

SPAIN: MECHANISM TO REDUCE THE WHOLESALE PRICE OF ELECTRICITY AND ADJUSTMENTS TO THE SPECIFIC REMUNERATION SYSTEM FOR RENEWABLES: RD-LAW 10/2022

WHAT IS THE AIM

The mechanism seeks to directly reduce the wholesale price of electricity by imposing on the power purchase units that will benefit from the mechanism, the obligation to cover the production costs of certain plants in excess of the natural gas reference price set by the Spanish Government. Also noteworthy in the package of measures adopted is the modification of the specific remuneration system, reintroducing the adjustment for market price deviations that Royal Decree-Law 6/2022 had eliminated.

WHAT HAPPENS TO THE MECHANISM ESTABLISHED IN RD-LAW 17/2021 TO REDUCE EXCESSIVE REVENUES AND THE €67/MWH MAXIMUM?

It is maintained. Both mechanisms will coexist, each one with their purpose and scope of application, until 30 June 2022. This mechanism set out in RD-Law 17/2021, commented on in our previous briefings, has the following features, in short:

- a) It is designed as a contribution to be made by certain electricity producers;
- b) To recover from some electricity producers the "excess" profits derived from internalising the cost of gas in the wholesale price of electricity, despite not having borne that cost;
- c) To apply these funds to reduce system charges;
- d) The reduction does not apply if the average price of gas in a given month is less than €20/MWh;
- e) The reduction applies to 90% of the "excess";
- f) It is in force until 30 June 2022.

Key issues

- A mechanism to reduce the wholesale price of electricity has been temporarily approved.
- This mechanism will coexist with the one for reducing excessive revenues and the maximum of €67/MWh established in RD-Law 17/2021 until 30 June of this year.
- The adjustment is subject to authorisation by the European Commission and will only apply after such authorisation is published in Spain's Official State Gazette.
- However, the Royal Decree has entered into force immediately, setting urgent and strict documentation and information obligations for power purchase units hoping to be excluded from the duty to pay for this adjustment.
- The adjustment for market price deviations is reintroduced for renewables with a specific remuneration system, but the value of futures is weighted.

TO WHICH POWER GENERATION FACILITIES DOES THE NEW ADJUSTMENT APPLY?

To marginal fossil fuel power plants in the Spanish peninsula: combined cycle, coal, and cogeneration plants without a regulated remuneration regime. For this new adjustment to apply, agents must register, modify where appropriate and, inevitably, identify the facilities that will benefit from it (the benefiting bid units and programming units).

As an exception, those declaring bilateral contracts with physical delivery will not qualify for the adjustment (which is logical, since they do not participate in the market and do not cause the cost of gas to be internalised in the wholesale price of electricity for such energy).

These power plants must internalise the compensation they receive from the electricity system and deflect that benefit to their bids in the wholesale market, or else face sanctions.

WHAT IS THE REFERENCE PRICE FOR NATURAL GAS?

It fluctuates and is rising: €40/MWh during the first six months of the application of the mechanism, increasing monthly by €5/MWh until the end of its application (€70/MWh in the last of the expected 12 months' duration).

WHO LIQUIDATES THE MECHANISM AND WHICH ENTITIES PAY FOR IT?

The market operator and the system operator perform the liquidations, determining the total cost or income in each trading session.

The revenue or total cost is distributed among all purchase units of the Iberian electricity market's agents, in proportion to the energy programmed for that period in their final trading session after the continuous market, except for:

- a) the storage bid units, both batteries and pumping units;
- b) the bid units for auxiliary generation services; and
- c) the purchase units that have hedging instruments as described below.

In addition, those entities obliged to pay this cost are required to provide guarantees to secure the fulfilment of that obligation.

WHICH HEDGING INSTRUMENTS DETERMINE EXCLUSION FROM THE OBLIGATION TO PAY FOR THE MECHANISM?

Those that meet the following requirements:

- a) forward contracts;
- b) signed before 26 April 2022. However, those signed subsequently are included, but also those signed prior to that date and that are renewed, undergo price reviews, or are extended after that date.
- c) entities excluded from paying this compensation must submit all supporting documentation specified in the Royal Decree-Law to the market operator by Monday, 23 May. If any documents need to be rectified, this must be done within a period of 2 days. The failure to comply with this deadline leads to the power plant being included in the group of those obliged to pay the compensation.

The required documentation includes, among others, a statement of compliance signed by the managing director or person holding a position with similar responsibility, as well as various other and thorough documents that vary depending on the entity concerned. For example, supply companies must provide the list of supply points, indicating the agreement's termination date or extension, expected amount of energy and other documentation and information.

WHEN DOES RD-LAW 10/2022 COME INTO FORCE, WHEN DOES THE MECHANISM BEGIN TO APPLY, AND WHAT IS ITS DURATION?

Royal Decree-Law 10/2022 entered into force immediately on Sunday, 15 May, and includes some extremely tight deadlines, as we have said.

Monday, 23 May, is the last day for production units and marketers to provide information that will allow them to be excluded from the obligation to bear the cost of the mechanism.

In addition, a maximum of 7 business days is granted to market operator and system operator to make the necessary system adaptations to apply the mechanism.

However, the mechanism's application is subject to prior authorisation by the European Commission and it will only apply on the date determined by the order which publishes such authorisation in the Official State Gazette (BOE).

The mechanism will apply for 12 months, and no later than 31 May 2023 (unless the expected 12 months' duration is amended).

REVISION OF THE SPECIFIC REMUNERATION SYSTEM FOR RENEWABLES: REINTRODUCTION OF THE ADJUSTMENT FOR DEVIATIONS IN THE MARKET PRICE OF ELECTRICITY

RD-Law 6/2022 eliminated, for energy generated in 2023 and thereafter with the right to specific remuneration, the adjustment for deviations in the market price of electricity as compared to the forecasts taken into account for each three-year regulatory half-period (and each six-year regulatory period). This increased the risk associated with such deviations, the goal being to incentivise the signing of PPAs with fixed-term prices.

This adjustment has now been reintroduced, again with changes to how it is regulated, so that the value of the adjustment includes the deviations from both the current price of electricity on the market and from the price of annual, quarterly and monthly futures, weighted accordingly.

In 2022, only the current price will be taken into account, not the price of futures.

For 2023, the change in the current price is weighted at 0.75, the change in annual futures at 0.15, in quarterly futures at 0.025, and in monthly futures at 0.

For 2024 and 2025, the weighting of futures prices will be set by Ministerial Order and will be at least 50% and 75%, respectively.

SMALL-SCALE POWER PLANTS WILL RECEIVE THE ADJUSTMENT WITHOUT CONSIDERING THE FUTURES

The value of the adjustment for small-scale power plants is calculated taking into account the deviations from the average annual daily and intraday market price for each year, without considering the price of futures. For these purposes, small-scale power plants mean:

- a) cogeneration and biomass plants with a capacity of 1MW or less;
- b) photovoltaic, onshore wind farms and hydroelectric power plants with a capacity of 5MW or less.

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