Mr Frans Timmermans
European Commission Executive Vice-President
European Green Deal

Ms Kadri Simson
European Commissioner
Energy

8 June 2021

Object: Draft law to reduce the remuneration of non-emitted CO2 in the electricity market

Dear Executive Vice-president,
Dear Commissioner,

The Spanish Government has sent the Commission a draft law for a new regulation on the electricity market that will reduce the revenues of non-CO2 emitting generation installed before 2005.

We believe that the draft law undermines very seriously the European Union legal and policy framework, notably in respect of the EU ETS and the internal electricity market. Specifically, in the following ways:

1. The proposed measure will create an important disincentive to investment in RES, at exactly the time that the EU needs to rapidly accelerate investment to have any chance of meeting the Green Deal objectives.

It is clear that in order to meet the Green Deal's 55% GHG reduction, the EU RES target will need to increase from 32% to at least 38%. This means that RES-E will need to increase from around 38% of the total electricity mix today to 62% or more by 2030. This will be hugely challenging, and the current measure will make this significantly more difficult, and not just in Spain.

Following the Spanish decision to retroactively reduce support for RES-E in 2013, investment in new projects stalled for more than six years and had an effect far wider than Spain. The effect was considered to be so significant and concerning by the EU, it explicitly made such measures illegal under the revised Renewable Electricity Directive in 2018.

The proposed measure will inevitably have a similar effect. Whilst currently limited to investments made pre-2005, the logic of the scheme means that, if accepted, investors must be concerned that governments could apply it to any asset, or any asset that a government considers has passed a 'reasonable' amortization period.

Investments in wind and PV over the next decades will require billions of Euros from the private sector. These investments take place because companies believe that they can make a fair return on their investments. This measure fundamentally prejudices that investment incentive and creates additional risk for investors.

The only result that can therefore occur from this measure is that investment will slow, and, in addition, for investments that do take place, the risk premium on capital for RES-E will increase, and that will feed through into higher RES-E and electricity prices. As such, the measure runs contrary to the requirements of the ETS system, and would create a very dangerous precedent that would undermine its effective functioning, and not just on the electricity market; it can be expected to have a far wider effect than simply on RES-E. If this mechanism is accepted, why should governments not place a similar windfall tax on assets outside the electricity sector? The proposal is thus not just contrary to the effective functioning of the ETS, it prejudices the achievement of the EU's Green Deal at a crucial time for investment in green electricity projects.

The mere announcement of the proposal has alarmed analysts and rating companies given that the measure will be credit negative for Spanish energy industry, the liquidity on the Spanish long-term wholesale power market could be reduced, and because this new change in the rules of the game affects investors' confidence.

2. The measure is likely to significantly distort the EU's Internal Electricity Market.

Article 3 of the Electricity regulation requires that Member States ensure that electricity markets are operated in accordance with the following principles: "*(a) prices shall be formed on the basis of demand and supply; (b) market rules shall encourage free price formation and shall avoid actions which prevent price formation on the basis of demand and supply*". This measure clearly runs contrary to these obligations, by introducing a pricing mechanism that changes the merit order based on 'recouping' ETS prices for certain generation.

This not only represents a measure contrary to the requirements of Article 3, and is discriminatory in nature, it will also have perverse and unpredictable consequences both in terms of market price formation and EU climate objectives. When bidding into the market in future, generators subject to the windfall tax will need to add the cost of the tax to their bid. This may have the perverse effect of actually taking them out of the merit order, resulting in additional fossil fuel generation than would otherwise be the case.

Furthermore, the proposed measures would represent an infringement of Article 3 (g) of the Regulation, which requires that Member States ensure that *"market rules shall deliver appropriate investment incentives for generation, in particular for long-term investments in a decarbonised and sustainable electricity system, energy storage, energy efficiency and demand response to meet market needs, and shall facilitate fair competition thus ensuring security of supply"*.

Spain argues that the proposed measures are compatible with EU law, based on a Court of Justice judgement of 2013, which considered that a windfall tax to take account of profits resulting from free ETS allowances from certain assets was legal. The current situation is, however, completely different from the one considered by the Court in 2013. In the 2013 case the tax - as a matter of fact - would not have the effect of dis-incentivising sustainable investment. As explained above, the contrary is true here. The Court was explicit that in order to be legal, the measures could not undermine the objectives of the ETS legislation[1]. It is very clear that the measures proposed by Spain will have such an effect.

3. The aim of Spain - reducing electricity prices and volatility - can also be achieved in a manner that does not create dis-incentives for future sustainable investment, distort the Internal Market and threaten the basic effectiveness and principles of the ETS mechanism.

Spain links a price mechanism for households, the 'PVPC', to the spot price, which creates huge volatility for these customers. This could be changed, for example, to a link to forward prices or another indexation, as is the case in other Member States such as France, Italy and Portugal. It could also, for example, reduce tax levels on electricity, or adopt other additional specific measures to protect vulnerable customers.

We urge the Commission to react to the Spanish Government's announcement and to express its concerns at a drat regulation that would undermine very seriously the objectives of the Climate Law and the Green Deal and that is contrary to the legislative framework in the ETS and the internal electricity market.

Yours faithfully,

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Cc:

- Maruo Petriccione, Director General, DG CLIMA
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- Diederik Samsom, Head of Cabinet, Executive Vice-president Timmermans
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[1] Judgment of the Court of 17 October 2013 in Joined cases C-566/11, C-567-11, C-580/11, C-620/11 and C-640/11. See, in particular, paras 42 and 44.