Draft Council Regulation proposing a price cap on electricity producers' market revenues COM(2022)473

Eurelectric position paper

September 2022

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:
- A vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- A smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

Dépôt légal: D/2022/12.105/35

Market & Investment Committee
Customers & Retail Services Committee

Contact:
Charlotte RENAUD – Head of Market & Customers –
crenaud@eurelectric.org
Alessandro ZAPPI – Policy Officer Wholesale Markets –
azappi@eurelectric.org

Draft Council Regulation for a price cap on electricity producers' market revenues COM(2022) 473

A Eurelectric position paper

September 2022

KEY MESSAGES

On 14 September 2022, the European Commission came with emergency electricity market intervention measures. This position paper provides technical input on one specific aspect of that proposal, the inframarginal revenue cap, as defined in section 2 (art. 6 – 10).

- **The proposed measure is not addressing the root cause of the energy price crisis: high gas prices.**
- **The proposed measure is based on the misconception that electricity producers are all exposed to high spot prices on the day-ahead markets**, while most production (in particular inframarginal production) is sold forward for hedging purposes aimed at reducing the price risk of the portfolio.
- **The proposed measure will therefore have a very limited impact in terms of collected revenues, while further fragmenting the internal energy market**, triggering important implementation challenges & requiring costly adaptations of IT & administrative processes.
- **To limit market distortions, the proposal should be adapted as follows:**
    - **Restrict the possibility for Member States to extend or introduce similar measures** and/or extend the list of eligible technologies; retroactive measures should be specifically prevented.
    - **Task the European Commission to assess existing measures and their compliance with the Regulation**
    - **Take into account the complexity of estimating "market revenues" to ensure a correct implementation of the price cap:**
        - **Consider all revenue streams across timeframes** (day ahead and intra-day markets, balancing markets, settlement of physical and financial instruments with different maturities, **across transactional instruments** (including but not limited to forward/future physical/financial hedging, OTC contracts, long-term bilateral contracts, internal transactions, proxy hedging, sales to end customers or retailers, PPAs etc.) and taking into account the **diversity in corporate structure and different jurisdictions**
        - **Estimate the average net market revenue value over a given time period** (minimum one month or ideally the foreseen delivery period of the measure) as a result of all electricity physical and financial transaction for that given period and apply the cap accordingly.
        - **Provide guidance on how to implement the measure on a portfolio hedging structure to avoid patchwork approach while allowing for sufficient flexibility to adapt to the different national and corporate realities:** a system

based on a self-assessment/declaration of the electricity producers and audit by NRAs is the way to go.

- **Exempt from the scope of the measure technologies with high variable costs** (biomass, oil, lignite) above the cap to avoid significantly distorting the merit order and endangering security of supply
- **Ensure that suppliers are fully and timely compensated when offering regulated retail prices below cost to fully cover suppliers' financial exposure**

- **The proposed measure creates huge political uncertainty for investments** & jeopardizes achievements of EU decarbonization targets
- **The asymmetry of treatment of exceptional revenues from electricity producers vs. oil, coal, gas and refinery sectors is regrettable**

Contents

Our understanding of the EC Proposal

Given that many of the elements remain somewhat open to interpretation, in this section we outline our understanding of the proposal.

We understand the following:

- The price cap **applies to all market revenues of electricity producers of inframarginal technologies** regardless of:
  - the market timeframe in which the transaction takes place;
  - the contractual form in which such electricity exchange takes place;
  - whether the electricity is traded bilaterally (OTC), in a centralised marketplace or with end customers.
  - And it excludes any support granted by the State.

- The proposed price cap therefore **applies to all the energy produced and the contracts settled during the period of application of the measure (01.12.2022-31.03.2023)**, both contracts that were entered into before the approval of the regulation and those approved after it. The date of delivery is the reference and the measure targets the physical feed-in.

- **The intent of the measure is to make sure that, whatever the way inframarginal electricity producers sell the energy produced, the maximum market revenue obtained by producers is 180 €/MWh**, to distribute surplus revenues according to Art. 9 and 10.
  - The same threshold applies for all Member States.
  - This figure is understood to represent an **average value for given time period** (minimum one month or ideally the delivery period of the measure). The application of the cap should consider the **net market revenues that a producer receives as a result of all electricity physical and financial transaction for that given period**.

- **The Regulation should clearly allow to implement such a cap based on a portfolio risk management approach**, across timeframes and hedging options for producers' output, as stated in Art. 6.2.

  - **The intention to avoid harming producers who do not actually benefit from the current high electricity prices** due to having hedged their revenues against fluctuations in the wholesale electricity market **is welcome**, as clearly stated in the recitals 28, 29 and 37 and in the definition of "market revenues" (Art. 2.5).
  - **However, this intention to take into account hedging options should be made clearer in the relevant articles.** Taking into account hedging transactions is key given that most revenues perceived for the delivery period under consideration in the Council Regulation proposal (1DEC-31MAR), comes from an important part of the production that has already been sold as part of the hedging activities which aim at reducing the price risk of the portfolio. In particular:
    - The cap mechanism should take into account that, in many cases, there is not a direct link between the production of a given plant and a specific

contract or hedge, therefore **the assessment of the market revenues from producers should consider the whole portfolio of hedging instruments.**

- The mechanism should also consider that risk hedging is sometimes directly carried out directly by the generation company that owns the asset, or indirectly through trading or retail subsidiaries, or even through a third-party in case of joint venture.
- **The application of the cap should therefore allow sufficient flexibility to adapt to the corporate structure to correctly assess the actual revenues of the producers and avoid that the same revenue is "taxed" twice".**
- See more explanations and concrete proposals in section 3 to limit implementation challenges and avoid a piece-meal approach.

