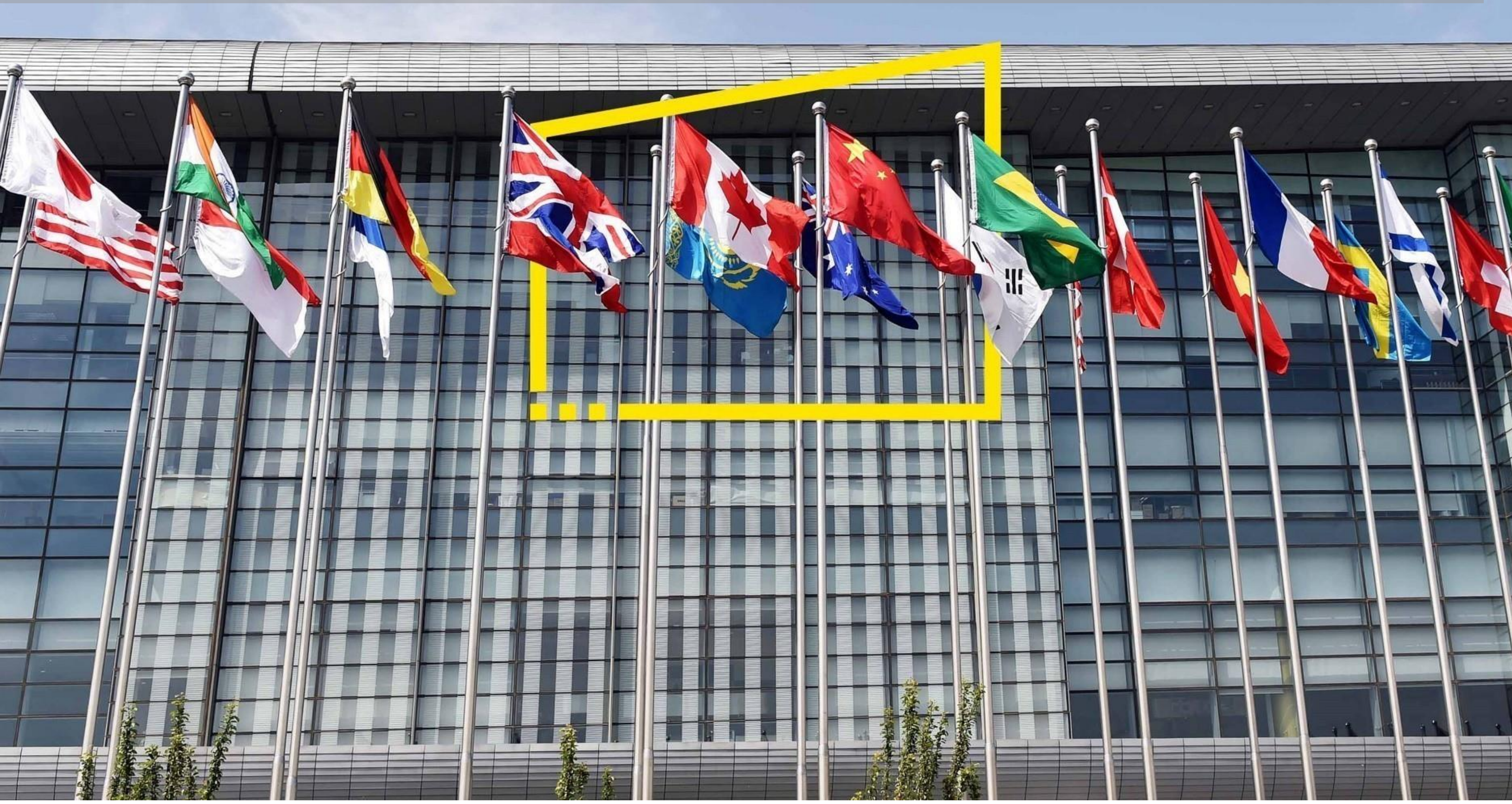
Legal Update – October 2022

Analysis of the Council Regulation (UE) of 6 October 2022 on an emergency intervention to address high energy prices



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On October 7, 2022, Regulation (EU) 2022/1854 (the "**Regulation**") adopted by the Council of the European Union, after the proposal from the European Commission, was published in the Official Journal of the European Union ("**OJEU**"). As advanced in our September 2022 legal update "*Analysis of the European Commission's draft regulation on emergency intervention to deal with high energy prices*", the Regulation sets out a series of measures aimed at an emergency intervention in European energy markets to provide a united and coordinated EU-wide response to deal with recent price hikes.

