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COMMISSION STAFF WORKING DOCUMENT
EXECUTIVE SUMMARY OF THE EVALUATION

Accompanying the document

Proposal for a Directive of the European Parliament and of the Council on common rules for the internal market in electricity (recast)

Proposal for a Regulation of the European Parliament and of the Council on the electricity market (recast)

Proposal for a Regulation of the European Parliament and of the Council establishing a European Union Agency for the Cooperation of Energy Regulators (recast)

Proposal for a Regulation of the European Parliament and of the Council on risk preparedness in the electricity sector

{ COM(2016) 861 final }

{ SWD(2016) 410 final }

{ SWD(2016) 411 final }

{ SWD(2016) 412 final }

1. EXECUTIVE SUMMARY

1.1. Background and purpose of the evaluation

This Evaluation supports the concomitant Impact Assessment aimed at improving the EU regulatory framework governing the internal electricity market ("Market Design Initiative"). The Evaluation analyses to what extent the existing legislation was successful in achieving its goals¹. In contrast, the purpose of the Impact Assessment is to identify and weigh options for a future reform of the regulatory framework.

As set out in the Evaluation Roadmap², this Evaluation will focus on developments in electricity markets which have been subject to a several legislative reforms in the past 20 years. The latest reform of the regulatory framework – which is the object of this evaluation - dates back to 2009 and is commonly referred to as the 'Third Energy Package'. The package followed on a first and second set of landmark energy legislation adopted in 1996 ('First Energy Package') and 2003 ('Second Energy Package') respectively.

The Third Energy Package pursued the general objective of completing the internal energy market and moving towards a competitive, secure and sustainable Energy Union. It covers in particular five main areas:

- unbundling energy suppliers from network operators;
- strengthening the independence of regulators;
- establishing the Agency for the Cooperation of Energy Regulators (ACER);
- enhancing cross-border cooperation between transmission system operators and the creation of European Networks for Transmission System Operators;
- open, fair retail markets and consumer protection.

This Evaluation also analyses the effects of the Security of Electricity Supply Directive (SoS Directive)³ as adopted in 2005 to establish some first rules on security of supply in electricity, and which has in the meantime been complemented and partly superseded by the Third Energy Package of 2009 and by other legislation⁴.

¹ See in detail the Commission's "Better Regulation Guidelines", SWD(2015)111 of 19.5.2015.

² Evaluation Roadmap " Evaluation of aspects of the regulatory framework of the EU electricity markets – AP 2015/ENER/061"; http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_ener_061_evaluation_eu_electricity_market_en.pdf

³ Directive 2005/89/EC of the European Parliament and of the Council of 18 January 2006 concerning measures to safeguard security of electricity supply and infrastructure investment, OJ L 33, 4.2.2006, p. 22–27.

⁴ Evaluation Roadmap " Evaluation of the Directive 2005/89/EC on security of electricity supply – AP 2016/ENER/032"; http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_ener_032_evaluation_elec_supply_investment_en.pdf

1.2. Key findings

Tangible progress

Overall and within the scope of the two evaluations carried out, the evaluation's findings support the view that the Third Package has positively contributed to competition and performance of the internal electricity market, delivering tangible market benefits that have translated into added net social welfare.

Although only a handful of years have passed since the entry into force of the Third Energy Package in 2011, the evaluation showed that the initiative to further increase competition and to remove obstacles to cross-border competition in electricity markets has **generally been effective**, and that active enforcement of the legislation has led to **positive results for electricity markets and consumers**.

The reinforced unbundling rules had a positive effect on competition and helped to limit problems of market foreclosure. Markets are in general less concentrated and more integrated than in 2009. The new rules aiming at removing barriers to cross-border trade and to enhance cooperation between transmission system operators and regulators contributed to **increased liquidity** of electricity markets and a **significant increase in cross-border trade**, resulting in more competitive wholesale markets and contributing to lower wholesale prices.

As regards retail markets, the set of new consumer rights introduced by the Third Energy Package have clearly **improved the position of consumer in energy markets**. The new rules enabled consumers to make better use of emerging competition between different suppliers in many countries, and switching between different suppliers increased. Also, consumers have access to a single point of contact for queries and to alternative (supplier-consumer) dispute settlement services while self-generation and smart technologies started to spread in several markets.

Remaining obstacles

However, in other fields the success of the rules of the Third Package in developing the internal electricity market further to the benefit of customers **remains limited**.

On *wholesale markets*, **persisting barriers to cross-border trade** and unused interconnector capacities resulting notably from insufficient cooperation between national grid operators and regulators on the shared use of interconnectors. The national perspective of the involved parties still prevents effective cross-border solutions in many cases and limits possible cross-border flows.

