Urgent measures to mitigate the impact of rising natural gas prices in gas and electricity retail markets

Legal flash – Energy

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The Official Gazette of the Spanish State has published Royal Decree-Law 17/2021, of September 14, on urgent measures to mitigate the impact of rising natural gas prices in gas and electricity retail markets ("*RDL 17/2021*").

RDL 17/2021, which entered into force on September 16, 2021, adopts a set of regulatory and tax measures, to be implemented in the short and long term, that will affect companies in the sector.

Highlights

- Mechanism to reduce the over-remuneration of certain facilities
- Long-term power purchase agreements (PPAs) fostered through auctions
- Extension of the temporary suspension of tax on the production value of electricity
- Approval of the temporary exceptional reduction of special electricity tax
- Criteria for the rational use of water resources
- Measures to protect vulnerable consumers

Mechanism to reduce over-remuneration in the electricity market

- RDL 17/2021 establishes a mechanism serving to "**reduce the profits made by power plants that produce electricity from technologies that do not emit greenhouse gases**," the reason being attributed to the marginalist operation of the electricity market.

- This temporary mechanism will apply until **March 31, 2022**, to the owners of each of the power plants that produce electricity from technologies that do not emit greenhouse gases **located in mainland Spain, regardless of the technologies they use, with the following exceptions**:

  - Power plants subject to a specific remuneration system (renewable energy, cogeneration and waste).

  - Small scale plants (with a net power of up to 10 MW), regardless of the date on which they first started operating.

- The reduction mechanism is established based on an amount in proportion to the highest profit attributed to the affected plants, as a result of the highest electricity prices ever reached in the organized energy market owing to the increase in natural gas prices, a fuel used by combined-cycle power plants, which usually set the marginalist price within that market. Depending on how these specific plants could affect price developments in the organized market, this reduction mechanism will apply to the profits each of the affected plants have made in the corresponding settlement period, **regardless of the type of agreement under which they sell the electricity they produce (thus including PPAs).**

- The reduction applied to each plant will be calculated according to its monthly production measured at busbar, using the formula specified in article 7 of RDL 17/2021. Once the reduction has been quantified, the resulting amounts will be notified (before the 15th day of the following month) to the owners of the affected power plants, who must transfer (within one month from the notification date) the amounts corresponding to the system operator (payments on account of the final settlement).

- RDL 17/2021 also establishes **a rule on dividing the reduction in cases involving a change of ownership of the affected plant**, so that the amounts accrued by that plant will be calculated for each owner taking into account the number of days they held that ownership.

- The amounts resulting from applying this measure aim to reduce the charges of the electricity system paid by end consumers. Therefore, these charges have been updated and will be applicable **from the date the regulation entered into force (September 16, 2021) until December 31, 2021.**

Auctions of long-term power purchase agreements

- To foster forward energy contracts, RDL 17/2021 provides for auctions of long-term PPAs, the terms and conditions of which will be defined by resolution of the Secretariat of State for Energy (specifying, among others, the sellers that are obliged to participate, the schedule, the energy to be auctioned and the framework agreement).

- The energy at auction will be equivalent to at least 25% of the energy generated by certain plants (manageable inframarginal plants that do not emit greenhouse gases, such as those relying on nuclear technology and pumped-storage hydroelectricity, which do not receive a set remuneration and have not been successful bidders in auctions for the development of renewable energies) during the year in which their volume was lowest over the previous 10 years.

- The auctions will be held using forward contracts, with a settlement period of at least one year. The product to be auctioned will be baseload energy and the bidding variable will be the price per unit of electricity, expressed in euros/MWh. A confidential reserve price will be set, and any offers below that amount will be rejected.

- The sellers at these auctions will be electricity producers qualifying as dominant operators in the electricity industry (article 7 of Act 3/2013, of June 4). According to the most recent list approved by the Spanish Markets and Competition Commission (the "CNMC"), the dominant operators are (i) Endesa Group, (ii) Iberdrola Group, (iii) Naturgy Group and (iv) EDP Group.

