Sources

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