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EU actions to mitigate high energy prices

December 2022

Beginning in the second half of 2021, Europe has been exposed to increasing natural gas prices which have in turn driven up electricity prices across the European Union. Between November 2021 and the peak of the price surge at the end of August 2022, prices of natural gas futures of the reference LNG benchmark in the EU – the Title Transfer Facility (TTF) –increased eightfold from €44 per MW to a level of around €350 per MW.

Since March 2022, the EU has taken an increasing number of regulatory measures to address the unprecedented increase in gas prices but also to mitigate the impact that high gas prices have on the setting of electricity prices in the EU, and consequently the impact of these high energy costs on consumers and businesses.

Which measures has the EU already taken?

Mandatory EU gas storage targets

On 8 March 2022, the European Commission proposed new rules to stipulate mandatory EU targets for the filling of underground gas storages. This Gas Storage Regulation was adopted on 27 June 2022.

It sets out a binding target for EU Member States to fill underground gas storage capacities located in their territory and directly interconnected to their market area to 80% by 1 November 2022 and to 90% by 1 November 2023. For 2022, the EU had already met the mandatory target by September and at the end of November, EU storages were filled at around 95%, exceeding by far the agreed mandatory target.

To coordinate and spread out the filling of gas storages in 2023, on 23 November 2022, the Commission adopted filling trajectories with intermediate targets for each Member State. This is primarily intended to ensure security of supply and to try to minimise the impact of Member States purchasing gas in large volumes at the same time on the price of gas, as well as to limit any undue distortion of competition.

While this measure seems to have had a positive impact on ensuring record filling levels for EU gas storage, policy makers and industry experts are already focusing on the winter of 2023/24, anticipating further decreases in the supply of Russian gas and continued elevated prices, which will impact the ability of the EU to reach similarly high levels of gas storage by November 2023. The success of these efforts will also depend on the severity of the 2022/23 winter and on the extent to which Member States will deplete existing storages. Should storage levels fall significantly below 50% by the beginning of the next filling season in March 2023, expert predictions are negative as regards the ability of many Member States to reach the mandatory 90% target for next year.

Coordinated gas demand reduction

As part of the EU's efforts to reduce reliance on Russian natural gas imports and to ensure sufficient gas supplies for the upcoming winter, the Commission made a new proposal for coordinated measures to reduce gas demand in the EU on 20 July 2022. The Council adopted the Regulation on coordinated demand reduction measures for gas under the emergency procedure set out in Article 122(1) of the Treaty on the Functioning of the European Union (TFEU) on 5 August 2022.

This Regulation sets out a voluntary demand reduction target for Member States that should undertake efforts to reduce their gas consumption by 15% during the period from 1 August 2022 to 31 March 2023 compared to their average consumption over the same period in the preceding five years.

The new rules also provide a mechanism for the Council to declare a Union alert if the Commission determines that there are substantial risks of severe gas supply shortages after national warnings have been issued in at least five Member States. Once the Union alert is declared, the voluntary demand reduction of 15% becomes mandatory.

The Regulation leaves it up to each Member State to choose which measures it applies to reduce demand, as long as the measures do not unduly distort competition or the functioning of the internal gas market, endanger security of gas supply or are not in line with existing rules for protected consumers.

The new rules are supposed to apply for one year. However, the Commission will review them by 1 May 2023 and propose an extension if justified.

Emergency Regulation to address high energy prices

The latest measure adopted by the Council on 6 October 2022 is a Regulation on an emergency intervention to address high energy prices, which was proposed by the Commission on 14 September 2022. This legislation was also put in place under the Article 122(1) TFEU emergency procedure that does not involve the European Parliament.

The Regulation contains a number of comprehensive measures, including a voluntary target for Member States to reduce their monthly gross electricity consumption by 10% in the period from 1 December 2022 to 31 March 2023 and a mandatory 5% reduction in gross electricity consumption during pre-identified peak periods.

Member States are given the option to apply public interventions in electricity price setting for SMEs, taking into account their annual consumption in the previous five years. Under certain conditions, Member States can also set a price for the supply of electricity below cost on a temporary basis.

