EUROPEAN
COMMISSION

Brussels, XXX
[... ](2022) XXX

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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

## Security of supply and affordable energy prices: Options for immediate measures and preparing for next winter

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## INTRODUCTION

Over the last 12 months, the retail prices of natural gas and electricity have been rising by respectively 65% and 30%. Russia's invasion of Ukraine is adding supply concerns to this difficult situation and has exacerbated the price volatility. High-energy prices are feeding inflation and hurting Europe's economy and potentially slowing its recovery from the COVID-19 crisis.

As part of the response to this exceptional situation, in October 2021, the European Commission adopted a **toolbox for action and support**[1] to mitigate the effects on consumers and businesses at the EU- and Member States levels. Targeted support measures to help reduce energy costs for consumers, households and industries, have helped alleviating the pressure.

On 8 March 2022, the Commission's **REPowerEU Communication**[2] provided further guidance to Member States on how to mitigate the increase in electricity prices for households and businesses, and on how to use high profits earned by some electricity producers to finance these measures. To ensure a more sustainable energy system, the Commission will propose in May a plan to phase out Europe's fossil fuel dependence from Russia while increasing the resilience of the EU-wide energy system.

In **Versailles on 10-11 March 2022**, EU leaders agreed[3] to phase out the EU dependency on Russian gas, oil and coal imports as soon as possible and invited the Commission to put forward a plan to ensure security of supply and affordable energy prices during the next winter season by end of March. In parallel, the EU leaders committed to urgently address and consider concrete options, building on the Communication of 8 March 2022, for dealing with the impact of increased energy prices on our citizens and business, especially our vulnerable citizens and SMEs, including at the next meeting of the European Council on 24-25 March 2022.

This Communication responds to the Leaders' call. It presents the benefits and drawbacks of concrete exceptional short-term options to temper price spikes and proposes collective European actions to address the root causes of the problem in the gas market with a view to ensure security of supply at reasonable prices for next winter and beyond, through EU partnerships with third countries to collectively purchase gas and hydrogen, and a proposal for a European gas storage policy aiming at improving the resilience of the EU-wide energy system.

## OPTIONS TO ADDRESS HIGH ELECTRICITY PRICES IMPACTS ON CITIZENS AND BUSINESS

**Several options for emergency measures** to limit the impact of high electricity prices have been put forward by Member States, stakeholders and in the academic debate. They aim at providing relief to end-consumers, while not distorting the longer term overarching

[1] Communication on tackling rising energy prices: a toolbox for action and support, COM(2021) 660 final, (13.10.2021)

[2] Communication on REPowerEU: Joint European Action for more affordable, secure and sustainable energy, COM(2022) 108 final, (8.3.2022)

[3] 20220311-versailles-declaration-en.pdf



decarbonisation, and thus energy efficiency objectives. To be successful, these temporary and targeted exceptional options need to be fiscally manageable and should not compromise

security of supply and level playing field in the internal market.

The short-term options on the electricity price can be broadly grouped in two categories:

| Financial Compensation | | Regulatory |
|---|---|---|
| Retail | Wholesale | |
| Income support | Cap price on the fuel price for fossil generators | Fixed price for generators |
| Temporary State Aid Framework | Cap on electricity price | |
| Reduced taxation | | |
| Aggregation model/ single buyer | | |
| **Main cons:**<br>• Fiscal costs<br>• Risks for level playing field | **Main cons:**<br>•Fiscal costs Distortion of competition<br>•Market disturbance | **Main cons:**<br>•Complexity Supply disruption<br>•Impact on investments |
| | | |

***Intervention options including financial compensation***

These options aim at lowering electricity prices, either directly on the retail side or indirectly on the wholesale market.

*Retail side*

These options aims at cushioning the effects of the high prices on end-consumers while letting the European electricity and gas markets set the price at wholesale level. In line with the Commission's October toolbox[4], 26 Member States have introduced such crisis measures.

[4] COM(2021) 660 final, (13.10.2021)

Within these measures, direct support to vulnerable end-users targets the aid to those most in need and State aid can help businesses struggling with excessive energy prices. The latter will be supported by the **new State Aid Temporary Crisis Framework**[5], adopted on 22 March, enabling support for undertakings directly or indirectly affected in the form of limited direct grants, liquidity support and aid for increased gas and electricity costs.

