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ANNEX 1

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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN
ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE
REGIONS**

REPowerEU: Joint European Action for more affordable, secure and sustainable energy

ANNEX 1

Guidance on Application of Article 5 of the Electricity Directive during current situation

1. *Introduction*

The objective of the Electricity Directive is using the advantage of an integrated market to ensure affordable, transparent energy prices and costs for consumers, a high degree of security of supply and a fair transition towards a sustainable low-carbon energy system. Article 5 in particular aims to ensure effective competition to the benefit of consumers, while ensuring protection for energy poor and vulnerable household customers. It contains the framework for exceptional, time-limited implementation of regulated prices, which may be allowed in specific circumstances, such as periods of significantly higher energy prices. To maintain incentives for energy efficiency and an efficient market, regulatory measures should remain temporary and include a well- defined roadmap for their gradual removal.

The current situation on energy markets is such that intervention in retail price setting may be necessary for Member States to meet their policy objectives and ensure affordable transparent energy prices and costs for consumers.

This Guidance aims to support Member States in the design of such measures, ensuring they benefit consumers during this current crisis and enhance competition to the benefit of consumers over the longer term. It sets out reasons why high and volatile wholesale gas and electricity prices may currently be restricting competition and harming customers. These could serve as the basis for Member States to identify the conditions under which they wish to use the flexibility in Article 5 in relation to price interventions at retail level

Article 5 sets out that suppliers are free to determine the price at which they sell to their customers rather than it being set by government or a regulator. This is because in a well-functioning market based on the interaction of supply and demand, this will:

- empowers consumers,
- sends investment signals in the market, which supports medium term security of supply and the move to a decarbonised system,
- support the move towards a flexible electricity system, in particular with demand side participation,
- encourages energy efficiency and energy savings – as the price of energy is an important signal of the real value of energy, and
- give consumers more choice as suppliers compete to make better offers based on price and service.

However, Article 5 also recognises that under certain circumstances it might be necessary to derogate from this general principle. Member States may intervene in retail price setting by suppliers (regulated prices) in accordance with the following³⁴:

- Article 5 (3) which allows Member States to regulate retail prices for supply to energy poor or vulnerable household customers, subject to specific conditions set out in Article 5(4), to ensure they can afford to meet their basic energy needs
- Article 5(6) which allows action on retail price setting for households and micro-enterprises for a certain period of time to facilitate the transition to effective competition between suppliers. This derogation is subject to the more specific conditions set out in

Article 5(7), which are different from those applicable to regulated retail prices for energy poor and vulnerable consumers. Recital 23 of the Electricity Directive which spells out the objective of Article 5, shows that this may be used to address the impact of situations of particularly high prices.

2. *Reasons to intervene in price setting in response to the current energy market situation*

While the exact impact will differ across Member States, there are several ways in which the current energy market situation with high and volatile wholesale gas and electricity prices may restrict competition and harm customers, including:

- cementing the position of dominant players,
- locking in energy sources with high carbon emissions,
- preventing suppliers from accessing hedging products or longer term markets that enable them to make offers to consumers;
- causing significant harm to consumers in a way likely to harm longer term market developments, thereby undermining competition and the energy transition,
- passing price increases and volatility on the wholesale market directly onto retail markets; - this would mean that the retail market is failing to protect consumers against volatile prices to the extent that those consumers are not able to adjust their demand,
- reducing the number of suppliers on the market below that required to ensure effective retail market competition as a result of the current (wholesale) market situation; and
- supplier-of-last-resort regimes being overwhelmed.

3. *Regulated retail prices during the current period of high and volatile energy prices*

Firstly, where a Member State has already taken measures as set out in Article 5(3) or Article 5(6), they may continue to do so during the current period. They may also take account of the impact of current high and volatile wholesale energy prices on any roadmaps that they had prepared for phasing out these retail market interventions.

In line with Recital 23 time limited retail price interventions during the current exceptional period of instability are allowed even if a Member State has already moved to a situation of full competition, either for all or for a class of customers, to meet the following objectives:

- to ensure protection of vulnerable and household customers against during periods of exceptionally high prices;
- to ensure continued transition to full competition;
- to prevent that the level of competition already achieved is seriously impaired (for the reasons set out above).

4. *Ensuring measures meet objectives of EU energy policy and Electricity Directive*

Where a Member State regulates retail prices because of the current period of high and volatile prices, it is important that this does not undermine wider objectives of EU energy policy and the Electricity Directive. These objectives include competitive markets, consumer empowerment, an increase in renewables, a flexible electricity system and greater energy efficiency.

