

## Government approves urgent measures to reduce impact of steep rise in natural gas prices on gas and electricity retail markets

September, 2021

Royal Decree-Law 17/2021, of September 14, 2021, on urgent measures to reduce the impact of the steep rise in natural gas prices on the gas and electricity retail markets (**RDL 17/2021**) came into force on September 16, 2021. It contains a raft of measures in various areas aimed at containing the steep rise in the price of electricity on the Iberian wholesale market and mitigating its effects on the most vulnerable.

The Preamble to RDL 17/2021 identifies the rise in natural gas prices on international markets and the lack of liquidity on the electricity forward market as factors influencing the rise in price of electricity on the wholesale market in 2021 and provides this as the reason behind the main measures described below.

### 1. Reduction mechanism for excess remuneration on the electricity market caused by the high price of natural gas on international markets

RDL 17/2021 sets out a temporary adjustment to the remuneration for certain types of generation plants, in proportion to the greater revenue obtained by those plants by internalizing in the price of electricity on the wholesale market the increase in price of natural gas on international markets by marginal emissions technologies (such as combined cycle technology).

#### Scope

- **Term:** between September 16, 2021 and March 31, 2022.
- **Subject parties:** it applies to all generation plants using greenhouse gas emission-free technology, except for (i) any in areas outside the peninsula, (ii) any that have one of the remuneration systems defined in article 14 of the Electricity Industry Law or (iii) any that have net capacities equal to or below 10 mega watts (MW).

In short, the measure will apply to the following types of plants on the mainland:

- (a) nuclear power plants;
- (b) hydroelectric plants, wind power plants, photovoltaic power plants, CSP plants, biomass, bioliquid or biogas power plants and plants in group b.3 (geothermal, tidal, wave power plants, etc.) with capacities higher than 10 MW and which do not have a regulated remuneration system and have not been awarded in any of the renewable energy auctions, either because they have reached the end of their regulatory useful lives or because they are new plants that are going “to market” (merchant projects).

- **Subject matter:** the measure affects the output of those plants regardless of the purchasing method used.

The publication of RDL 17/2021 has sparked an intense debate on the implications arising from using the reduction mechanism for excess remuneration on the electricity market for plants whose electric power is hedged, in full or in part, by any forward purchasing instrument. To clarify the scope of this reduction

mechanism, the system operator has filed with the Ministry for the Ecological Transition and the Demographic Challenge a request on the criteria for the power to be taken into account to calculate the reduction. In reply to this request on September 20, 2021 the ministry clarified that the reduction mechanism does not apply to the electric power produced by plants for which their owners substantiate that:

- (a) the electric power affected by the reduction mechanism is hedged by a forward purchasing instrument signed before September 16, 2021;
- (b) those forward purchasing instruments determine a fixed price, in other words they cannot state a delivery price indexed to the spot market price for the production of electric power; and
- (c) those forward purchasing instruments do not relate to agreements signed between the producer and any company in the same group for the sale of generated electric power, ultimately, to a retailer in the same group.

This exclusion will only affect therefore the portion of generated electric power subject to bilateral forward purchasing instruments with physical delivery and the power actually hedged by instruments with settlement in the valid term of the mechanism, at the plant owner's net selling position. Moreover, if the hedging provided by the financial instrument is not associated with a specific plant, the figure for a plant's power actually hedged by financial instruments will be determined by distributing the company's net selling position among the installed capacities of the plants owned by it adjusted to account for the availability factor (expressed as a percentage) of the technology of each of them, unless the company provides documents proving that a different type of allocation method was used.

### Calculation and payment of the reduction

RDL 17/2021 sets out a calculation method for the reduction in euros relating to each plant by reference to:

- (i) the power produced by each plant, measured in power plant bars (less any excluded as described above), multiplied by
- (ii) the average natural gas price, calculated by taking the average natural gas spot price at the virtual balancing point (PVB) on the Iberian gas market (MIBGAS) for each day in the period (the closing value on the previous day and for non-trading days the closing price for the latest trading day will be taken), provided it is over 20 €/MW, and multiplying it by
- (iii) a modulation factor, originally set at 90%, and all of the above, divided by
- (iv) an average monthly internalization factor for the natural gas price in the price on the daily market in the Iberian electricity market. This factor consists of the average performance of a combined cycle (with a value of 0.55) divided by the percentage of hours in a month in which the combined cycle technology (a) either marked the marginal price (b) or presented bids in the region ( $\pm 10\%$ ) of that marginal price.

Red Eléctrica de España, S.A., as system operator, is responsible for calculating the reduction for each plant on a monthly basis and for issuing a monthly invoice to the companies concerned before the 15th day of the month following the month to which the reduction relates and a correction invoice for differences in respect of the original invoice before the 15th day of the month following the final determination of measures for the month to which the reduction relates. The owner of each plant will have to pay that amount in the month following receipt of the correction invoice by the system operator.

The paid amount will be used to fund the costs financed out of the amounts charged by the electricity system and to cover any temporary gaps between the costs and revenues of the system.

