

Rachel Guyet\* - 15 January 2024

## **The EU Electricity Market Reform and the Protection of Consumers: A Move Towards a More Ambitious Approach?**

During the winter 2022-2023, 42 million Europeans were not able to heat their homes properly, which represents a surge from 6.9% of the population in 2021 to 9.3% in 2022<sup>1</sup>. This highlights how the consequences of the post-Covid high gas demand which, combined with a lower quantity of gas available following the war in Ukraine, increased inequalities, and vulnerabilities in the access to affordable energy services across Europe. The price spikes, affecting both the economy and the consumers, led the European Commission to first support emergency mitigation measures<sup>2</sup> and then to put the reform of the electricity market on the political agenda. Before deciding on the content of the reform, the European Commission entrusted the Agency for the Cooperation of Energy Regulators (ACER) with an assessment of the functioning of the electricity market. The final report, produced in April 2022, stated that a reform of the market was necessary to ensure the decarbonisation pathway and therefore the energy sovereignty of the EU and that structural measures must be taken to “hedge electricity customers against possible future periods of sustained high energy prices<sup>3</sup>.” In March 2023, the European Commission proposed a reform, the general approach of which was agreed upon by the Council on 17 October 2023, leading to a provisional agreement concluded between the Council and the Parliament on 14 December 2023, although the text has not yet been formally adopted. The reform aims at striking a balance between four priorities: setting market rules to ensure the integration of the European electricity market, guaranteeing the deployment of low-carbon energies, securing a continuous supply at an affordable price while improving consumer protection. This paper focuses on the latter priority, examining how consumer protection has been designed for households who have been confronted with the volatile pricing system leaving them struggling with affording their energy services.

### **Acting to reduce the volatility of prices is necessary**

After negative prices on the wholesale electricity market during Covid, prices started increasing in the summer 2021 and skyrocketed after the invasion of Ukraine. The high volatility of the market resulted in many bankruptcies of suppliers and made energy services unaffordable for an increasing number of low and middle-income Europeans. Of course, the energy crisis has not created energy vulnerabilities, but it has worsened the situation for millions of households in Europe and created new vulnerabilities, as illustrated by the above indicator on the inability to heat. European households had to face an increase in energy prices of 42%<sup>4</sup>. Member States intervened to mitigate the social consequences of the price hike, mobilising huge budgets of roughly €646 billion between 2021 and 2022<sup>5</sup>. Although the short-term emergency measures alleviated the price shocks, they had very limited redistributive effects, didn't support fossil-free energy production and consumption and created additional burdens on households, but also on local public authorities, on national budgets and ultimately on the suppliers themselves (see CIFE Policy Paper n°143).

### **The need for reform is acknowledged**

A group of countries, led by Germany<sup>6</sup>, considered, like ACER, that the energy price crisis was not the result of market failures but of exceptional geopolitical circumstances and therefore tended to defend the status quo or a targeted change of rules, allowing a quicker integration of low-carbon energies to maintain low gas and electricity prices. This group opposed another alliance of “southern” countries, led by France<sup>7</sup> who were pushing for a more ambitious overhaul of the electricity market design. If the scope and timeline of the reform were still a matter for debate, the need for structural improvement to limit the price volatility and stimulate investment in low-

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carbon energies was widely recognised. This led the EU institutions to introduce a set of mechanisms such as longer-term contracts in the form of Power Purchase Agreements (PPA) and two-way Contracts for Difference (CfDs). Their aim is to stabilise prices, avoid windfall profits, boost investments in low-carbon electricity production assets and redistribute excess revenues to final consumers<sup>8</sup>. However, these new mechanisms will only help households if they can be translated into a fair retail tariff design and if the distribution of excess revenues have a real redistributive impact to address the unequal access to energy services.

### Improved protection for consumers

While claiming that consumers are at the core of the reform, the EU Commission and the Member States also acknowledged the need for public intervention in price setting within the market rules to secure investors in low-carbon energies and shield the consumers from price volatility. In this framework, three main categories of consumer protection mechanisms are being introduced.

First, a higher protection against disconnection. This approach might not be considered new since disconnection prohibition was encouraged in article 3 of EU directive 2009/72/EC concerning common rules for the internal market in electricity. The main difference now is that the reform could make it mandatory. This is accompanied by the obligation of implementing a last resort supplier and allowing for the possibility to offer regulated prices in times of crisis (under certain conditions). However, this requires clarification on how exactly such measures can be implemented and how responsibilities between private companies, regulators and public authorities are shared at national level. The concrete implementation of such a ban and the management of the debt risk need to be adequately addressed or it will not contribute to making energy an essential service.

The second dimension of the reform aims at creating conditions for consumers to benefit from stable prices through different types of contracts. Indeed, it pushes for the right of consumers to choose between multiple contracts, including dynamically priced, fixed price, or fixed term contracts, according to their needs. Unilateral price increases in fixed price or fixed term contracts will be prohibited. This is coupled with the roll-out of smart meters designed to help

consumers adjust their consumption patterns. This model is expected to offer more stable and affordable price options provided consumers gain an increased power of decision. That should be ensured by a transparent information system related to the different contract opportunities<sup>9</sup>. However, the expected outcomes will depend on the design of the retail tariffs and how the different groups of consumers can benefit from them. Most of all, it requires consumers to regain confidence in the way the market is working, the many failures of suppliers in the winter 2022-2023 having generated mistrust not only in the tariffs offered but also in the suppliers themselves. Commercial abuse or incorrect billing have also contributed to the loss of trust in the market players, which explains why so few consumers are switching suppliers (on average 1 in 5)<sup>10</sup>. If the lack of trust in the system is not seriously tackled, the reform won't bring the expected outcomes in terms of consumer protection and empowerment.

