



POLICY GUIDELINES

by the Energy Community Secretariat

**for reforms of electricity market model, regulated electricity prices
and electricity tariff reform in the Contracting Parties of the Energy
Community**

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1. Regulated end-users' electricity prices

Price regulation can take different forms, such as the setting or approval of prices, price caps or combinations of these. Regulating prices has an impact on the introduction of competition in the energy markets. Being prohibited by the *acquis* under certain circumstances, price regulation has distorting effects on the market and contradicts key principles of the Energy Community. If prices are regulated at a level below cost, existing suppliers will not be able to perform their activities and provide services, neither to make profit. There is also no incentive nor economic viability for new entrants to enter the supply market. With the limited number of existing suppliers, there will be no development of wholesale and retail markets, and liquidity will remain at a too low level. As a result, neither the wholesale nor the retail markets will be opened. Artificially low regulated prices also limit the incentives of customers to switch supplier which further limits the prospects for competition in the market.

The Secretariat has been made aware many times, by public utilities, system operators and private investors alike, that tariffs and prices regulated below real costs endanger not only the viability of these companies, but of the energy systems as a whole. They discourage, or even render impossible, investment in generation and thus represent a risk for security of electricity supply. In addition, noting the increase of complaints to the Secretariat related to regulatory decisions in relation to network tariffs there is a clear need for strengthening and improving cost-reflectivity of electricity tariffs in most of the Contracting Parties.

In addition, artificially low energy prices are counterproductive for the efforts to save energy to which the Contracting Parties committed through the incorporation of three directives on energy efficiency.

2. Need for reforms

The two Athens Memoranda already envisage “comprehensive tariff reforms” by the (now) Contracting Parties to the Energy Community. The discussion on the level of price regulation has continued within the institutions of and the events organized by the Energy Community ever since. Low and non-cost-reflective energy prices have been identified by many studies as the key impediment to the establishment of competitive regional energy markets. The ECRB, in its 2009 and 2011 Position Papers,¹ stressed the negative effects of regulation of energy prices at non-cost-reflective level. The need to reform and phase-out the existing system of price regulation was underlined both by the Secretariat in its Implementation Reports and the European Commission in its 2011 Report on the Energy Community Treaty.

¹ ECRB, Vulnerable Household Customers - An ECRB Contribution to a Common Understanding (2009) and ECRB, Treatment of the vulnerable customers in the Energy Community (2011).

At its meeting of 5 October 2011, the Permanent High Level Group “reiterated its concern about persisting barriers to the establishment of open national and regional markets, including excessive price regulation.” The Secretariat was invited to make proposals in that respect for the first meeting in 2012.

The Secretariat developed an analytical report titled “Regulated Energy Prices in the Energy Community – State of Play and Recommendations for Reform” which provides a legislative analysis of the relevant Energy Community law and the state of play in relation to end-users’ price regulation in the Contracting Parties. It presented the report to the Permanent High Level Group on 23 March 2012. The Contracting Parties were invited to submit their comments by end of April. Subsequently, the Secretariat submitted the Report for public consultation² and consulted the ECRB as well as the Electricity Forum held in Athens in June 2012. The legislative analysis provided in the analytical report has shown that the issue of electricity price regulation raises concerns and requires further action.

In addition, the Report identified the need for addressing several other issues closely linked to price regulation namely the eligibility and electricity market models currently in place in many Contracting Parties, the regulation of the generation price for tariff customers, the concepts of public supplier/supplier of last resort as well as the cost-reflectivity of grid tariffs and cross subsidisation.

The Secretariat’s Report and the policy recommendations taken therefrom were presented to the Permanent High Level Group on 21 June 2012. The members of the Permanent High Level Group were invited to submit their comments by mid July 2012. The PHLG members from the former Yugoslav Republic of Macedonia, Serbia and UNMIK/Kosovo³ have submitted comments. The Permanent High Level Group, at its meetings on 21 June 2012 and on 17 October 2012, welcomed the Secretariat’s initiative.

