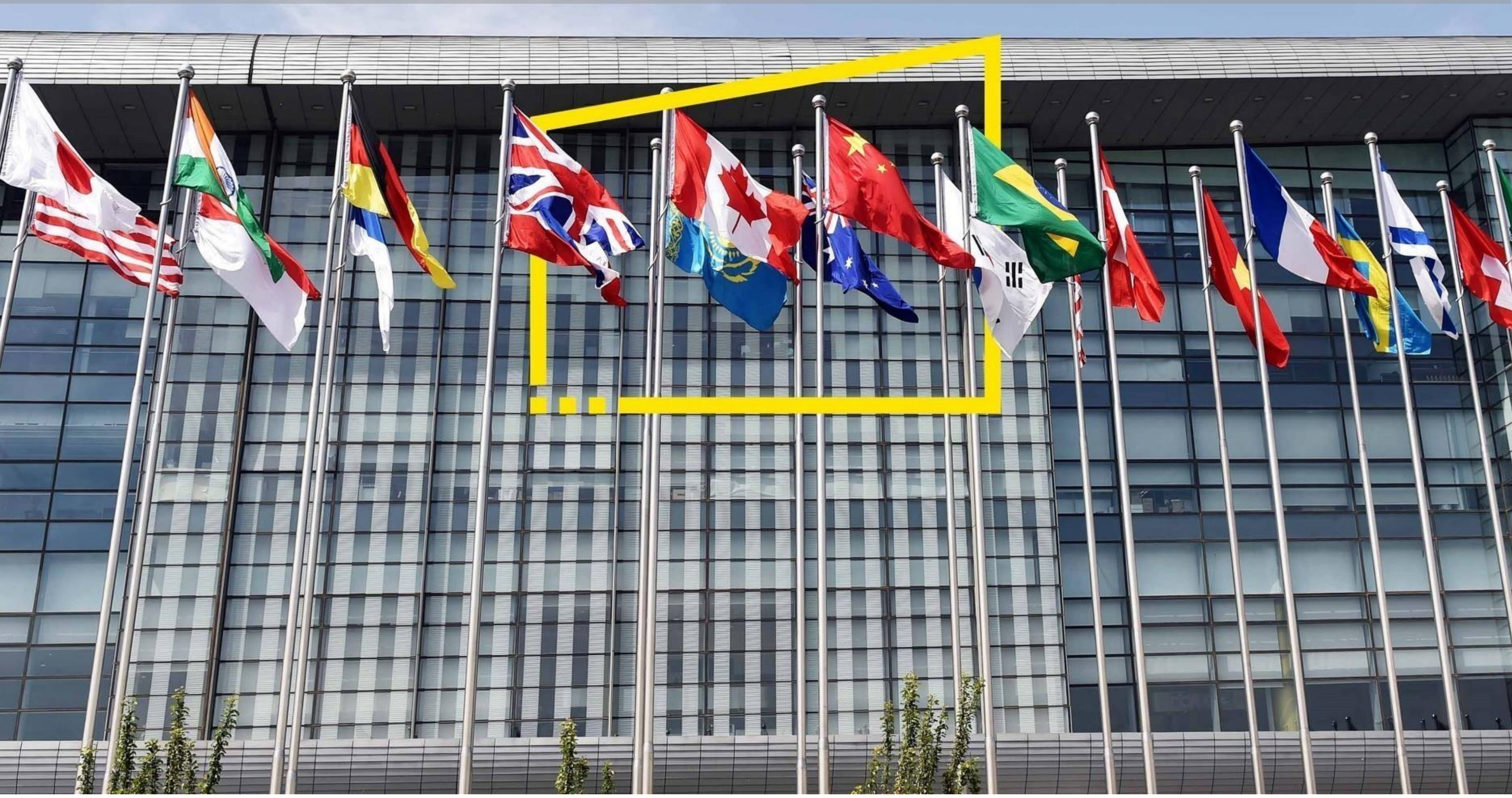
Legal Update – June 2023

Analysis of the Report from the Commission to the European Parliament and the Council on the review of the emergency interventions to address high energy prices in accordance with Council Regulation (EU) 2022/1854



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The European Commission has presented the report entitled "*Report from the Commission to the European Parliament and the Council on the review of the emergency interventions to address high energy prices in accordance with Council Regulation (EU) 2022/1854*" in which it questions the extension of the exceptional measures introduced on October 6, 2022.

The report examines the provisions of Chapter II of Regulation 2022/1854 in accordance with Article 20(1) of that Regulation (Council Regulation). It is based on information provided by twenty-five Member States in accordance with Article 19 of the Council Regulation, as well as responses to some of the questions raised by the European Commission itself in the public consultation, for its proposal on the reform of the electricity market configuration.

In this Alert we will detail how the market has changed and the measures that were introduced, as well as the situation why it is not considered necessary to prolong them.

Context.

During the years 2021 and 2022, the energy sector has experienced an unprecedented conjunctural situation that led to a dizzying rise in electricity prices across Europe. This price increase was intrinsically linked to the high price of gas, which led to an increase in the price of electricity due to the role of gas-fired power plants (combined cycle) in meeting demand.

