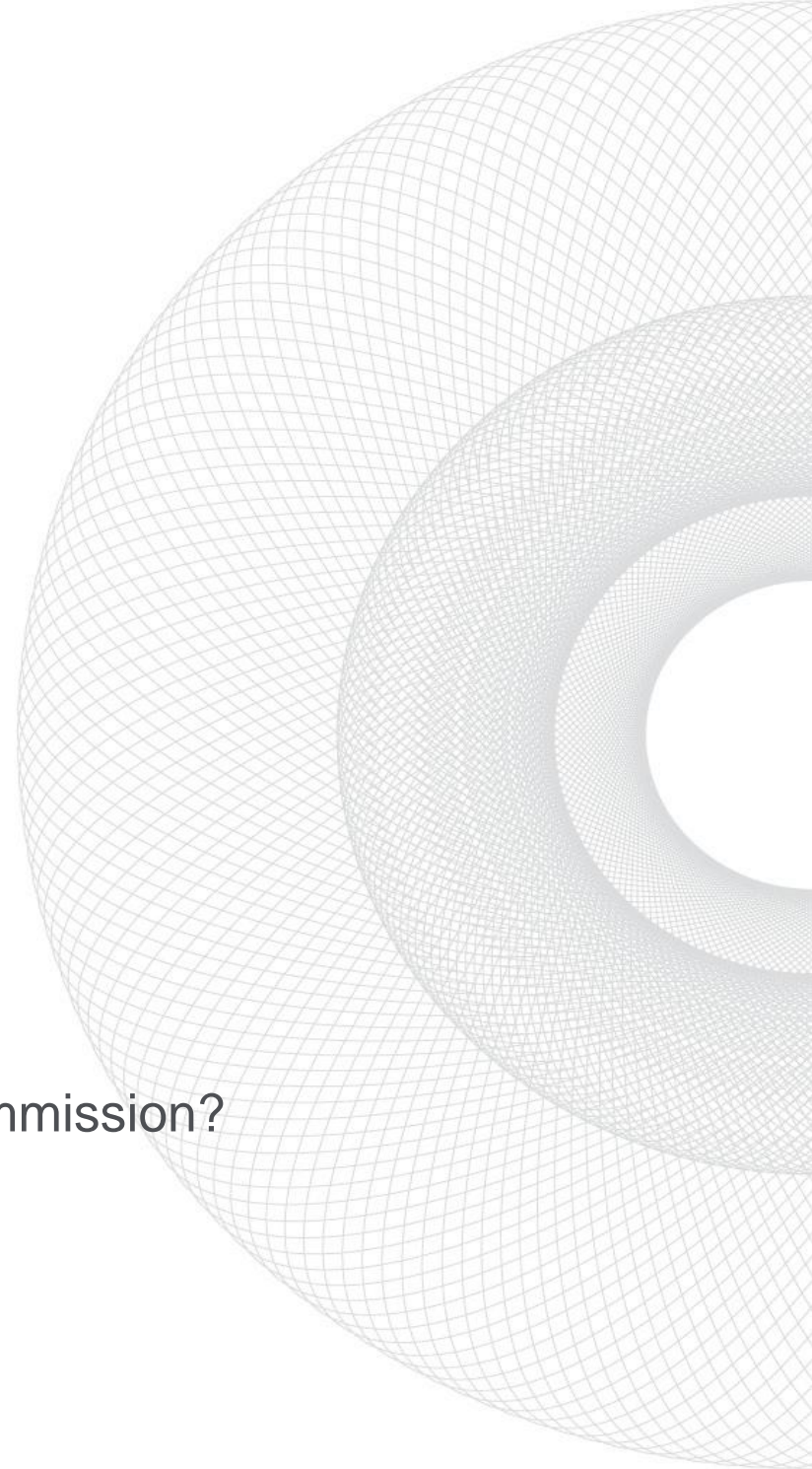


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Energy Law Newsletter

EU Energy Policy: Turnaround by the European Commission?

November 2013



Rethinking EU energy policy:

The new Commission Communication on public intervention in the EU electricity market

Further to the European Council's energy market conclusions in May 2013 (which we reported in one of our previous newsletters) and to the European Commission's (the "**Commission**") previous conclusions on the internal energy market, the Commission published a new Communication on 5 November 2013 entitled "Delivering the internal electricity market and making the most of public intervention" (the "**Communication**") – which may indicate the dawn of **a new era in EU energy policy**.