- Purchasers include (i) production market agents that participate in the market (marketing companies that have a client portfolio and direct consumers in the electricity market), or their representatives; and (ii) suppliers for the regulated rate market, for the supply at the voluntary price for small consumers. Purchasers cannot belong to business groups the parent company of which has been considered at any time by resolution of the CNMC to be a main operator in the electricity industry (article 7 of Act 3/2013, of June 4).

- The first auction of long-term power purchase agreements will be held before December 31, 2021, for a total annual energy amount of 15,830.08 GWh with the following sellers:

(i) Endesa Group: 6,737.26 GWh; (ii) Iberdrola Group: 7,323.63 GWh; (iii) Naturgy Group: 1,405.48 GWh; y (iv) EDP Group: 363.72 GWh.

Measures on energy taxation

RDL 17/2021 approves two tax measures with the aim of reducing the cost of final electricity bills.

- First, **the temporary suspension of the tax on the production value of electricity has been extended for further three months, i.e., until the fourth quarter of 2021**, which was approved for the third quarter under *Royal Decree-Law 12/2021, of June 24, adopting urgent measures in the field of energy taxation and energy generation, and on the management of the regulation charge and the water use rate*. The suspension has been implemented by reducing the taxable base for the tax corresponding to the 2021 tax year on remuneration for the electricity stored in the system during the third and fourth quarters of 2021. This affects the definitive tax and payments on account of the tax corresponding to the third and fourth quarters of 2021.

- Second, RDL 17/2021 applies **a temporary exceptional reduction of special electricity tax rate**, which will drop from 5.11269632% to 0.5%, as long as the resulting amount is not lower than the minimum taxation levels set out in Directive 2003/96/EC:
  - €0.5 per megawatt-hours if supplied (i) for industrial purposes (those carried out using high voltage or in plants or facilities, as well as those carried out using low voltage for agricultural irrigation purposes), (ii) to vessels berthed in ports, other than private pleasure craft; and (iii) for railway transport.
  - €1 per megawatt-hours in all other cases.

  This new reduced 0.5% rate enacted under RDL 17/2021 is applicable to the supply of electricity the price of which is payable from September 16 to December 31, 2021.

  Bear in mind that the minimum rate of €0.5 to €1 per megawatt is not applicable to energy supplied or consumed in chemical reduction, electrolyte, metal or mineral processes, or industrial activities where the value of the electricity supplied or consumed accounts for more than 50% of the manufactured product. In these cases, an application can be filed for an 85% reduction of the taxable base, as provided under article 98 of Act 38/1992, on Special Taxes.

  As the collection of this tax is divided among the autonomous regions, these amendments will likely be reviewed to adopt any compensation measures that may be appropriate.

Criteria for the rational use of water resources

- As a measure to guarantee the rational use of the hydraulic public domain, RDL 17/2021 imposes the obligation to establish **a stocks and flows system** applicable to reservoirs exceeding a total storage capacity of 50 hm3, the main uses of which do not include supply, irrigation and other agricultural purposes.

  Specifically, in cases where it is used for those purposes owing to the water reserve in the reservoir and the seasonal forecast, the basin organization, at the beginning of each hydrological year, must establish:

  a) a **minimum and maximum system of average monthly flows to be a released** in normal hydrological situations and periods of prolonged drought;
  b) a **minimum volume system for water reserves in reservoirs** for each month; and
  c) the **minimum monthly reserve that must be stored** in the reservoir to prevent damaging environmental effects on the flora and wildlife species of the reservoir and the water bodies associated with it.

  This measure will apply from the 2021-2022 hydrological year, so by December 31, all basin organizations, at the proposal of the Water Distribution Management Council, must have approved the corresponding resolutions.

Measures to protect vulnerable consumers

- **Vital minimum supply**: RDL 17/2021 adopts a measure to protect a vital minimum supply of energy, forbidding the supply to be cut off as a result of non-payment in the case of beneficiaries of the social discount rates. The measure will apply for an additional six months on top of the initial four-month term. During that period, a minimum associated power of 3.5 kW has been set to ensure basic levels of comfort.

- **Cap on gas prices:** An exceptional restriction has been imposed during two quarters on the increase in the price of raw materials included in the last resort rate for natural gas, with the aim of preventing the inclusion in that rate of increases in international natural gas prices.

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