A majority of Member States have put in place reduced VAT rates for gas, electricity and/or district heating. However, **many possibilities of the legal framework, including exemptions for households, are not yet fully exploited.**

Given that uncoordinated action by Member States in the area of energy taxation leads to negative spill-over on other Member States' environmental and budgetary perspectives, thus impeding the proper functioning of the Single Market, the Commission considers providing guidance to Member States on how to make best use of the legal framework, including on targeted country-specific derogations under the Energy Taxation Directive[6].

All the options above can provide direct relief to citizens and businesses. However, they are fiscally costly. Using higher revenues from energy tax and carbon pricing or from abnormal profits of some energy companies can help finance such measures[7].

*Wholesale side*

Member States can consider setting up an **aggregator model** under which an entity would buy electricity on favourable commercial terms and make it available to certain consumer categories below market price passing onwards the advantages to the consumers, essentially subsidising the difference between lower retail prices and higher wholesale ones.

Other options would involve **intervening directly in the functioning of the wholesale electricity markets**. These consist in either **compensating financially fossil-based electricity generators** for part of their extraordinary high fuel costs so that they reduce their offered price in the wholesale market or in **directly capping the electricity price in the wholesale market** by establishing a reference benchmark and compensating the difference with the offered price.

While such options would aim at reducing the negative impact of very high gas prices in the wholesale electricity market, their main drawbacks relate to their fiscal cost, potential distortion of competition, risks to cross-border trade and hence security of electricity supply.

***Regulatory options without fiscal compensation***

These options consist in establishing a **regulatory cap for the maximum price** that certain baseload generators can charge. Whilst this option would bring the costs down in the longer

[5] Communication on Temporary Crisis Framework for State Aid measures to support the economy following the aggression against Ukraine by Russia, COM(2022)XX final, (22.3.2022)

[6] In accordance with its Article 19 (1) of Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity (OJ L 283, 31.10.2003, p. 51).

[7] Some (renewables) electricity generators currently get excessive profits from the very high electricity prices. These excessive rents can be taxed or clawed back temporarily in line with the guidance the Commission has presented on 8 March (see COM(2022) 108 final, (8.3.2022)).

term, its added value in the short term is to address the excessive profits of certain technologies.

The main drawbacks of these options are related to implementation challenges as they would require access to information on cost and revenues for the generators that might not be accessible to public entities and possible legal challenges. They would also induce regulatory uncertainty, as such options may remove some incentives for private investments in renewables which are key to achieving our long-term goals of a resilient, sustainable and secure energy system.

**All options are presented and analysed in more detail in the Annex.**

Based on this assessment, **the Commission considers that there is no single easy answer to tackle the high electricity prices** given the diversity of situations among Member States**.** Some options are only suitable for specific national contexts. At the same time, some interventions would require an EU- legislation and/or EU level common approach to be effective and not harmful for the internal market and supply security. They all carry costs and drawbacks.

## ENSURING SUPPLY OF GAS AT REASONABLE COST FOR NEXT WINTER AND BEYOND

While many options put forward in the public debate address the symptoms, **the root cause of the current high electricity prices is the gas market**. Today's high electricity price is driven by the high gas price. Volatility is high and not fully linked to fundamentals in the spot market.

Capping or modulating the gas price through regulatory means is an option that may be considered. It is important to signal that the EU will not pay any price for gas but it should be considered as last resort, as it entails some drawbacks in terms of security of supply of gas flows.

**With the gas replenishing season starting now, it is urgent to agree on a common strategy.** The current context of high prices and tight gas markets makes the refilling of storage for the next winter more challenging that in normal years. Using the collective leverage of the Union to help secure gas imports in the best possible conditions is essential to avoid Member States bidding against each other for the same supplies.

The **EU is stronger when acting together.** The **EU should act jointly to harness its market power through negotiated partnerships with suppliers**.