While the main purpose of the Communication is to present the principles and direction of changes in EU energy policy for discussion by Member States and stakeholders, the Commission still makes the case for the establishment of a true internal electricity market for Europe on the basis of the three EU energy policy objectives: secure and competitive supply, the 20-20-20 renewables and climate change targets, and an increase in energy efficiency.

However, the Commission is proposing **guidance for Member States' authorities** on how to **design new and adapt existing public interventions** in the internal electricity market, based on the Commission's re-thinking of public interventions. It hence brings substantial novelty to the Commission's approach regarding State's intervention on the EU energy markets.

It is worth noting that although the Communication focuses on the electricity sector, the Commission indicated that the principles set out in the Communication may also apply to other energy sectors.

In this Newsletter, we highlight the most important elements of the Commission's proposals set out in the Communication.



Why is the Commission rethinking Government intervention in the electricity markets?

The Commission takes the view in the Communication that public intervention in the EU electricity sector is still necessary to achieve the key EU energy public policy objectives. At the same time (similarly to its 2012 Communication on the internal energy market), the Commission stresses the importance of these **public interventions being well-designed** in order to be effective and not to distort the functioning of the internal electricity market.

In the Commission's assessment, currently applied public interventions do not entirely support the goals of EU energy policy; sometimes they rather distort the market. The Commission opines in the Communication that this is mainly because:

- most support schemes for renewables applicable today were designed when the technologies were in their infancy; as renewable energy technologies mature and as their market share increases, **support schemes should be adapted to the changed circumstances**;
- in spite of developments in technology which create new opportunities for demand-responsiveness, **the potential of the demand-side in markets is currently underutilised**;
- to ensure generation adequacy, **inefficient plants are sometimes being artificially kept in operation** through public support or unnecessary new generation capacities are being built; and
- due to increasing integration of national markets, public intervention **affects prices** not only nationally but also **in neighbouring markets**.

Why is the Commission rethinking Government intervention in the electricity markets? – cont'd

Specific forms of public intervention and Commission guidance on these measures

The interventions of the Member States in the electricity sector may take various forms, such as state aid to certain sectors or companies in the form of grants or exemptions from taxes, imposition of public service obligations or regulatory measures.

The Commission accepts that these measures may be useful, but they must be well-designed and must adapt to the changes in the market as it develops in time. To ensure their effectiveness, the Commission has therefore given guidance in the Communication to Member States on how to:

- ensure adequate generation capacities;
- design and reform national support schemes for renewables; and
- enhance the role of consumers in the electricity market by adopting certain demand response measures.



Guidance on generation adequacy

As a clear reflection on recent developments in certain Member States such as the United Kingdom, the Commission points out in the Communication its appreciation of **the volatility and uncertainties caused to power generators' expected revenues** by increased renewable power generation, the need to replace aging electricity generation assets, retail price regulation and wholesale price caps, and serious volatility on primary energy markets.

Notably, the Commission refers in the Communication both to the **capacity markets contemplated** in certain Member States, as well as to calls by Member States **for specific state aid measures to support new nuclear builds**.

On that note, the Commission stresses that any support measures taken by Member States to resolve their generation adequacy concerns **should not result in inefficient plants being artificially kept in operation through public support** or in unnecessary new generation capacity being built.

Therefore, the **Commission is putting forward a test** to be applied prior to any intervention by a Member State, plus it proposes a number of **potential measures** that could help solving identified generation adequacy issues.

The test the Commission requires to be applied prior to public intervention comprises three main elements:

- first, identify the actual adequacy issues and prove it cannot be solved under existing energy policies without new intervention;
- second, assess the proposed intervention through a holistic approach to take into account all energy policy objectives and verify it against alternative measures (such as enabling demand response, accelerated rollout of smart metering, expansion of interconnections, etc.); and
- third, ensure that the contemplated new measure passes the well-known proportionality test under EU law.



Guidance on generation adequacy

– cont'd

If the result of such a test still supports public intervention by the Member State, the Commission proposes the following **possible generation adequacy measures**:

- creation of **strategic reserves**;
- **promotion** and **enabling of demand response**;
- establishment of **market-wide capacity mechanisms**; and
- **promotion of long-term contracts (PPAs) for constructing new power plants** between generators and future consumers.