Most importantly, the new Regulation introduces two measures which represent *de facto* levies on windfall profits of electricity producers using sources other than gas and on fossil fuel companies.

A **cap on market revenues** is set at €180/MWh for electricity producers using the following inframarginal energy sources: wind, solar (thermal and photovoltaic), geothermal energy, hydropower without reservoir, biomass fuel (solid or gaseous, excluding bio-methane), waste, nuclear energy, lignite, crude petroleum products, and peat.

Member States can decide whether to apply the cap on revenues from the sale of electricity at the settlement of the exchange of energy or thereafter. They can also choose to limit the revenue cap to only 90 per cent of the revenues exceeding the cap of €180/MWh.

Member States can, under certain conditions, choose to (i) maintain or introduce national measures that further limit (e.g. lower) market revenues of covered producers, including for specific technologies, and other market participants (e.g. electricity traders), (ii) increase the revenue cap for covered producers if their investments and operating costs exceed the 180 EUR/MWh cap, (iii) maintain or introduce national measures to limit market revenues of producers generating electricity from sources not covered by the cap, (iv) set a specific cap for market revenues from the sale of electricity produced from hard coal, and/or to (v) apply a revenue cap (i.e. not necessarily the cap of €180/MWh) to hydropower technologies not covered by the Regulation.

The surplus revenues must be used to support final electricity customers. However, the mechanism for doing so is left to Member States, albeit subject to certain criteria. The market revenue cap will apply from 1 December 2022 until 30 June 2023. The Commission will review it by 30 April 2023 and propose an extension if needed.

The other tax measure, which applies unless an equivalent national measure generating comparable or higher proceeds is enacted by a Member State (in terms of objective, covered activities, taxable base, rate, etc.), is a **temporary solidarity contribution** on surplus profits generated from activities in the crude petroleum, natural gas, coal, and refinery sector. According to the Regulation's preamble, companies fall within the scope of this tax measure if they achieve at least 75% of their turnover in these business sectors.

The rate of the levy will be “at least” 33 per cent of taxable profits in the fiscal year(s) 2022 and/or 2023 (to be decided by Member States) which are above a 20 per cent increase of the average taxable profits in the four fiscal years starting on or after 1 January 2018.

The proceeds from the solidarity contribution are to be used for financial support measures, including to support vulnerable households and energy intensive industries, to help reduce energy consumption, to develop energy autonomy in the EU and promote investments in renewables. Member States are also allowed to assign a share of the proceeds to common financial measures to reduce the harmful effects of the energy crisis.

You can read more about the two windfall tax measures in our dedicated article.

Which measures is the EU currently preparing?

Solidarity Regulation

On 18 October 2022, the Commission proposed a Regulation to enhance solidarity which includes a package of additional measures to fight high energy prices and ensure supply security.

One of the proposed measures is a temporary joint purchasing tool that should be ready by spring 2023 to support the filling of gas storages for the next season. The tool would be used to aggregate gas demand across the EU through a service provider, and in a second step to coordinate gas purchasing through the establishment of gas purchasing consortia among interested companies. This should allow participants to negotiate better gas prices and reduce the risk of Member States outbidding each other.

The Solidarity Regulation also includes several measures to facilitate better use of existing gas infrastructure, including more effective use of transmission capacity. Furthermore, it sets out basic rules for bilateral gas solidarity arrangements between Member States, including deadlines to respond to solidarity requests, procedural aspects for requesting and providing solidarity, and rules on the coverage of costs.

Regarding gas prices, the Commission put forward three specific measures: an intra-day volatility mechanism, a new LNG benchmark, and a 'gas market correction mechanism'.

Under the Solidarity Regulation, trading venues in the EU would be obliged to introduce a new temporary **intra-day volatility management mechanism** based on an upper and lower price boundary by 31 January 2023 that is aimed at limiting large price movements in electricity and gas derivatives contracts within the same trading day. The volatility mechanism should not prevent the formation of reliable end-of-day closing prices, and it would be additional to any static or dynamic circuit breakers that trading venues have already put in place.

The proposal tasks the European Agency for the Cooperation of Energy Regulators (ACER) to create an **objective price assessment tool** and a **new reference EU LNG benchmark**, representing the spread between the new daily LNG price assessment and the settlement price for the TTF Gas Futures front-month contract. ACER will publish this benchmark from March 2023.