The Commission stands ready to create a **Task Force on common gas purchases at EU level.** By pooling demand, the Task Force would facilitate and strengthen EU's international outreach to suppliers of LNG and of gas, with the view to secure well-priced LNG and gas imports ahead of next winter. The EU can better ensure LNG, gas and hydrogen at affordable prices from third countries in the short term, if it engages with those countries on the long term, setting up long-term renewable gas partnerships which would also lay the basis for future hydrogen imports

Thus, the Task Force will prepare the ground for **energy partnerships** with key suppliers of LNG, gas and hydrogen in the Mediterranean region, with our partners in Africa, but also the Middle East and USA.

The Task Force would be supported by Member States representatives in a Steering Board. A joint negotiation team led by the Commission would hold talks with gas suppliers. It would be inspired by the experience from the COVID-19 pandemic, where EU wide action was crucial to guarantee sufficient supplies of vaccines for all.

The Task Force would also promote the efficient usage of EU's gas infrastructure notably LNG terminals, but also storage facilities and pipelines.

Filling sufficient gas storage will provide European customers with some protection against risks of supply shortages and potential disruptions by providing some stability. This is why the Commission proposes a **European gas storage policy**, common and strategic, implemented through coordinated joint action and burden-sharing across the 27 EU Member States. Over the next months, the Task Force will help in promoting filling of storages ahead of the winter in close cooperation with the Gas Coordination Group.

Common efforts are necessary to **optimise the use of existing storage infrastructure**. Storage measures taken jointly rather than individually avoid over-investments since gas is a transitory energy source and any new infrastructure should be useable for cleaner energy sources in a longer term perspective, notably for hydrogen.

To guarantee a sufficiently high filling level, the Commission has made a **legislative proposal on energy storage** aiming at ensuring that the existing storage infrastructure are filled up to at least **90% of their capacity by 1 November of each year;** a target which can be adjusted over time if the economic and geopolitical realities, as well as the energy supply security change. Recognising the specific situation of the current year, a flexible path to ensure smooth phasing-in will be provided. Member States should already take action to ensure adequate storage filling for next winter, anticipating the legislative proposal.

**Solidarity is fundamental**. Joint gas storage is an insurance benefitting everyone, and to which everyone should contribute in a fair way. This is why Member States without storage should contribute to the storage filling levels in other Member States and in exchange benefit from enhanced security of supply. The burden sharing mechanism embedded in the proposal ensures a fair allocation of security of supply costs among all Member States as they all benefit, thanks to the EU energy market, from lowering the risks of supply disruption regardless of where storage is located in the EU. This mechanism builds on the solidarity agreements which should be concluded without delay to allow that gas be shared effectively in case of an emergency as proposed in December 2021[8]. Equally important is transparency and monitoring of the progress towards reaching the filling target. The Gas Coordination Group will monitor the progress in filling towards the target and consider appropriate actions to sustain the storage filling effort if necessary.

[8] Proposal for a Regulation of the European Parliament and of the Council on the internal markets for renewable and natural gases and for hydrogen (recast), COM(2021) 804 final, (15.12.2021)

Finally, as gas storage infrastructure is critical to EU's security, the **certification** of storage operators will provide the necessary safeguards against risks related to the ownership from third country operators from a security of supply perspective.

## CONCLUSIONS

The options for dealing with the impact of increased energy prices on our citizens and business, presented in this paper cover emergency time -bound interventions to limit the rise of energy prices. None of them is a silver bullet and all of them carry advantages and drawbacks.

What is urgently needed is to contain the rise in energy prices and ensure adequate gas supply for next winter and beyond. The best option is to work as EU27, together in a coordinated approach, to save costs and use the leverage of our joint strength.

In the medium term, more structural solutions are needed, including interconnections, much more renewable energy, energy efficiency measures and the diversification of energy supply to avoid dependencies. The REPowerEU plan will accelerate the introduction of measures on all those fronts. The Commission will table its detailed **REPowerEU plan in May**. In that context, the Commission also stands ready to propose a Union-wide energy savings plan.

With the roll-out of REPowerEU, the EU regulatory framework needs to be made fit to a substantial larger share of renewable energy in the energy mix in line with the EU's ambitious decarbonisation targets. The Commission will assess options to **optimise the electricity market design by May**. This exercise will consider the final assessment by the European Union Agency for the Cooperation of Energy Regulators (ACER) on the benefits and drawbacks of the EU electricity market design, and other contributions on the functioning of the electricity market[9].