This drastic increase in electricity prices has mainly affected households, small and medium-sized enterprises, and industry in the EU, unless they were covered by forward or fixed-price contracts.

The Commission has been committed since the beginning of the energy crisis to mitigate the effects of high energy prices on European citizens and businesses by rapidly putting in place, in close cooperation with the Member States, a set of mitigating measures.

Description of the current market situation

The Commission states in the Report on the review of emergency interventions to address high energy prices, submitted dated June 5, 2023, to the Council, that the temporary emergency measures introduced for the energy market at the end of last year helped to calm European energy markets, along with other emergency proposals adopted in 2022. These were mainly measures to reduce electricity demand, to introduce limits on "infra-marginal" revenues and to fix retail prices.

However, the Commission considers that, at present, the situation on the EU electricity market has eased considerably from last year's record levels, so that the adoption of a prolongation of these crisis measures is neither necessary nor proportionate considering the current situation.

As a proof of this, as reflected in the Report, European electricity market prices have decreased considerably, going from more than 350 €/MWh in August 2022 to values below 80 €/MWh in May 2023.

Similarly, gas prices have not only been reduced, but have also stabilized. In view of this, the Commission concludes that the electricity price peaks observed throughout 2022 are considered "less likely to occur in the coming winter".

Demand reduction

The exceptional measures to reduce electricity demand were adopted with the aim of contributing to lowering the cost of electricity for consumers, while reducing electricity demand could have an impact on reducing electricity prices and have an overall calming effect on the market.

In this regard, the Council Regulation establishes two objectives: firstly, an indicative objective consisting of an overall reduction of 10% in the electricity demand of all consumers. And secondly, a mandatory target of reducing demand during peak electricity demand hours by at least 5%. Member States could choose appropriate measures to achieve this demand reduction, which could potentially include financial compensation.

These would consist of reducing gross electricity consumption during selected peak price hours by at least 5 %, corresponding to at least 10 % of the hours in each month when prices are expected to be the highest.

These electricity demand reduction measures have been in effect from December 1, 2022, to March 31, 2023, and subsequently extended until the end of December 2023.

However, the Commission's Report notes that, at present, the reporting Member States have indicated that they have managed to reach the 5% target and some, including Spain, have reached the 10% target. Also, in the public consultation on the electricity market reform process, the majority of stakeholders indicated that prolonging this measure would not be necessary.

Taking into account the information currently available to the Commission, including the current market expectations set out above, the Commission considers in its report that a prolongation of the demand reduction measures set out in the Council Regulation is not necessary.

Revenue limitation for low-cost energy generation

The reason for adopting a temporary revenue cap measure for "infra-marginal" electricity producers is that they may be receiving windfall profits, as high gas prices caused the price of electricity traded on the spot market to rise.

The measure to implement a temporary revenue cap for "infra-marginal" electricity producers consisted in the imposition of a maximum limit of 180 €/MWh for "infra-marginal" electricity produced from the following technologies: nuclear, lignite and renewable sources, among others.

This measure would aim to recover surplus revenues from electricity producers with the lowest marginal costs, i.e., technologies with lower variable costs than gas, such as renewables, nuclear or lignite, which supply electricity to the grid at a cost below the price level set by the most expensive "marginal" producers, while ensuring a reasonable return on investment for the technologies concerned.

This revenue reduction measure consisting of a limit of €180/MWh applicable to all electricity producers is in force from December 1, 2022 to June 30, 2023.

However, the Commission notes in its Report that, based on the information submitted by the reporting Member States, the application of the "sub-marginal" revenue cap has been very heterogeneous, both in cap levels and in time duration, creating significant regulatory uncertainty which, in turn, poses risks to the development of new investments, in particular in renewable sources, necessary to achieve EU targets.

In particular, the difficulties reported in some Member States in relation to the conclusion of long-term contracts, including PPAs, as a result of the application of the revenue cap, could create further uncertainty for investors and hamper the attractiveness of and confidence in forward markets.

The above risks may ultimately undermine the establishment of an attractive investment environment for renewable and low-carbon generation, the objective of the Commission's proposal on electricity market design and ultimately the energy transition.

Finally, the public consultation included questions on a possible extension of the infra-marginal revenue cap and the majority of respondents were against it due to the following risks and challenges it would bring:

- The heterogeneous application of the infra-marginal revenue limit in the Member States seems to have created uncertainty among investors and has been reported to discourage new investments.
- The measure is difficult to apply, and its administrative costs are high compared to its benefits.
- When the "infra-marginal" revenue limit is set at a low level, as some Member States have opted for, generators may be inclined to reduce their output while the limit is in force.
- Consumer protection can be ensured without interfering in the design of the electricity market, e.g., by adopting specific social policies.

Taking into account the information currently available to the Commission, as stated above, it does not recommend the extension of the Council Regulation with respect to the "infra-marginal" income limit.

Thus, the question arises as to how this consideration by the European Commission will affect the Spanish case, which is expected to apply until the end of the year.