Lastly, this Regulation includes a proposal for a so-called '**Gas Market Correction Mechanism**', empowering the Commission to propose, as a last resort measure, a Council Decision to establish a maximum dynamic price at which natural gas transactions can take place in the TTF spot markets under specific conditions. Other EU gas trading hubs would be linked to the corrected TTF spot price via a dynamic price corridor. The measure is meant to allow for over-the-counter gas trades, not affect the EU's security of gas supply and intra-EU flows, not lead to an increase in gas consumption and not affect the stability and orderly functioning of energy derivative markets.

A gas price cap mechanism was requested by several Member States, who were largely dissatisfied with the proposal made by the Commission as it merely provided a legal basis for future legislation without providing any specific details on the functioning or setup of the mechanism. After the proposal of the Solidarity Regulation, around two thirds of Member States strongly and repeatedly urged the Commission to quickly come forward with a dedicated proposal on a market correction mechanism.

Market correction mechanism

On 22 November 2022, following strong pressure from Member States, the Commission presented a Regulation establishing a market correction mechanism for front-month TTF gas derivatives. According to the proposal, the mechanism is activated automatically by ACER if the front-month TTF derivative settlement price exceeds €275 for two weeks and the TTF European Gas Spot Index exceeds the reference global prices during the previous ten trading days by €58. For as long as the mechanism is triggered, orders for front-month TTF derivatives exceeding €275 are not accepted. If the triggering conditions are no longer met for ten consecutive trading days, ACER would immediately publish a deactivation notice. The Commission could also suspend the mechanism at any time if it leads to unintended market disturbances, especially negative effects on supply security, intra-EU gas flows, or financial stability.

The reaction to the proposed mechanism among Member States was largely negative, with most countries criticising the high triggering threshold which would have not been met even during the period of the highest price spikes experienced in August 2022. Countries that opposed the adoption of such a mechanism were highlighting that it could disrupt the security of gas supply and lead to financial instability. The strong opposition became especially clear during the meeting of EU energy ministers on 24 November, where, while an agreement was reached on the substance of the proposal for the Solidarity Regulation and another emergency proposal to temporarily speed up permit-granting procedures for renewable energy projects, due to the strong disagreements regarding the market correction mechanism the ministers concluded to decide on all three proposals at the same time in a future meeting.

Looking ahead

The next extraordinary Energy Council meeting is scheduled for 13 December 2022, and energy ministers will then attempt to reach an agreement on the design of the market correction mechanism. Currently, Member States are discussing lowering the price thresholds (at the time of writing, a price of €264/MW is being discussed) and halving the timespans needed for elevated prices to trigger the mechanism. However, positions among Member States and between Member States and the Commission still remain starkly different.

In case the ministers cannot agree on the current package of measures, it will have to be taken up by EU leaders at their next summit on 15 December. This could raise doubts regarding progress on the planned measures and their adoption before the end of 2022.

Looking beyond the immediate crisis measures, the Commission has announced a targeted redesign of the EU electricity market, with the main aim being to limit the impact of gas prices on the formation of electricity prices in the EU and thereby their impact on electricity consumers' bills. No specific details are known at present. The Commission has floated the idea of using so-called contracts for difference (CFDs) to ensure long-term supply of electricity at lower prices (up to 15 years). This is seen as a potential solution for new capacity. However, it remains unclear how CFDs could help alleviate the current high prices. They would also not address issues related to existing electricity production capacity.

The Commission has announced that it will present more specific details in time for the Energy Council meeting on 13 December. It will also launch focused stakeholder consultations from mid-December onwards. A legislative proposal is expected before the end of March 2023.

The specific measures taken by the Commission will largely depend on how the current crisis develops over the next few months, potentially increasing pressure on the Commission for a more significant intervention in the electricity market. Amid significant short- and medium-term uncertainty, the outlook of all stakeholders, at national and EU level, seems to be that this crisis is far from over and that high energy prices will remain persistent for the next few years. Therefore, it can be expected that EU policymakers will continue to be actively engaged with these issues until the end of the current legislative mandate in 2024 and beyond.

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