Over time, accelerating the uptake of renewable energy sources and encouraging more efficient energy consumption, together with a European storage policy and diversification of supply through a more coordinated engagement with reliable suppliers, will provide structural solutions to ensure access to affordable energy.

The options and proposals outlined in this paper call on all Member States to rely on Europe's best strength: unity and solidarity.

Leaders at the 2022 March European Council are invited to provide steer for proceeding with the work at Commission and legislative level to ensure security of supply and affordable energy prices now, for next winter and beyond.

[9] In this context, it is worth noting that some elements of the envisaged options for short-term interventions, such as the procurement of new capacity through two-way contracts of difference or the use of the aggregator model could help pave the way for future changes to Europe's long-term market design, helping protect consumers against high price volatility in the future and increase the resilience of Europe's energy market.

## Annex - Overview of Options

### I – Electricity Market Interventions involving financial compensation to consumers

### A. Interventions at retail level: direct support to consumers through vouchers, tax rebates or through an "aggregator model"

The REPowerEU Communication announces a new State aid Temporary Crisis Framework. That Framework will enable limited direct grants and liquidity support for all undertakings directly or indirectly affected by the Russian aggression against Ukraine, sanctions imposed or by the retaliatory counter measures, as well as aid to undertakings, in particular energy-intensive consumers, to compensate a part of their energy costs. The Communication also clarifies that, under the current circumstances, it is possible for Member States to regulate retail prices for all households and micro-enterprises.

Another way to shield household consumers, in particular the poor and vulnerable, (but also companies) would be for Member States to use an "aggregator model", under which a State-controlled entity purchases electricity on the market and makes it available to certain consumer categories – directly or through suppliers – at prices below current market prices based for example on a strike price. Any extension of this approach beyond what is foreseen under the existing Article 5 of the Electricity Directive and State aid rules should be carefully assessed to avoid distortion in the Single Market.

**Most of these could be taken nationally.**

**Benefits**

As these options directly target consumers, they are particularly effective at moderating the impact of high prices for end users. They leave flexibility to Member State as regards the categories of household and business consumers to be supported, taking into account national circumstances and competition rules. Member States wishing to set up an aggregator model would need to decide on the design features, including the volumes sold and which specific consumer categories/suppliers would benefit from this option. The Commission could provide Guidance on how to implement such a model so as to ensure level playing field and fair competition in the Single Market.

**Drawbacks**

This option could limit competition on retail markets, which would need to be mitigated by ensuring fair and non-discriminatory treatment of all suppliers. The guidance on regulated prices annexed to the REPowerEU communication illustrates how this could be achieved for the aggregator model.

If a large part of consumers get support compensating for the full price increase, the incentives to reduce their consumption would be more limited. As with all options that reduce consumer costs, it could increase fossil fuel use, the EU's dependence on imports and increase security of supply concerns. The availability of this option depends on the budgetary means of Member States.

**Costs**

The costs and the way they are covered would depend on national choices as regards the coverage of certain consumer categories and the extent to which the financial burden on consumers is relieved.

## II – Electricity market intervention at wholesale level: price setting coupled with financial compensation to producers

### B. Wholesale Intervention on the Fuel Price for Fossil Generators

This option would entail introducing compensation on the price which fossil electricity generators pay for their fuel (coal, gas, oil, diesel). As this would shield fossil fuel generators from the effect of the current price spikes on international commodities markets, it would allow them to offer their electricity cheaper than it is currently the case. This option would be operationalised by paying electricity generators the difference between their actual sourcing costs for fuel (gas, coal) and a pre-established reference price for these commodities.

**Benefits**

This option is expected to influence the bidding behaviour of fossil power plants in the EU and is likely to trigger a reduction of the cost of electricity sold by these plants and thus of the marginal price in the wholesale market. This in turn should lead to lower retail prices.

**Drawbacks**

If introduced at national level, it could distort the flow of electricity in the internal market and trigger flows from countries with the reference price to those without it without consideration for scarcity considerations, security of supply or relative costs.