Finally, it also aims at empowering citizens to become active agents of the energy transition by supporting citizens' investment in energy communities and in sharing energy. This should help citizens take ownership of the energy system, even if they don't own a rooftop or can't afford to invest in solar panels themselves. This is consistent with the political slogan of the EU to leave no one behind. However, mechanisms to promote a democratisation process in the energy transition require more support and clarity at national level if these "alternative" models are to contribute to a fairer transition. This will depend on whether national legislation will act as an enabling framework to allow the social, economic and environmental benefits expected from these models to be achieved and made accessible to all.

### An increasing consideration for vulnerable households

If the reform is attempting to make consumers more active in the energy transition, it doesn't distinguish much between customers, while vulnerable households are suffering the most from price fluctuations and hikes. The statement "The protection and empowerment framework for energy sharing should pay particular attention to energy poor and vulnerable consumers<sup>12"</sup> is welcome because it extends the protection not only to vulnerable consumers, (who are already targeted in the previous directives), but also

to households exposed to energy poverty. If the direction is clear, it remains to be seen how it is going to be introduced by way of national legislation to create adequate conditions since most Member States do not recognise energy poverty as a topic of public policy. Moreover, even if the reform proposal might be adequate for citizens who have the economic, social and cultural capital to be active on the market, more needs to be done to allow the same level of empowerment to citizens who need it the most. How, in concrete terms, will access to energy sharing and energy communities be managed for vulnerable households? Who is going to be the key enabler? Is it only about protection or can we take a step further towards reducing the negative distributional impacts of the market and promote a “just transition”?

A week after the reform of the design of the electricity market was approved by the EU Council, the EU Commission published a recommendation on energy poverty<sup>13</sup> demonstrating that the EU is taking an important step towards a European recognition and definition of the phenomenon. First the Commission recognises that energy poverty is a multidimensional issue, enshrined in root causes such as low income, bad housing quality and high energy prices. By proposing a definition and 13 indicators to measure it, the Commission positions itself as a key actor in promoting the recognition of energy poverty as a separate topic from “vulnerable consumers” and as a

specific field of public policy. The energy crisis has driven the energy vulnerabilities of citizens up the agenda of both the EU and the national states. Furthermore, for the first time, the revised energy efficiency directive offers a European definition of energy poverty<sup>14</sup>. It is expected that a definition of energy poverty and its measures should be integrated into the updated version of the National Energy Climate plans that are to be submitted by June 2024, knowing that only 18 member states had defined energy poverty in their previous version. The EU Commission also requires the Member States to define energy poverty in their Social Climate Fund plans that should be submitted by June 2025. It also recommends some good practices in terms of public policies addressing energy poverty based on income support and social policies and structural measures such as the retrofitting of buildings, including the improvement of energy efficiency and the installation of renewable energy. Although such a move is an important step towards increased consumer protection and empowerment, including the most vulnerable households, it fails to embed the reform into the principle 20 of the European Pillar of Social Rights, recognising energy as an essential service. If the aim is to move to a fairer transition, the reformed mechanisms should not only be protective and compensatory but redistributive in nature.

## References

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8. These mechanisms are defined as followed by the EU: “**A Power Purchase Agreement** is a commercial contract between an electricity customer and a generator, whereby the generator agrees to sell energy (directly) to the customer at a certain price. **A Contract for Difference** is a contract which is concluded by a public entity to encourage investment. It tops up the market price paid for electricity if the price is below a certain level, but requires the generator to pay back amounts where the market price is above a certain level. The net effect is that the revenues and the price are stable, close to the costs of production and do not exceed such costs. Many CfDs currently only have a revenue guarantee, but there is clearly scope to pursue more two-way CfDs. **A two-way contract for difference** is a contract signed between an electricity generator and a public entity, typically the State, which sets a strike price, usually by a competitive tender. The generator sells the electricity in the market but then settles with the public entity the difference between the market price and the strike price. It thus allows the generator to receive a stable revenue for the electricity it produces, while at the same time it provides a revenue limitation for generators when market prices are high. In a two-way CfD, if the market price is below the strike price, the generator receives the difference; if the market price is above the strike price, the generator pays back the difference.”
9. <https://www.jean-jaures.org/publication/marche-europeen-de-lelectricite-investir-dans-la-transition-energetique-protger-les-consommateurs/>

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- <sup>14</sup> “a household’s lack of access to essential energy services that provide basic levels and decent standards of living and health, including adequate heating, hot water, cooling, lighting, and energy to power appliances, in the relevant national context, existing social policy and other relevant policies, caused by a combination of factors, including but not limited to non-affordability, insufficient disposable income, high energy expenditure and poor energy efficiency of homes”.