Support to the final consumer

The high energy prices have an impact on EU consumers, both households and businesses. In this regard, a series of measures were adopted to lower the regulated bills of the most vulnerable consumers and small and medium-sized enterprises.

These measures were necessary to mitigate the increased costs for consumers, as they allow Member States to collect funds from energy windfall profits and redistribute them to the most vulnerable individuals and businesses in the EU, thus providing direct support to those who have difficulties in paying their bills.

These surplus revenues could be used to provide income support, rebates, investments in renewable energy, energy efficiency or decarbonization technologies. The support provided should maintain an incentive to reduce demand.

In this regard, the Council agreed that Member States could temporarily fix a price for the supply of electricity to small and medium-sized enterprises, to provide additional support to SMEs in difficulties due to high energy prices. Member States also agreed that, exceptionally and temporarily, they could set a price for the supply of electricity below cost.

This measure would apply from October 8, 2022, to December 31, 2023.

The Commission notes in its Report that, based on the information presented and the conditions of electricity supply and prices in the EU at present, there are no elements of judgment to determine that a prolongation of the retail interventions is necessary or advisable.

In the case of Spain, a reform of the Voluntary Price for Small Consumers (PVPC) aimed at protecting consumers is foreseen, which is expected to be presented next week at the Council of Ministers.

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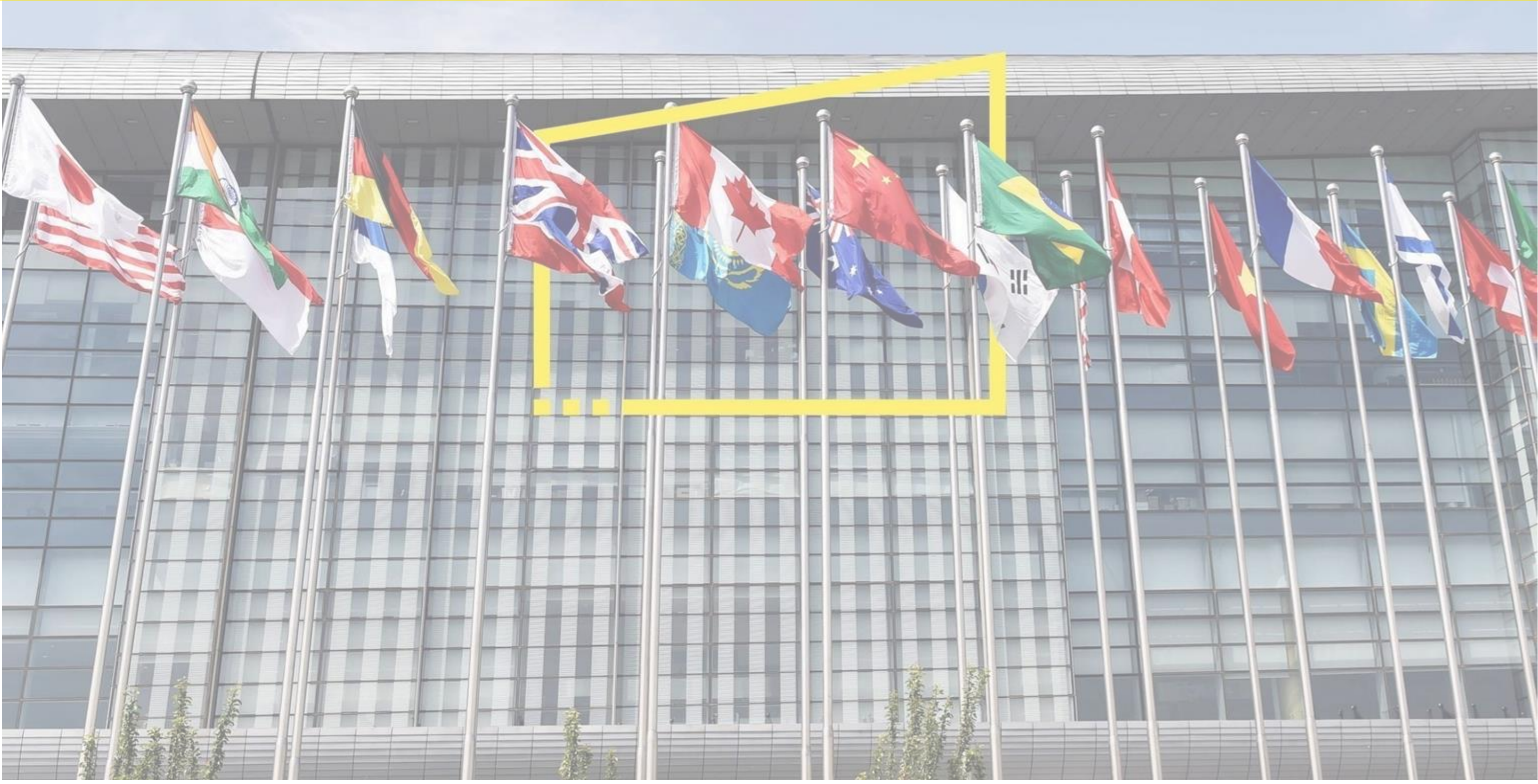

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