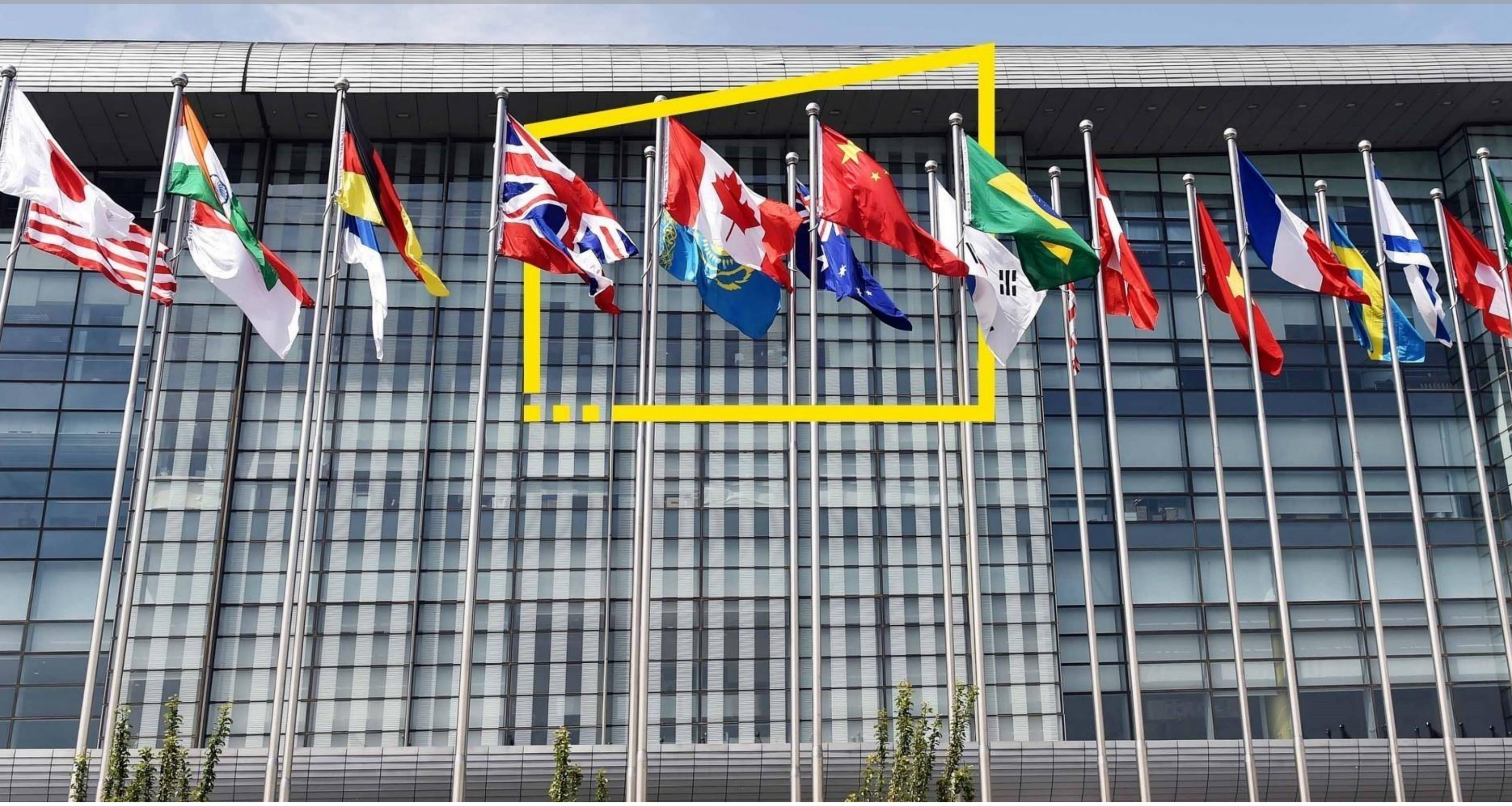
Legal Update - September 2022

Analysis of the European Commission's draft regulation on emergency intervention to deal with high energy prices



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The European Commission (hereinafter "**EC**") announced on 14 September 2022 a series of proposals for emergency intervention in European energy markets to address recent price rises. The proposed regulation must be approved by qualified majority in the Council and is expected to be adopted on 30 September 2022.

These measures complement those already adopted on gas storage filling and gas demand reduction. In addition, the EC will continue to work to improve the liquidity of market operators, reduce gas prices and reform the long-term configuration of the electricity market.

The measures are of an extraordinary nature and will therefore be limited in time.

In this Alert we will summarize the main developments proposed.