With regards to *retail markets*, competition performance could be significantly improved. Electricity and gas prices still vary significantly from Member State to Member State for non-market reasons, and **prices have risen steadily** for households as a result of significant increases in non-contestable charges in recent years (network charges, taxes and levies). Poor competition, as evidence through a range of market structure and conduct indicators, may help to explain lacklustre consumer satisfaction and engagement in the energy markets, as well as the slow deployment of innovative retail products such as dynamic price supply contracts. A

number of Member States still practice some form of blanket price regulation for electricity and/or gas – a practice that may cause gross market distortions.

With regard to **consumer protection**, rising energy poverty, as well as lack of clarity on the most appropriate means of tackling consumer vulnerability and energy poverty, hamper the further deepening of the internal energy market. Switching related fees such as contract termination charges continue to constitute a significant financial barrier to consumer engagement. In addition, poor consumer satisfaction with energy bills, and poor awareness of information conveyed in bills⁵ suggests that there may still be scope to improve the comparability and clarity of billing information.

New developments were not addressed by the existing rules

While the principles of the Third Energy Package achieved its main purposes (e.g. more supplier competition), new developments in electricity markets led to significant changes in the market functioning in the last five years and dampened the positive effect of the reforms for customers.

The commitment to **decarbonize** the economy led to a steep increase of energy generated from renewable energy sources (RES). The physical nature of renewable electricity generation – more variable, unpredictable and decentralized than traditional generation – had important practical consequences on electricity markets and grid operation. As most RES generation can only be predicted shortly before the actual production (due to weather uncertainties), effective **short-term markets** play a key role today. Most electricity from RES is produced decentrally and fed into the local distributions grid. The market design rules of the Third Package, however, are based on the predominant generation form of the last decade, i.e. central, large-scale fossil fuel-based power plants.

In parallel, we have seen a dramatic increase of **state interventions** into the electricity market. Sub-optimal rules for the support of RES generation had the unintended effect to distort the wholesale market price signal. Uncertainty about the ability of the new market to incentivise sufficient investments led many Member States to introduce national subsidies aiming at protecting existing generation or triggering new (so-called Capacity Mechanisms). These state interventions had a significant impact on the market price signals of the market to guarantee lower consumer prices investment signals and to limit cross-border trade. State interventions also translated into higher transmission tariffs, ultimately neutralising the positive developments on wholesale electricity markets and driving up prices for end customers at the retail level. The volumes of electricity trade affected by such state interventions contracted under such mechanisms have increase significantly in the last years, with increasing impacts on functioning of the internal electricity market.

Equally dramatic changes have taken place on the **technological** side. Power exchanges (PX) and market coupling are facilitating wholesale trading while digitalisation of energy markets and metering increasingly allows to use so-called '**demand response**' solutions, enabling the

⁵ European Commission (2016), ' Second Consumer Market Study on the functioning of retail electricity markets for consumers in the EU ',

demand of industry, businesses and households to participate in electricity markets. However, the current legislation has not been effective in removing the primary market barriers especially for independent demand response service-providers and creating a level playing field for them. Nor was it designed to address currently known challenges in managing large, commercially valuable consumption **data** flows. In addition, technological progress allows **distribution system operators** to reduce network investments by locally managing the challenges posed by increasing amounts of distributed RES E directly connected to distribution systems. However, outdated regulatory frameworks prevent them from operating more innovatively and efficiently. And the increased use of online comparison tools is changing the way consumers interact with the retail market. The nature of the transformation of Europe's energy system and the gap in the existing legislation to deal with these changes has been clearly confirmed by stakeholders.

Overall, the Third Package partially fulfilled its original mission and created a stable market-based approach on which however further legislation should be built on. However, retail level competition could be significantly improved, and consumer protection strengthened further in order to ensure that the full benefits of the internal market can be passed through to all EU consumers. Moreover, the existing rules are not fully adapted to deal with the recent changes in electricity markets effectively. The direction and speed of such changes had not been fully foreseen by the Third Package, creating a clear rationale to update market rules so that they may be able to cope with the reality of today's energy system.

In the area of **security of electricity supply**, the evaluation finds that the objectives that inspired SoS Directive are still relevant. But the Directive itself was quickly overruled by newest EU rules and had a limited impact on the security of electricity supply in Europe. Moreover, its objectives match only partially the current needs on security of supply in Europe, in particular concerning risk preparedness. Indeed, the Directive failed to address emergency related aspects, i.e. how to make sure that Member States are aware and duly prepared to all kind of security of supply risks, that they clarify roles and responsibilities in case of emergency and that they take into consideration the potential cross border impact when adopting safeguard measures.