## 2. Encouraging forward purchasing using market mechanisms for the allocation of emission-free manageable inframarginal power

To encourage forward power purchasing, RDL 17/2021 sets out an auctions system for forward power purchase agreements with settlement periods longer than a year and states that the first of these auctions will be held in 2021 for an amount of 15,830.08 GWh.

The main terms and conditions for these auctions are:

- **Commodity to be auctioned:** baseload electric power up to 25% of the value of the lowest annual power output in the past 10 years of emission-free manageable inframarginal plants, which do not receive specific remuneration and which have not been successful bidders in renewable energy development auctions. The bidding variable will be the unit electricity price, expressed in €/MWh.

However, sellers may ask for the energy offered to be higher than the mandatory amount, if the commodities to be auctioned are identical to the mandatory commodities.

- **Sellers:** dominant operators in electric power generation, in other words, as things stand today, the Iberdrola, Endesa, Naturgy and EDP groups.
- **Buyers:** retailers who have customer bases, direct consumers in the market, or their relevant representatives, following fulfillment of the conditions on bonds and formal requirements laid down for the auction.

The specific terms for each auction will be defined in a decision by the Secretary of State for Energy, following a report by the Spanish Markets and Competition Commission (CNMC).

Auctions will be administered by OMI-Polo Español S.A. (OMIE) and supervised by the CNMC.

## 3. Tax measures

RDL 17/2021 also adopts tax measures designed to reduce the cost of the final electricity bill, adding to those already in place (reduction to the taxable amount for VAT purpose on certain supplies). The specific reductions are as follows:

- **Tax on the value of electricity output:** The temporary elimination of the tax under Royal Decree-Law 12/2021, of June 24, 2021, is extended for a further three month term. This means that the elimination already in force for the third quarter of 2021 will also be extended over the last quarter of the year.

Namely, the taxable amount for the tax on the value of electricity output (total amount to be received for producing and bringing power into the electricity system in the annual tax period) will be reduced by the remuneration relating to the electricity brought to the system in the third and fourth calendar quarters.

Similarly, prepayments for the third and fourth quarters will be calculated by reference to the value of the electricity output less the amounts of remuneration relating to the electricity brought to the system in the third quarter and in the third and fourth quarters, respectively (and with deduction of any prepayments made earlier).

Moreover, additional provision two clarifies that, in the time period mentioned above, the lower revenue arising from the reduction mechanism mentioned in point 1 will also be taken into account for determining the taxable amount and prepayments for the tax.

Lastly, as is usually the case, the CNMC is given the power to deduct from the settlements relating to plants under the specific remuneration regime any amounts not paid by the plants as a result of that elimination of the tax on the value of electricity output.

It should be remembered that this tax is charged on producing and bringing electric power into the system, in other words, to the electricity producer (i.e. it is not charged on the consumer's bill) so the idea behind the measure is that after having one of their operating costs lowered producers can offer more competitive prices which will have a positive effect on consumers.

- **Excise tax on electricity:** A new exceptional and transitional measure is brought into force by RDL 17/2021 until December 31, 2021, consisting of a reduction to the rate for this tax. The excise tax rate (which, among other circumstances, is charged on the electricity bill for electricity use) is reduced from 5.11269632 percent to 0.5 percent.

Because energy taxation is harmonized in the EU, taxation levels cannot fall below certain thresholds determined by EU legislation. For that reason the royal decree-law reproduces the rule (also present in the law on the tax) determining that the tax rate mentioned above cannot result in a tax liability below €0.5 per megawatt hour (MWh) if the electricity is for industrial uses (including low voltage uses for irrigation in agriculture), use on vessels moored in ports which are not private recreational vessels or use in rail transport; and €1 per MWh where it is put to other uses.

If this condition is not fulfilled, those limits will be treated as mandatory tax rates, except for certain electricity intensive activities set out in the law on the tax.

Because this tax has been devolved to the autonomous community governments, the law allows the impact of this provision on autonomous community finances to be analyzed, to allow netting measures to be adopted if necessary under the Organic Law on Autonomous Community Financing.

## 4. Other measures

Lastly, some of the other measures in RDL 17/2021 are:

- The laying down of a 6 month period in which the supply of electricity to vulnerable consumers cannot be interrupted (called the "vital minimum supply"), which starts 4 months after the first default notice.
- In relation to reservoirs with aggregate capacities above 50 hm<sup>3</sup> and not having the provision of running water, irrigation and other agricultural uses as their main uses, it puts in place (i) minimum and maximum limits on outflows for the water that may be released from reservoirs in circumstances where reservoirs are at normal levels and in events of prolonged drought, (ii) rules on the minimum volumes of reserves that may be released from reservoirs in each month and (iii) a minimum reserve that must remain stored each month to avoid unwanted effects on the environment.
- The time limit for a change in the value of raw material costs in the last resort tariff for natural gas.
- A temporary reduction in the charges relating to the electricity system for the period between September 16, 2021 and December 31, 2021. The charges applying in that period are set out in additional provision three of RDL 17/2021.

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