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

In this Alert we summarize the main changes that have been finally approved.

Main objectives

The Regulation establishes an emergency intervention to mitigate the effects of high energy prices through exceptional, specific, and time-limited measures.

These measures are aimed at (*i*) reducing electricity consumption, (*ii*) capping the market revenues received by certain producers for electricity generation and (*iii*) redistributing them to final electricity customers in a targeted manner so that Member States ("**Member States**" or "**MMSS**") can apply public intervention measures in the pricing of electricity supply to household customers and SMEs, and (*iv*) establish rules for a mandatory temporary solidarity contribution from Union companies and permanent establishments operating in the crude oil, natural gas, coal and refining sectors, in order to contribute to the affordability of energy for households and businesses.

Reduction of gross electricity consumption

First, there are (*i*) measures for the reduction of gross electricity consumption and (*ii*) measures for the reduction of gross electricity consumption during peak hours.

Member States will implement measures aimed at reducing the total monthly gross electricity consumption by 10% compared to the average gross electricity consumption in the months corresponding to the reference period.

MMSS shall reduce their gross electricity consumption during identified peak hours. The reduction shall reach at least 5% on average per hour during the identified peak price hours. Member States will determine peak hours corresponding in total to at least 110% of the hours in the period between December 1, 2022, and March 31, 2023. In addition, it is foreseen that Member States may decide to set a different percentage of peak hours, provided that at least 3% of the peak hours are covered, and provided that the energy saved during these peak hours is at least equal to the energy that would have been saved with the parameters indicated. This last possibility was not contemplated in the Commission's proposal and has been introduced subsequently.

The general objective of demand reduction envisaged in the Commission's proposal is maintained.

As indicated in our September 2022 legal update, to reduce electricity consumption and achieve these objectives, MMSS may choose the measures they deem most appropriate, including the extension of national measures already in place. In any case, the Regulation 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; (*iv*) shall not unduly impede the process of substitution of fossil fuel technologies by electricity-using technologies and (*v*) shall only include financial compensation where such compensation is paid for the additional electricity not consumed compared to the expected consumption in the relevant hour without tendering.

In its development, the Council of Ministers approved last October 11 the Energy Security Plan (+SE), which includes 73 energy security measures grouped around six major objectives: savings and efficiency; transformation of the energy system; extension of protection to citizens, especially the vulnerable; fiscal measures; transformation of industry through renewable energies or hydrogen, and solidarity with the rest of the European countries.

Mandatory cap on market revenues to infra-marginal producers

The Regulation finally sets a temporary revenue cap for electricity producers[1] at €180/MW. Member States must ensure that the revenue cap applies to all market revenues of generators and, where applicable, intermediaries participating in wholesale electricity markets on behalf of generators irrespective of the time horizon of the market in which the transaction takes place and whether the electricity is traded bilaterally or on a centralized market.

In this regard, Member States may maintain or introduce measures that further limit producers' market revenues if they are proportionate, ensure coverage of investment costs, do not distort the functioning of wholesale markets, and do not jeopardize investments. Thus, among others, Member States may (*i*) maintain or introduce measures that further limit revenues, including the possibility to distinguish between technologies, (*ii*) set a higher revenue cap, (*iii*) maintain or introduce national measures to limit the market revenues of non-indicated producers, (*iv*) set a specific cap on market revenues that have been obtained from the generation of electricity from anthracite and hard coal.

In this sense, the Regulation gives more flexibility to the MMSS when applying the revenue cap, while maintaining the essence of what was proposed by the Commission.

In addition, Member States may decide not to apply the cap to (*i*) generation facilities with a maximum installed capacity of 1 MW, (*ii*) hybrid power plants using conventional energy sources if its application entails a risk of increasing CO2 emissions and reducing renewable energy generation. They may also decide that (*i*) the cap on market revenues shall not apply to revenues from electricity sales on the balancing energy market and from financial compensation for redispatch and compensatory exchange and (*ii*) the cap shall only apply to 90% of market revenues exceeding 180 €/MW.

However, this limit (€180/MW) will not apply to demonstration projects, nor to producers whose revenues per MWh of electricity produced are already subject to a cap because of state measures not adopted under the Regulation.

It should be noted that the Regulation does not clarify how long-term contracts (PPAs) will be treated and whether or not they will be exempt from the cap.