Introduction

Gas and electricity prices have reached record levels in 2022, reaching all-time highs following the outbreak of the war in Ukraine. In addition, energy prices are expected to remain high due to market uncertainty following gas supply disruptions.

The European Union is thus faced with an extraordinary situation, which is why in this context a rapid and coordinated response at European level is essential to mitigate the hardship that high prices are causing consumers.

The EC has therefore proposed a package of temporary measures to overcome the energy crisis.

The measures can be grouped into the following blocks: (i) electricity demand reduction, (ii) mandatory cap on market revenues to infra-marginal producers, as well as (iii) mandatory temporary solidarity contribution from oil, gas, coal and refinery sectors through a so-called solidarity contribution.

Reduction of gross electricity consumption

The EC proposes that Member States (hereinafter "MMSS" or “Member States”) implement mandatory measures to reduce their total monthly gross electricity consumption by at least 5% on average per hour during the identified peak price hours. To this end, the EEMMs must identify the 10% of the hours with the highest expected price and introduce measures to reduce demand - by at least 5% - during those hours.

In addition, it also proposes that Member States should aim to reduce overall electricity demand by at least 10% by 31 March 2023.

The EC estimates that, if these measures are implemented, a reduction in gas consumption of 1.2 bcm (1.2 billion cubic metres) would be achieved during the winter.

In order to reduce electricity consumption and achieve these targets, Member States may choose the measures they consider most appropriate, even if they are more ambitious. In any case, the EC gives a series of guidelines to the Member States in the adoption of these measures, which (i) may consist of economic compensations established through open competitive processes; (ii) shall not unduly distort competition or the internal electricity market; (iii) shall not be limited to specific groups; and (iv) shall not unduly prevent the process of replacing fossil fuel technologies with technologies using electricity.

Mandatory cap on market revenues to infra-marginal producers

The regulation proposes to set a temporary revenue cap for infra-marginal producers[1] at €180/MW. In this regard, Member States may maintain or introduce measures that further limit producers' market revenues if they are proportionate, ensure that investment costs are covered, do not distort the functioning of wholesale markets and do not jeopardize investments.

However, this cap will not apply to demonstration projects, nor to generators whose revenue per MWh of electricity produced is already capped as a result of state measures already in place.

Revenues above the cap will be collected by Member State governments and will be used to finance support measures for final electricity customers to mitigate the impact of high electricity prices (e.g., financial compensation to final electricity customers for reducing their consumption, direct transfers to final customers, etc.). Ultimately, they will be aimed at reducing electricity bills.

In the spirit of solidarity, provision is also made for the possibility of sharing surplus revenue between Member States exchanging electricity, so that the producer State can share part of the revenue collected for the benefit of final consumers in the importing State.

It is important to highlight the limited effects that this measure will have for Spain and Portugal due to the effect of the Iberian exception implemented a few months ago.

Mandatory temporary solidarity contribution in the oil, gas, coal and refining sectors

In addition, the EC also proposes a temporary solidarity contribution on windfall profits generated by activities in the oil, gas, coal, upstream and refining activities that are not covered by the infra-marginal revenue cap. This contribution would apply on profits considered as extraordinary for the tax year beginning on or after 1 January 2022 considering as such those that are more than 20% higher than the average profits of the previous three years.

The rate applicable for calculating the temporary solidarity contribution shall be at least 33% of the extraordinary surplus base.

The Member States shall use the revenue from the temporary solidarity contribution for the purpose of financial support measures for final energy customers - especially vulnerable households, severely affected businesses and energy-intensive industry -, measures to reduce energy consumption and the development of energy autonomy, among others.

This measure and the previous one are in clear contradiction with the bill presented in the Spanish Congress of Deputies last July, the processing of which has already been validated by the Congress this week, and which proposes to require to the main operators of the energy sector to pay a non-tax public benefit of 1.2% calculated on the net turnover of each of the entities subject to the tax, for the years 2023 and 2024, and not for a single year as proposed by the European Regulation currently being processed.

Other measures

On the other hand, the EC also proposes to extend the Energy Pricing Package for MMEEs (known as Toolbox) and include, for the first time, the possibility of setting regulated prices below cost, and extend regulated prices to include small and medium-sized enterprises.

The EC is also continuing to consider measures to improve the liquidity of market operators, reduce gas prices and reform the long-term configuration of the electricity market.

Entry into force and application

The regulation would enter into force on the day following its publication in the Official Journal of the European Union ("OJEU"). The Member States have expressed their intention to decide on the proposal during the extraordinary Council meeting on 30 September 2022; qualified majority is required for its adoption.

On the other hand, the proposed measures are extraordinary and have a temporary nature to combat the current energy crisis. Thus, the regulation will apply for a period of one year from its entry into force. However, certain aspects of the package of measures (demand reduction and collection of windfall profits) will apply from 1 December 2022, without prejudice to an earlier voluntary application and until 31 March 2023.