3. The objective of the Secretariat’s Policy Guidelines

When assessing the compliance of the Contracting Parties with their obligations in this area of the electricity *acquis*, the Secretariat will follow the present policy guidelines. Several discussions in the Permanent High Level Group, the ensuing public consultation and its publication on the website ensure transparency and the inclusion of all stakeholders in this sensitive reform process.

In relation to the proposed reforms related to the electricity market models of the Contracting Parties, the Policy Guidelines also take into account the results from the study on Wholesale Market Opening (WMO) Study developed in 2010.⁴ The main proposal by this Study, streamlined with the European market model, is the establishment of Local Day Ahead Markets (DAM) combined with bilateral trading and physical forward markets organized by local Market Operators. Since national markets are too small and incumbents are too dominant for establishing local markets on their own, the WMO Study proposes that regional and local processes must go hand in hand and that establishing a regional DAM together with a parallel implementation of local markets, is the pre-requisite for the wholesale market opening. For this aim to be achieved, according to the WMO Study, the most important decision to secure DAM liquidity is to cancel the commitment of the incumbent generators to serve tariff customers directly or through full supply contracts with Public Suppliers.⁵ The present Policy Guidelines follows this proposal.

Taking into account the social dimension of the problem, the present Policy Guidelines also limits itself to what the Secretariat considers indispensable for the attainment of the Treaty’s objectives, to stimulate further opening of the wholesale and retail electricity markets, and to ensuring long-term supply security

² http://www.energy-community.org/portal/page/portal/ENC_HOME/SECRETARIAT/Consultation/PRICES

³ The designation throughout this document is without prejudice to positions on status, and is in line with UNSCR 1244 and the ICJ Opinion on the Kosovo declaration of independence.

⁴ And updated with information on Moldova and Ukraine in 2011, http://www.energy-community.org/portal/page/portal/ENC_HOME/AREAS_OF_WORK/ELECTRICITY/Regional_Market/Wholesale_Market_Opening

⁵ WMO study (2011), p.134

to all customers in the Energy Community. The discussion on the social dimension of price reform, including on concrete assistance to be provided to certain categories of customers, should be intensified in the future.

Given that all the issues covered by the Secretariat's report and the present draft Recommendation concern more than one Contracting Party, joint action and a common approach seems adequate. At the same time, this Policy Guidelines will be without prejudice to existing legal obligations of the Contracting Parties and their enforcement.

The present Policy Guidelines are without prejudice to the interpretation of Energy Community law in accordance with the case law of the Court of Justice of the European Union or guidance given by the Ministerial Council under Article 94 of the Treaty.

4. The Secretariat's Policy Guidelines in detail

1. Eligibility

Eligibility needs to be defined in line with Article 21 of Directive 2003/54/EC, i.e. as full and unconditional right of all non-household customers to choose a supplier and that is implemented in line with the requirements from Annex I to the Treaty establishing the Energy Community, including also a right for all household customers to choose a supplier from 1 January 2015.

For this purpose, it is required

- (a) that there is a clear and compliant definition in primary law;
- (b) to remove all conditions and requirements other than the status of being a non-household customer, including references to voltage levels or electricity consumption;
- (c) to remove all administrative obstacles to exercising eligibility such as discretionary or conditional approval by regulatory authorities or market operators, registration requirements, etc.;
- (d) that the right to switch supplier can be exercised continuously and swiftly;
- (e) to include resellers in the category of eligible customers, including public suppliers and suppliers of last resort, and to remove all explicit or structural barriers for them to exercise their eligibility.

The deadline for implementing the right to eligibility has already expired. In cases of non-compliance, the Secretariat will initiate enforcement action.

2. Electricity Market Model

The market design in each Contracting Party may not impede the goals of market opening and price reforms.

For this purpose, the possibility for public supply should be limited to small customers and may not affect eligibility. There may be no legal obligation for the public supplier to buy exclusively from one single generation company or wholesale supplier.

To require incumbent generators to sell all the electricity generated to the public supplier amounts to a disproportionate public service obligation. They should instead be entitled to sell certain amount of their portfolio to the domestic and regional market, including on the short-term market. The national regulatory

authority should require incumbent generators to implement electricity release programs for that purpose if necessary.

