

Energy

Spanish Royal Decree-law 10/2022 of 13 May: mechanism for adjusting production costs factored into wholesale electricity prices and other important regulatory amendments

Main changes introduced in the regulation of the electricity sector by Royal Decree-law 10/2022 of 13 May, temporarily establishing a production cost adjustment mechanism to reduce the price of electricity in the wholesale market.

ENERGY TEAM

In its meeting of 13 May 2022, the Cabinet of Spain approved Royal Decree-law 10/2022, of 13 May, temporarily establishing a production cost adjustment mechanism to reduce the price of electricity in the wholesale market (“Royal Decree-law 10/2022”).

In this paper we will focus exclusively on the main changes introduced by Royal Decree-law 10/2022 that refer to the electricity sector, including an examination of the mechanism for adjusting production costs factored into wholesale electricity prices and the PVPC tariff (regulated tariff for households) and the RECORE scheme (subsidy payments scheme for facilities producing electricity from renewable, energy source cogeneration and waste).

1. Mechanism for adjusting production costs factored into wholesale electricity prices

With effect from the date determined in the Order publishing in the Official Journal of Spain the European Commission’s authorisation of the mechanism, and for a period of 12 months (no later than 31 May 2023), a production cost adjustment mechanism is established to reduce the price of electricity in the wholesale market.

The mechanism will be applied to the following production facilities on mainland Spain that are registered in the market on the day the daily market matching occurs: (i) natural gas combined cycle plants, (ii) conventional

power plants using coal as fuel, and (iii) co-generation plants that do not have any of the remuneration frameworks provided for in Article 14 of the Spanish Electricity Sector Act.

The adjustment value for plants included in the mechanism is established as the difference between a reference gas price and the effective spot market price of natural gas on each day, so that these facilities recover all their costs. The reference gas price established in the mechanism will be variable, starting at a value of 40 €/MWh for the first six months and increasing thereafter in successive monthly steps of 5 €/MWh until it reaches a value of 70 €/MWh in the last month. The aim is to achieve a gradual and staggered exit that allows participants to adapt to the scenario in which the mechanism ceases to apply.

In order to receive the adjustment, the market participant shall request the market operator and the system operator to register and, where appropriate, modify the relevant bid units and scheduling units. The facilities benefiting from the mechanism shall bid in the daily market with their best production forecast, internalising the unit amount of the adjustment in their market bids.

The settlement of the adjustment mechanism made by the market operator in each trading period or by the system operator in each hourly period shall be distributed by the market operator among all the purchasing units of the Iberian electricity market participants, in proportion to the power scheduled for that period in their final hourly schedule after the continuous trading system, or by the system operator among all the purchasing units of the Iberian electricity market participants in their respective zone, in proportion to their power measured at busbars for that period.

Notwithstanding the above, Royal Decree-law 10/2022 states that the following will be excluded from the adjustment payment of the cost:

- a) the storage supply units, both battery and pumped storage, as well as the supply units for ancillary generation services.
- b) purchasing units under certain power purchase agreements (“PPAs”), in accordance with the provisions of Article 8 of Royal Decree-law 10/2022, which provides for these cases the rules for the progressive incorporation of the adjustment cost for power subject to PPAs.

Specifically, only those PPAs signed prior to 26 April 2022 may be used as a means for the power associated with them to be exempt from the payment of the adjustment cost. PPAs signed after that date, as well as renewals, price revisions and extensions of PPAs prior to 26 April 2022 that occur after that date will not be exempt from the payment of the adjustment.

For this purpose, purchasing market participants shall have a maximum period of five business days from the entry into force of Royal Decree-law 10/2022 to declare to the market operator the information required with respect to the part of the power that is subject to PPAs. For market participants who do not declare PPAs, it shall be understood that all the power associated with their purchasing units shall be subject to the payment of the adjustment.

Schedule II to Royal Decree-law 10/2022 provides the statement of compliance forms (which must be signed by the market participant’s managing director or officer with a similar authority) and templates that must be submitted to declare the power subject

to PPAs and the maturity calendar of the hedges, on a monthly basis.

In the case of direct consumers in the market and electricity suppliers, the above information must be accompanied by the supporting documentation relevant to said PPAs, specific provisions laid down in both cases.

2. Other important amendments to electricity sector legislation

Article 13 of Royal Decree-law 10/2022 provides that the cost of the adjustment mechanism will be a component of the final hourly price of the peninsular market for the purposes of calculating PVPC tariffs. In this regard, the fifth additional provision (para. 1) of Royal Decree-law 10/2022 states that before 1 October 2022 the Government will make the necessary amendments to the methodology for calculating PVPC tariffs provided for in Royal Decree 216/2014 in order to introduce a reference to forward market prices.

With regard to the RECORE scheme, Royal Decree-law 10/2022 amends Article 22 of Royal Decree 413/2014 of 6 June¹, reintroducing the market price deviation adjustment as from

2023². From now on, this adjustment will be calculated taking as a reference a basket of prices made up of the real daily market price for the year and the forward prices (annual, quarterly and monthly) with different weightings.

In addition, Article 14(4) of the Electricity Sector Act (relating to subsidy payments for activities) is also amended to allow until 28 February of the first year of each regulatory period for the review of the payment parameters of the subsidy payments scheme.

Royal Decree-law 10/2022 also amends Royal Decree-law 17/2021, of 14 September³, in order to specify that the gas price with respect to which the reduction established in this Royal Decree-law is calculated may not be lower than the reference price of natural gas established for the purposes of the adjustment mechanism now established.

Finally, some amendments are also made with respect to the regulations governing the category of vulnerable consumer, the social energy tariff and other protection measures for household electricity consumers.

¹ Royal Decree 413/2014, of 6 June 2014, regulating the activity of electricity production from renewable energy sources, cogeneration and waste ("Royal Decree 413/2014").

² As is known, this adjustment will be eliminated as from 2023 by Royal Decree-law 6/2022, of 29 March, adopting urgent measures within the framework of the National Plan in response to the economic and social consequences of the war in Ukraine.

³ Royal Decree-Law 17/2021, of 14 September, on urgent measures to mitigate the impact of soaring natural gas prices on the retail gas and electricity markets ("Royal Decree-law 17/2021").