Given their extraordinary nature, the EC has committed to carry out a review of the measures by 28 February 2023 (and by 15 October 2023 for the solidarity contribution), in order to assess them in the light of the overall energy situation.

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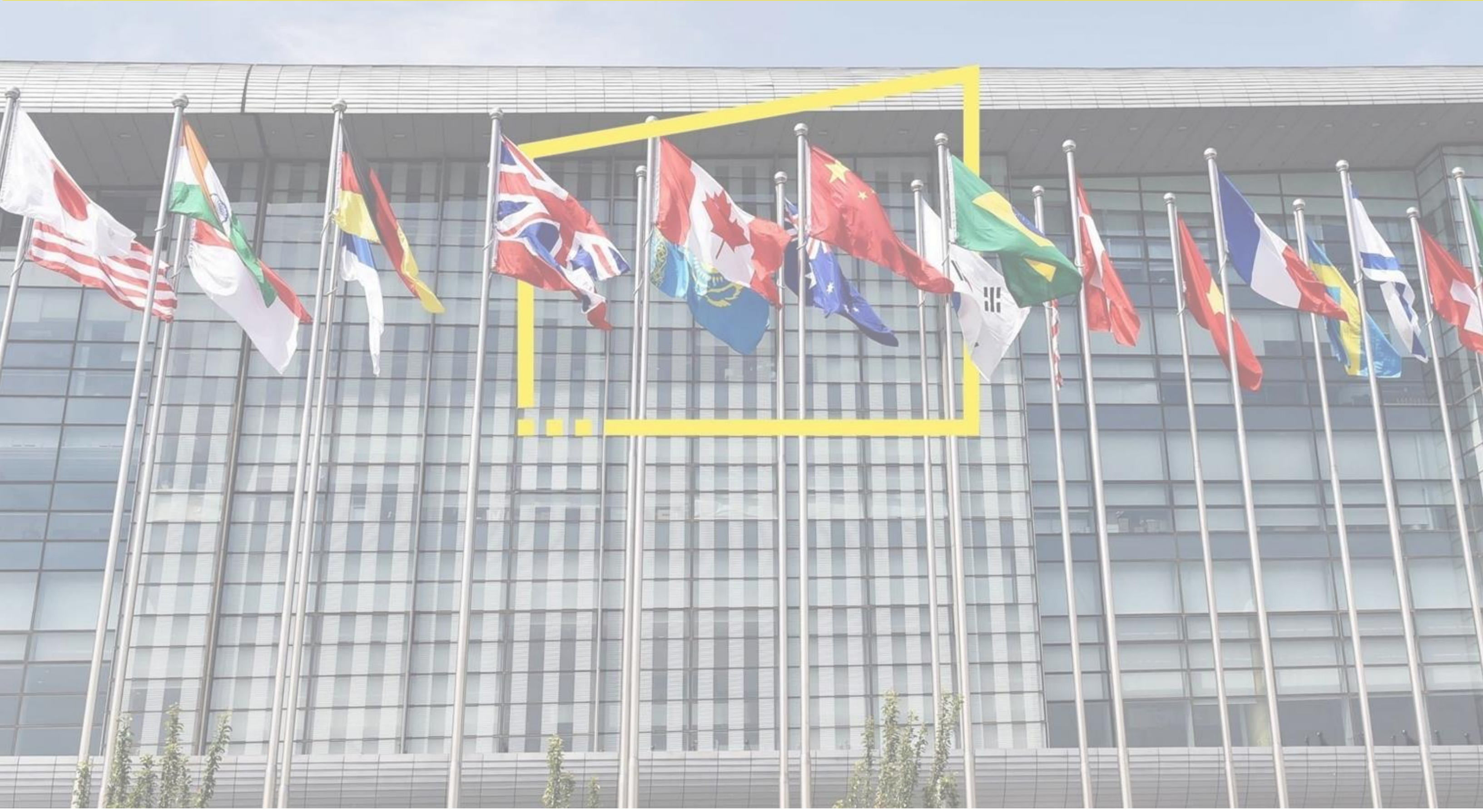

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Notes

[1] Infra-marginal generators are defined as those that supply electricity to the grid at a cost below the price level set by the most expensive marginal generators. These are the following technologies: (i) wind energy, (ii) solar energy (solar thermal and solar photovoltaic), (iii) geothermal energy, (iv) hydroelectric energy without reservoir, (v) biomass fuel excluding biomethane, (vi) waste, (vii) nuclear energy, (viii) lignite, (ix) crude oil and other oil producers.