

Energy

# Reduction in revenue of electricity companies under Royal Decree-law 17/2021 (V)

Royal Decree-law 17/2021, of 14 September, on urgent measures to mitigate the impact of the escalation of natural gas prices in the retail gas and electricity markets.

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### 1. Introduction

The Official Journal of Spain of 15 September 2021 published the awaited set of Government measures to address the unstoppable rise in the price of electricity. These measures are contained in Royal Decree-law 17/2021, of 14 September, on urgent measures to mitigate the impact of the escalation of natural gas prices in the retail gas and electricity markets. These measures revolve around four axes: direct protection of consumers, exceptional and temporary reduction of taxes, elimination of barriers to competition by imposing forward power agreements on dominant operators in the generation market and reduction of the remuneration of the surplus

revenue earned from the increase in the price of gas in a marginal cost pricing system. From these different levels, the aim is to act on the various elements which, in one way or another, put pressure on the price and are generating a situation of alarm and social unrest which is exacerbated every day when the news bulletins report that the price of electricity has reached a new all-time high.

Given that just a few minutes after its approval by the Cabinet and even before, all the media have reported on the piece of legislation and, in the midst of the heated political dispute, they are disseminating it and submitting it to the opinion of the most disparate panellists, the series of documents

dedicated to the new legislation aims to focus on its legal impact and analyse, with calmness and rigour, the measures adopted and their effect on the electricity system, on the legal system and on society as a whole, paying special attention now to one of the most controversial measures: the mechanism for reducing the surplus remuneration of the electricity market caused by the high price of natural gas on international markets.

## **2. Reduction of the surplus remuneration of the electricity market caused by the high price of natural gas on international markets**

Undoubtedly, it is this “mechanism for reducing the surplus remuneration in the electricity market caused by the high price of natural gas on international markets” that has caused the greatest political and media stir. There has been talk of “reimbursement of profits fallen from the sky” and electricity companies have suggested a possible shutdown of nuclear power plants due to loss of profitability and a possible appeal to the courts.

Article 4 of the Royal Decree-law establishes that “with effect from the entry into force of this Royal Decree-Law (16 September 2021) and until 31 March 2022, the remuneration for the electricity production activity of production facilities using technologies that do not emit greenhouse gases will be reduced by an amount proportional to the greater income obtained by these facilities as a result of the inclusion in electricity prices on the wholesale market of the value of the price of natural gas by the marginal emitting technologies”.

### *2.1. Facilities affected*

The reduction in remuneration (not return of revenue), for the coming months,

applies to non-greenhouse gas emitting facilities in the Spanish peninsular territory, whatever the technology used (wind, photovoltaic, hydroelectric...), regardless of the type of contracting used (i.e. power sold outside the daily market, through bilateral agreements, will also be reduced, as all of it is internalising the opportunity cost of selling it in the daily market, where the cost of natural gas is internalised), by the amount determined by the average price of the gas used by the emitting facilities that incur the highest (marginal) cost (Arts. 5 and 6).

The following facilities will not be affected by the reduction in remuneration:

- Production facilities in the electricity systems of non-peninsular territories;
- Production facilities that have a recognised remuneration framework of those regulated in Article 14 of Act 24/2013 of 26 December (renewables, cogeneration and waste);
- Small production facilities, whose net power is equal to or less than 10 MW, regardless of their date of commissioning.

### *2.2. Calculation of the rebate: the price of gas is the key factor*

Based on the information provided by the Market Operator (OMIE) regarding the plants that have set the marginal market price in each hour (highest production cost), the average monthly internalisation level of the cost of natural

gas in the wholesale market price will be calculated. The formula for calculating the monthly reduction in remuneration is based on the so-called “Average Natural Gas Internalisation Factor” in the daily market price on the Iberian Electricity Market in the month in question. This factor is calculated on the basis of a variable which is the price of natural gas (average of the spot price of natural gas at the virtual balancing point of each day of the relevant period on the Iberian gas market (MIBGAS)) and the estimated average yield of a combined cycle plant, considering that it is the combined cycle plants that set the marginal price. In those hours in which the marginal price has not been set by a combined cycle plant, or when it has been set by a bidding unit that groups together several plants of different technologies, it shall be assumed that the bid has internalised the price of natural gas when there are bids from combined cycle plants in the vicinity of the said marginal price (i.e. around 10% higher or lower than the said marginal price) (cf. Art. 7).

For each plant, the reduction in its remuneration will be calculated by multiplying its monthly production at busbars by the adjusted average cost calculated in accordance with the formula indicated.

The reduction will only be applied if the average gas price in the month in question is higher than €20/MWh. Otherwise, the amount of the reduction will be zero, which, given the evolution of the gas market in recent months, is unlikely to occur in the medium term. According to the explanatory notes to the Royal Decree-law, in the Iberian

gas market, managed by MIBGAS, the spot gas price at the virtual balancing point – VB - has recently exceeded €60/MWh, compared to the minimum prices of the year recorded in February, which were around €15/MWh.