The financially supported electricity from the EU would flow into neighbouring countries instead of benefitting the EU consumers due to international agreements.

By improving the competitiveness of fossil generation compared to cleaner technologies this option would therefore hinder efforts to decrease the EU's dependence on fossil fuel imports.

**Costs**

The costs and the way they are covered would depend on choices. The cost could be financed through contributions from electricity consumers through their electricity bills. Whilst this cost could in principle be offset by the reduction in wholesale electricity prices brought about by the measure, the net impact on consumers will depend on changes in the prices of fossil fuels, the quantities of fossil fuels imported and the volumes of electricity exported to neighbouring countries. The introduction of such measures would lower the revenues from excess profit taxation.

As with all options that reduce consumer costs, it could increase fossil fuel use, the EU's dependence on imports and increase security of supply concerns.

### C. Wholesale intervention introducing a Price Cap on the Wholesale Electricity Market

This option would entail capping electricity prices at a predefined level.

To keep generators running that use fuels which currently involve costs that prevent profitable generation at the cap (e.g. gas, coal), financial compensation would be required to cover the difference between the market price for the generated electricity and the pre-established cap. Strong regulation may be required to ensure that electricity generation offers above the cap (which set the entitlement to financial compensation) are 'reasonable'. Similarly, regulation may be required to ensure that generators whose costs are below the cap do not bid above the cap (in order to obtain a higher price). This may eventually require a close regulation of bids, which could lead to complexity.

**Benefits**

This option would cap the wholesale prices which in turn should lead to lower retail prices. It would lead to reduced infra-marginal rents for generators not directly affected by the cap.

**Drawbacks**

This option requires detailed knowledge by the administration of cost structures and operating modes of individual power plants.

As for Option B, **if not introduced at EU-level**, this option could distort the flow of electricity in the internal market and trigger flows from countries with the cap to those without it without consideration for scarcity consideration.

As for option B, this option would unduly benefit the EU's neighbours, who would receive electricity subsidised by Member States.

Finally, this option could distort the flow of electricity in the internal market because of lack of price signal and could lead to security of supply risks.

As with all options that reduce consumer costs, it could increase fossil fuel use, the EU's dependence on imports and increase security of supply concerns.

**Costs**

Funding would be needed to compensate the difference between the market price and the price cap.

Over time, there could be security of supply risks linked to lack of differentiated price signal in the EU market as well as following regulatory uncertainty. Similarly, unsubsidised renewables projects would be discouraged as market revenues would be lower (also because consumers would have reduced incentives to sign long term power purchase contracts with renewables because the price cap reduces their need to hedge high prices).

## D. Regulatory intervention on the electricity market: limiting returns of certain market players

In electricity wholesale markets, the price is set by the last source required to meet all demand. Fossil fuel electricity generators face at present extremely high costs of fossil fuels as well as increased prices to emit CO2. This means marginal electricity prices are high. Baseload generators which do not depend on fossil fuels do not have a similar cost structure in this situation and earn additional returns well beyond their expectations when deciding to invest.

Annex 2 of the REPowerEU Communication sets out that Member States may exceptionally introduce tax measures that capture some of these high returns.

The same objective pursued by such taxation measures can also be achieved via **regulatory interventions.** This can be done by temporarily allowing Member States to set a strike price limiting excessive returns of generators. The relevant strike price may need to vary to reflect the characteristics of different market participants and would have to be set by national regulatory authorities. In effect, this option works as a **one-way contract for difference**, where payments become due only when the reference price (market price) is higher than the strike price. Similarly to the excess profit tax contained in the REPowerEU Communication, a separate mechanism would be needed to redistribute the revenues from such a regulatory intervention to consumers.

Member States could turn their support schemes for new generation into systems **of two-way contracts for difference**. By asking the power generators to repay their investment support when prices are high, this mechanism would prevent a situation where new generation built at the moment will in the future benefit from subsidies also in situations when market prices are very high and volatile.

Where players in the natural gas markets earn excessive returns due to the current crisis situation, e.g. because they are able to sell volumes contracted long term at significantly higher prices on the spot market, the returns could be covered by similar tax interventions.