The legal framework requiring incumbent utilities to sell a certain amount of energy at power exchanges or at platforms developed for Day Ahead Market and publishing the contracts for full transparency and accountability should be developed.

The Secretariat considers that an electricity market model fulfilling these requirements should be created in the Contracting Parties in the course of the upcoming amendments of the legislative for the transposition of the Third Energy Package.

3. Electricity prices for large customers

In line with the principle of proportionality, the Secretariat does not consider it in compliance with Articles 3 of the Electricity and Gas Directives to regulate electricity prices for all large customers. It may initiate enforcement action where the requirements of these Articles are not fulfilled.

The Secretariat is also concerned that even though being formally eligible, large customers may switch back to the regulated tariff system, thus thwarting market opening in practice.

The Secretariat invites Contracting Parties to send to the Secretariat a list of large customers in the Contracting Party by 31 July 2013, and to update the list annually.

4. Electricity prices for households and small enterprises

The Secretariat considers it indispensable that regulated electricity prices for all customers falling within the category defined for the purposes of universal service provision in the first sentence of Article 3(3) of the Electricity Directives (“households and small enterprises”) are ensuring coverage of the actual costs. It will continue with enforcement action where there is evidence that prices are not covering the actual costs.

Covering the actual costs in this sense must extend to the real costs of electricity supply, including the costs of generation, reflecting the cost for procuring electricity for households and tariff customers from domestic generation and from import, necessary investments/an appropriate profit rate, the costs of supply services and bad debts. This should not exclude adequate regulatory measures incentivizing suppliers to reduce level of bad debts.

There is no need to regulate the price of domestic generation separately, as is still the case in some Contracting Parties.

Any remaining price regulation in the Contracting Parties must be limited in duration to what is strictly necessary to achieve the public service objectives pursued kept within the limits of Article 3(2) of the Electricity Directive (clearly defined, transparent, non-discriminatory, verifiable and guaranteeing equality of access for Energy Community electricity companies to national consumers).

In the course of the upcoming amendments of the legislative for the transposition of the Third Energy Package, the Secretariat will insist on provisions making the necessity for and proportionality of remaining price regulation for all customer categories subject to regular review in the light of the defined public service objective pursued. The national regulatory authority (in collaboration with the competition authority) should be charged with carrying out annual reviews of the methodologies and the end-user price level adopted.

Any price regulation of household customers beyond 2015 should be subject to regular review by the competent national authorities.

The Secretariat invites Contracting Parties to notify it of any public service obligations imposed by 31 July 2013, and to submit the annual reviews referred to in the preceding paragraphs to the Secretariat.

5. Cost-reflectivity of network tariffs

Further to cost-reflectivity of regulated prices for energy, cost-reflectivity of network tariffs is to be ensured. System operators need to be allowed to recoup the costs of operation, maintenance and investments of the network (including the procurement of energy for network losses), and an appropriate rate of return. This should not exclude adequate regulatory measures incentivizing operators to reduce their costs and increase the efficiency of operation. The Secretariat will continue with enforcement action where there is evidence that tariffs are not cost-reflective.

6. Vulnerable customers' definition and protection

The Secretariat will assist the Contracting Parties in fulfilling their obligation to define clearly and through legislation the notions of vulnerable customers subject to special protection or support. Such definition of vulnerable energy customers should address the real needs for economic support.

The Secretariat invites Contracting Parties to notify the Secretariat of their categories of vulnerable customers and on the protection/support measures in place for the defined categories of customers immediately after taking those steps.

7. Supplier of Last Resort

The Secretariat will develop a document analysing the concept of supplier of last resort under the applicable energy *acquis* and reviewing the Contracting Parties' state of compliance with that concept. It will invite Contracting Parties to (re-)design the function of supplier of last resort if needed.

Where the function of a Supplier of Last Resort leads to non-compliance, the Secretariat will initiate enforcement action.

Done in Vienna on 1 June 2013

For the Secretariat:

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(Director)