The measure is limited in time from 16 September 2021 to 31 March 2022, by which date gas prices are expected to have returned to average values observed in recent years.

- But why the price of gas?

As the drafter of the regulation explains, “the price of natural gas is a determining factor in setting the daily market price, insofar as its effect is multiplying (approximately, an increase of €1/MWh of gas means an increase of €2/MWh of electricity), compared to the price of CO<sub>2</sub>, whose signal is transferred to the price of electricity in a more attenuated way (an increase of €1/tCO<sub>2</sub> means an increase of €0.37/MWh in the price of electricity, given the specific emission factor of the combined cycle).

This situation is combined with a marginal cost market model, which is determined by EU law, and which establishes that all the production facilities that operate in a certain hour receive the same price, appropriate to the price offered by the last facility that has been matched to supply demand in that hour (the one that incurs the highest production costs). This marginal cost design, among others, allows the aforementioned price signals and externalities to work, since

the cleaner and, in general, more competitive facilities earn higher revenues, which encourages their facility and entry into the market, replacing the more polluting and, in general, less competitive ones.

As a moral: if the change means that the most competitive facilities (renewable energy facilities) earn less revenue, there will be disincentives to investment in these technologies. Some associations have already made it clear that, if the Royal Decree-law is not amended during its passage through Parliament, they may be forced to stop production or even close their facilities.

- Is there such a thing as “profits fall from the sky” or is it an unreal myth?

In the context described above, as long as there is no definitive displacement of generation plants that depend on variables such as the price of natural gas, the price signal will continue to be set by CO<sub>2</sub> emitting technologies.

Correlatively, given this marginal cost design of the market, - according to the Government -, “the differential between generation costs and profits of non-emitting and infra-marginal facilities is evident”. Therefore, the drafter of the rule considers it “essential to incorporate regulatory instruments that, given the exceptional circumstances of the raw materials markets, temporarily limit the surplus remuneration obtained by these facilities to the detriment of all consumers”. In the

case of CO<sub>2</sub>, a bill is currently passing through Parliament that acts on the remuneration of non-emitted CO<sub>2</sub> in the electricity market, which aims to reduce the surplus remuneration of those non-emitting facilities that, unable to foresee the extraordinary profit associated with the creation of the European Trading System (ETS) created in 2003 at the time of the investment decision (which was prior to that date), are currently the recipients of the so-called CO<sub>2</sub> dividend (surplus remuneration earned by these non-emitting and infra-marginal facilities). The aforementioned Royal Decree-law acts directly on the surplus remuneration derived from the increase in the price of gas for facilities that do not need it to generate electricity.

### 2.3. Procedure

The settlement and payment of the reductions shall be made monthly in accordance with the system operator’s calculations. For these purposes, before the 15th of each month, the system operator shall notify the owners of the affected facilities of the amounts resulting from the reduction for the previous month, detailing the calculations made. The payments shall be made within one month of receipt of the notification and shall be considered payments on account of the settlement, which the system operator shall make for each facility once the definitive data of the production measurements at busbars for the year are known. These amounts will be considered settleable revenue of the system and will be used to finance the costs financed by the electricity sys-

tem charges referred to in Article 16(1) of the Electricity Sector Act 24/2013 of 26 December ('access tolls' [connection charges] and other charges associated with the costs of the system) and to cover, where appropriate, temporary mismatches between revenue and costs of the system.

#### 2.4. *Effect of the remuneration reduction mechanism: reduction of electricity system charges*

Taking into account the additional revenue available to the electricity system as a result of the instrument for reducing the surplus remuneration of natural gas, the third additional provision of the aforementioned Royal Decree-law includes an extraordinary update of the electricity system charges to be applied from 16 September 2021 to 31 December 2021. This updating of charges has been carried out in accordance with the methodology set out in Royal Decree 148/2021, of 9 March, setting out the methodology for calculating electricity system charges.

Irrespective of the type of agreement and the contracting conditions, suppliers must include in the bills they issue to end consumers, corresponding to the consumption made since the Royal

Decree-law came into force, the reduction in tolls derived from the discount associated with the new charges in relation to the charges established in Order TED/371/2021, of 19 April, setting out the prices of the electricity system charges and capacity payments that are applicable as from 1 June 2021. Said discount shall appear expressed in euros and on a separate line of the bill. Failure to comply with this obligation constitutes a serious infringement for non-compliance with consumer protection measures (Art. 65(25) of Act 24/2013).

On the other hand, the amount corresponding to the greenhouse gas emission rights that will be used to finance the costs of the electricity system provided for in Act 24/2013, referring to the promotion of renewable energy, has also been increased. The first final provision of the aforementioned Royal Decree-law amends the Spanish Government Budget for 2021 Act (Additional Provision 132), to increase the initial amount from 1,100 million euros to 2,000 million euros, earmarked for the automatic reduction of electricity system charges, given the higher revenue earned as a result of the increase in the price of CO<sub>2</sub> emission rights.