This can be ensured by applying the tests set out in Article 5(7). This will ensure that measures are designed in such a way that they can achieve their objective, are proportionate to that objective and interfere not more than necessary with the normal functioning of the market.

In practical terms, they measures must necessarily take account of the specific circumstances prevailing right now with high and volatile wholesale energy prices, and the overall purpose of ensuring the longer term transition to a fully competitive retail market and facilitating the energy transition.

5. *Key considerations when developing regulated retail prices*

Regulated retail prices in the current situation should provide space to ensure that markets can work well for consumer in the longer term. This means they should be accompanied by measures to achieve effective competition and a methodology for assessing progress on the measures. The most appropriate measures will depend on the specific situation in each Member State and the specific challenges they face, and could include the following:

- Measures to empower consumers
 - measures to enable self-consumption and production;
 - energy efficiency measures to reduce energy demand, increase energy efficiency and make consumers less exposed to the impact of price volatility; and
 - tapping into the potential of demand-side flexibility to respond to fluctuations in demand and supply notably to ensure customers can participate in demand response measures through aggregation.
- Measures to ensure that all suppliers operate in a prudential way, protecting consumer interests.
- Measures to ensure suppliers are able to make offers on the market that meet consumer needs:
 - suppliers are able to access long term contracts on an equal basis;
 - measures to support effective access for new suppliers to wholesale markets ;
 - measures on dominant producers to make forward contracts available on a fair basis (e.g. on same terms as to their supply arm). If generators have already sold forward energy through long-term power purchase agreements or bilateral contracts, this energy should be excluded; and
 - removal of barriers to entry of new participants.

In any case, Member States should ensure full and effective implementation of Chapter III of the Electricity Directive to ensure consumer empowerment.

The method is needed for assessing progress in returning to fully competitive markets. A roadmap with milestones for removing of regulated prices would be one way of achieving this:

- in particular, milestones should be associated with mitigation of the impact of exceptional supply and demand conditions; without expecting their return to pre-crisis levels. This would mean that we would expect full competition to resume on the basis of new wholesale price level;
- the Roadmap should be sufficiently clear as to enable market participants to plan ahead.

Minimising potential adverse impacts of regulated prices also means ensuring non-discriminatory treatment of suppliers. This needs to include the following:

- Suppliers should be free to develop other offers, not based on regulated prices.

- Dynamic price contracts should not be affected, and consumers should continue to be able to choose dynamic tariffs.
- The methodology should ensure it does not cement the position of dominant players.
- The regulated price should not be based on a single particular operator's generation fleet. However, where the generation fleet of a particular operator was in the past made available to all suppliers on non-discriminatory terms, this could be taken into account.
- There should be transparency in the selection of the supplier subject to the regulated price and the selection process should be based on non-discriminatory selection criteria.
- If compensation is provided to the supplier for providing the offers at regulated cost, two options are available:
 - All suppliers should be eligible to provide offers at the regulated price on the same basis. The timing of compensation should take into account the different financial impact on small suppliers to protect them against disproportionate burdens that might arise from the obligation to offer electricity at regulated prices,
 - the supplier should be chosen through an open process such as a tender

Regulated prices should be cost-reflective, at a level where effective price competition can occur. In this regard Member States should take into account the following:

- The regulated price setting methodology should be fully auditable.
- For the calculation process, the authority implementing the regulated prices should have access to the necessary information the cost structure of the industry;
- The regulated price needs to be able to cover reasonably incurred costs of suppliers and to be assessed on the basis of objective economic criteria, including regulated or administrative costs;
- Identifying the appropriate reference price for suppliers' costs when procuring electricity is particularly difficult during a period of high and volatile prices. It is however important that even if regulated prices might be below what is needed to cover wholesale market costs during specific short term period, they must be cost-reflective taking into account a duly justified longer period. This could for example be based on the normal forward procurement of energy by suppliers in the relevant Member State.

Other requirements under Article 5(7) of the Electricity Directive include

- minimising any negative impact of regulated retail prices on the wholesale electricity market;
- ensuring beneficiaries of regulated retail prices continue to be able to choose competitive market offers, and are provided with support and information in this regard;
- directly informing customers of the possibility of installing smart meters and providing them with the necessary assistance, and
- Ensuring that regulated retail prices should not lead to direct cross-subsidisation between customers supplied at free market prices and those supplied at regulated supply prices.