Revenues above the cap will be collected by the governments of the Member States and will be used to finance support measures for final electricity customers to mitigate the impact of high electricity prices (such as, for example, the granting of financial compensation to final electricity customers for reducing their consumption, direct transfers to final customers, etc.). In short, they will be used to reduce 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 may share part of the revenue collected for the benefit of final consumers in the importing State. In addition, notwithstanding the provisions on congestion rents in the Union rules, Member States may use surplus congestion rents revenues resulting from the allocation of capacity to finance support measures for final customers.

As mentioned in our September legal update, the compatibility of this measure with the mechanism for reducing the excess remuneration of the electricity market established in Royal Decree-Law 17/202 approved in Spain should be examined.

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

The Regulation introduces the temporary solidarity contribution proposed by the Commission, although with certain changes compared to the initial proposal.

It provides a mandatory temporary solidarity contribution on windfall profits generated by companies operating in the crude oil, natural gas, coal, and refining sectors (not covered by the revenue cap).

The measure is mandatory so MMSS shall adopt measures implementing the mandatory temporary solidarity contribution no later than December 31, 2022.

However, Member States are not required to apply this solidarity contribution if they have adopted equivalent national measures. Thus, Member States should ensure that national measures approved share similar objectives and are subject to similar rules to those of the solidarity contribution, generating revenues comparable to or greater than the estimated revenues from this contribution and if they are used for purposes comparable to the solidarity contribution.

The profits considered as extraordinary, on which this contribution would be applied to the following for fiscal year 2022, and/or, if so decided by each State, fiscal year 2023, considering as such those that exceed by more than 20% the average taxable profits of the previous four years (instead of the three years initially proposed by the Commission). If the average profit result is negative, the average will be assigned a value of zero for the purposes of calculating the contribution.

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

The Member States will use the proceeds of the temporary solidarity contribution for the purpose of financial support measures for final energy customers -especially vulnerable households, severely affected companies and large consumption industry-, measures to reduce energy consumption and development of energy autonomy, among others.

Thus, the solidarity contribution no longer requires compliance with the principle of generality and, in addition, MMSS can approve measures of equivalent effect that generate comparable revenues.

In the case of Spain, the bill presented in the Congress of Deputies last July, which has already been validated by the Congress, and which is currently in the amendment submission period, which proposes to require the main operators of the energy sector to pay a non-tax public contribution of 1.2% of the net turnover of each of the entities subject to the tax, for the years 2023 and 2024. The Government has not yet confirmed whether it will adapt to the structure followed by the Union Regulation, or whether it will instead justify that the proposal is an equivalent national measure.

Other measures

On the other hand, the Regulation establishes a Set of Measures on Energy Prices for the Member States (known as "toolbox") and includes, for the first time, the possibility of establishing regulated prices below cost, extending regulated prices to also include small and medium-sized companies. This measure was already included in the Commission's proposal.

All the measures will be reviewed by the Commission. In this regard, no later than April 30, 2023, the Commission will make a review considering the general situation of electricity supply and prices and will submit a report to the Council, which, based on this may propose an extension of the implementation period, a modification of the level of the revenue cap or any other modification. In addition, no later than October 15, 2023, and again on October 15, 2024, the Commission shall conduct a review of the solidarity contribution.

It should be noted that finally, no price cap has been set for gas purchased by European countries, a price cap that already exists in Spain through the so-called Iberian exception. However, it seems that this measure will continue to be discussed as some Member States continue to insist and, therefore, it could be considered by the Commission in a future package of measures.

Entry into force and application

The Regulation entered into force on the day following its publication in the OJEU, i.e., October 8, 2022, and will be directly applicable in each Member State and binding in its entirety.

Given its extraordinary nature, the measures are of a temporary nature. In this regard, the Regulation will apply until December 31, 2023, subject to the following:

- The reduction of gross electricity consumption during peak hours will be applicable from December 1, 2022, until March 31, 2023.
- Measures to achieve demand reduction and distribution of surplus revenues will be applicable from December 1, 2022.
- The mandatory market revenue cap, the application of the market revenue cap to electricity producers and national crisis measures will be applicable from December 1, 2022, until June 30, 2023.
- The Commission's revisions will be applicable until October 15, 2024.

These dates should be considered without prejudice to (*i*) the obligation to ensure the distribution of surplus revenues, (*ii*) to use the revenues collected through the temporary solidarity contribution and (*iii*) the notification obligation.

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Notes

[1]. It will apply to market revenues obtained from the sale of electricity from the following sources: (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 petroleum producers and (x) peat.