### Benefits

If well designed, such option does not interfere with price formation in the wholesale electricity markets, preserving signals for intra and extra-EU trade and security of supply. It does not affect EU-wide electricity trading.

Reforming the design of support schemes for new investments could pave the way for possible more long-term market design changes.

### Drawbacks

This option will in itself not reduce prices to consumers but the generated revenues can be used to provide direct relief to energy consumers most suffering from the high prices, for instance, through vouchers to households, and financial support to businesses in line with State aid and competition rules.

In order to determine accurately the existence of excessive infra-marginal profits, national authorities would need to have detailed information about generators' costs, to which they may not have access. A fast implementation may give rise to legal challenges as market participants will be differently affected.

Competition questions would need to be carefully assessed and contained by following the Commission's guidance on regulated retail prices and fiscal measures on infra-marginal rents as well as by complying with state aid rules.

Implementing windfall taxation is likely to impact investor certainty, which may mean support may be needed for all future electricity generation. This regulatory risk will be reflected in higher costs of capital and lower renewables deployment in future.

## III- Interventions in Gas Markets

### E. Price limits for trading gas in the EU

This option relies on defining an EU-wide maximum price at which gas can be traded between operators in all EU Member States or, alternatively, on setting price limits within which the price of gas can evolve. Such a price cap/bands would limit bids on European exchanges. The capped gas price would become the new contractual reference price for long-term and derivative contracts.

**To be effective, this option would need to be implemented across all Member States.**

**Benefits**

A price cap for trading gas across Europe would lead to significantly lower gas prices. This would in turn reduce the costs of electricity generated by gas-fired power plants and consumer prices for both gas and electricity.

**Drawbacks**

The right level of the cap would need to be determined. If the gas price cap is set too low, it would be difficult to attract more gas to Europe. It could even incentivise European companies to export gas to countries where prices are higher. A lower price would promote more gas consumption and therefore increased demand in Europe. In order to mitigate this risk, this option would have to be accompanied by strong demand management. In combination, these factors could lead to additional tightness on the gas market and pose risks to security of gas supply.

If the same cap price applies across the EU, it would become difficult to ensure that gas flows to the destinations where it is needed and to ensure that the grid can operate safely keeping supply and demand in balance.

Consumers that have purchased gas on long term contracts at a price above the cap would not benefit from a price cap until their contracts expire, which could be perceived as unfair.

Depending on the level of the cap and the period during which it is applied, it may attract supplies from our trading partners. However, their reaction to an administratively set price is uncertain and cannot be anticipated. They might challenge this option in the courts and/or restrict or suspend supplies.

**Costs**

Costs are related to possible supply disruption.

## F. Negotiated volume and price with international suppliers

An option would be to establish more specific gas volume and price targets for different supply routes/suppliers and to work these volume and price targets on the basis of a joint negotiating strategy coordinated at EU level vis-à-vis the EU's trading partners. The relevant target prices would concern the supply contracts with third countries but would not affect transactions taking place inside the EU (e.g. for balancing in the internal market).

In order to secure well-priced LNG and gas imports, the EU should take a longer-term perspective on the gas partnerships with its suppliers and extend the scope of the negotiations to securing long-term hydrogen imports.

Such partnerships could consist of:

- Long term contracts for increased **LNG and pipeline supplies;**
- EU investment in additional **LNG import capacity**, hydrogen-compatible;
- **A H2 partnership** with a 5-10 year horizon to establish infrastructure and a sound framework for and a partnership on investment (a common framework that would ensure predictability and stability of investments and demand in the EU as well as stable investment conditions in partner countries).

**The success prospects of such a negotiating strategy would depend on a common approach at European level.**

### Benefits

If successful, a negotiated lower price across Europe would lead to significantly lower gas prices combined with agreed import volumes of gas. This would in turn reduce the costs of electricity generated by gas-fired power plants and consumer prices for both gas and electricity.

As the option would be based on negotiations and would not impose any restrictions on the trading of gas inside the EU (e.g., for balancing), disruptions of intra-EU gas flows would be avoided.

### Drawbacks

The success of this option ultimately depends on the outcome of the relevant negotiations with third country suppliers.

### Costs

If successful, this option would lead to a lasting reduction of sourcing costs for natural gas.