The Commission further notes that even when applying any of the above (permitted) measures, **Member States must take into account a number of policy requirements**, namely that: (i) fossil fuel generation subsidies should be phased out by 2020; (ii) there should be no export charges or export restrictions or procedures to reserve electricity for the domestic market; and (iii) public interventions should be limited in time.

Accordingly, the Commission will require Member States intending to intervene to support generation adequacy to make a thorough generation adequacy assessment as to why such intervention is needed.



Guidance for renewables

Even though promoting renewable forms of energy is a key pillar of EU energy policy, the Commission concludes that energy markets are yet unable to deliver the desired levels of renewables. As such, the Communication provides for **continued public intervention in support of renewables** – albeit **in a substantially revised way**.

The Communication also notes that support should be oriented more towards the enhancement and development of new, yet uncompetitive technologies, rather than continuation of support of those which are already mature. Therefore, the renewable support schemes should be regularly re-evaluated.

The Communication sets forth policy recommendations that bring substantial change to the existing renewable support schemes by putting forward the following **new policies and measures**:

- support for renewable electricity generation should reflect the maturing and growing of the renewable sector and renewable technologies and the consequent decline in their costs;
- any further support that is necessary **should only supplement market prices**, rather than replacing them;
- in essence, this means **phasing out feed-in tariff schemes** and a **move toward feed-in premiums and renewable quota obligations** – which will force renewable generators to respond to market prices;

- renewable support should be designed to be consistent with the EU ETS, i.e. **if carbon prices increase, renewable support should be reduced**; and
- feed-in premiums or quotas should be **allocated primarily through tendering procedures** as these make it possible to reveal the costs of different technologies, operators and projects and therefore limit discrimination between different renewable energy sources.

These new policies and measures signal substantial reform by the Commission to the renewable support schemes currently applied in most Member States. However, the Communication stresses that there should be no retroactive changes to existing support schemes which would undermine investor confidence – in other words, the Commission's reforms are not intended to go as far as to frustrate investors' legitimate expectations.

In order to give momentum to the cross-border cooperation mechanisms foreseen by the Renewable Energy Directive, which so far has only resulted in a single joint support scheme between Norway and Sweden, the Commission has put forward detailed guidelines on the use of such cooperation mechanisms, including templates of standardised cooperation agreements.

Guidance for demand response measures

In connection with demand-side measures, the Commission emphasises that ensuring adequacy of electricity supply should go hand-in-hand with enhancing the role of consumers in the electricity market – whether industrial, commercial or households.

Consumers may help the functioning and development of the electricity market by making the electricity system more flexible, namely through:

- energy efficiency solutions;
- local renewable energy generation; and
- demand-response services.

This will require, in the Commission's view, at least accelerating the rollout of smart metering systems, as well as removing certain network tariff elements that hinder market participation and the introduction of clear rules on data exchange and protocols.

In addition, the Commission proposes the introduction of a dynamic pricing system, i.e. billing based on wholesale prices instead of billing on consumption profiles.

To ensure technical background for these incentives, the Communication announced that European standardisation organisations will develop a complete set of standards for smart grids, including for demand response, by the end of 2014.



Further observations

In our view, the following two points in the Communication are particularly interesting – partly because of the Commission's previous actions and in part because they indicate how the Commission will assess public interventions in the EU electricity market:

- **Promotion of long-term contracts (PPAs) to enhance investment in power generation** – The Commission seems to turn back to a once fiercely opposed instrument by suggesting that to facilitate the construction of new power plants, Member States could promote long-term contracts **between the generators and future consumers**, such as industrial consumer groups. Of course, the Communication points out that such new PPAs would have to comply with EU state aid rules. Nevertheless, it is quite peculiar to read from the Commission that long-term PPAs “*may provide both the generators and companies with the predictability they need to make investments*” in light of the Commission's previous state aid decisions, in e.g. Hungary's PPA case.
- **Taking into account regional and EU level effects** – A clear indication that the Commission's future assessment of Member State interventions will focus on the cross-border and EU-wide impact of any such State intervention which will no longer be viewed only in the local or national context.

Finally, we note that the Commission announced the planned adoption of **new EU guidelines on energy and environmental aid** for the period 2014-2020 and, to this end, a public consultation on a draft text of these guidelines will be launched soon.



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This newsletter provides concise information on certain topics. Its content is not necessarily exhaustive and should not be considered as legal advice. If you have any questions in relation to the content of this newsletter, please feel free to contact us and we will be more than happy to assist you.

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