Our assessment of the EC proposal

The inframarginal revenue proposal, as currently drafted, could distort wholesale market functioning, weaken the internal energy market and endanger the energy transition. We elaborate on how in the below section:

i. **Fragments the European electricity market & creates a patchwork of "allowed/uncaptured revenues":** Of concern, the proposal leaves the door open to Member States to maintain or introduce measures that further limit the market revenues of producers (Art. 6.4) and even extend the list of eligible technologies. It is surprising to see that the proposed solidarity contribution for the fossil fuel sector seems more protected against this accumulation risk[1]. We regret that the electricity sector is not protected to the same extent. First, the measure proposed for the latter is based on actual extraordinary profits (I.e., profits above the historical average), while the measure proposed for electricity ignores the complex functioning of this market and the actual costs. Second, the possibility for Member States to maintain existing measures that further limit the market revenues of producers, based on dramatically different price ranges and different eligible technologies, or introduce additional measures should be removed. Or at least, the European Commission should assess existing measures to ensure that they are consistent with this Regulation.

ii. **Affects producers' incentives:** Any price cap on a market is a distortive measure that could have important side-effects. If the cap on market revenues for inframarginal producers is too low, it could affect the producers' incentive to increase production and could in fact lead to less production and less available flexibility and, in general, erode the signals for an efficient dispatch.

iii. **Raises significant implementation challenges:** The lack of guidance on how to link contracts and hedges to production risks leading to a patchwork of national implementations and further fragment the Internal Energy Market. The foreseen implementation by 1st December is very challenging as it will require huge adaptations of IT & administrative processes.

iv. **Breaches investors' confidence and disincentivizes crucial investments needed in RES & low carbon capacities to reach EU decarbonization objectives** by changing the market rules at European level in a way that could create a patchwork of electricity markets and even by allowing MS to capture in addition electricity producers' revenues they do not have if the measures are badly designed.

[1] Article 13.2 "Member States shall ensure that existing or planned national measures sharing similar objectives as the temporary solidarity contribution under this Regulation comply with the rules governing temporary solidarity contributions set by this Regulation."

Concrete recommendations on the EC proposal

We believe the following measures would improve the proposal.

Guard internal electricity market integrity & avoid patchwork approach (Art. 6)

- Member States shall not be allowed to extend or introduce measures that further limit the revenues of electricity inframarginal producers and/or extend the list of eligible technologies. Retroactive measures should be specifically prevented.
- Existing national measures that are not aligned with the cap on revenues now defined and were introduced or whose application was extended after 31st August 2022 should be adapted to the proposed cap on revenues.
- As guardian of the Treaty, the European Commission shall analyse the existing measures in detail and assess their impact on the Internal Energy Market.

➔ **See our amendment 1 in Annex II**

Do not unduly harm hedging/risk management strategies through a too narrow definition of "market revenues" (Art. 2 & 6)

The measure is based on the misconception that electricity producers all benefit from high spot prices on the day-ahead markets. The reality is that, as ACER reported, most production (in particular inframarginal production) is sold forward for hedging purposes[2] aimed at reducing the price risk of the portfolio.

Therefore, generators are paid spot prices only for a fraction of their output if not fully hedged, and for the rest they receive the fixed pre-agreed prices. The same reasoning on hedging holds on the supply side (consumers), which is the natural counterpart of the generation side (producers), leading to many customers being protected against variations of the spot price. A large fraction of the electricity supplied in Europe in 2022 was contracted in 2021 or even earlier, before the price crisis started. Neither those producers nor their customers have been exposed to the increases of the spot markets.

Because of this reality, we doubt that the measure will raise anything like the €117bn anticipated. As a concrete demonstration, the similar measure implemented in Spain[3] since Sept 2021 was expected to collect 9€bn euro, while the actual amount raised between September 2021 and mid 2022 was only 366€Ms[4].

To estimate the market revenues of electricity producers, the complex relation between physical power generation and hedging of expected future power generation to mitigate risks should be duly taken into account in the Regulation. Indeed, risk management of the generation assets can be carried out directly by the generator itself, or indirectly, through retail or trading units of the same group. This complexity is further explained in Annex I through concrete examples.

[2] More than 80% of the electricity transactions happen in the forward timeframe
[3] Royal Decree 17/2021
[4] CNMC Settlement of Regulated Costs

Indeed, one should clarify that market revenues of producers over a certain period should be estimated by taking into account:

a. **various revenue streams across timeframes** (besides revenues from the DA market, if any, there will be sales in other markets, and settlement of physical and financial instruments of different maturities),
b. **across transactional instruments** (e.g. including but not limited to forward/future physical and financial hedging, OTC contracts, sales to end customers, long-term bilateral contracts, internal transactions, proxy hedging, PPAs etc.),
c. **taking into the corporate structure:** the application of the cap has to take into account the different corporate organisations to ensure that only the actual revenues are taxed and no revenues are taxed twice). For instance, in some cases, not all risk hedging is carried out by the entity owning the generation assets.
d. and **across different jurisdictions** (transactions can be carried out in different countries and subject to different supervisors and regulations).

A small example about possible economical consequences if market revenues are not well estimated:

A producer has a capacity that is expected to produce 1 TWh and has hedged 50% at 50 €/MWh, done before the crisis. Assuming that the price cap is 180 €/MWh, day- ahead price is average 500 €/MWh and the full production is exposed to day-ahead (incorrect assumption) gives the following

- *Uncapped Income of 500.000 MWh * 50 €/MWh + 500.000 MWh * 500 €/MWh = 275 M€*
- *Revenue to MS: 1.000.000 MWh * (500-180) €/MWh = -320 M €*
- *= Net income = - 45 M€*

Our understanding of an appropriate application of the mechanism in that example: Uncapped market revenue of the producer: 275 €/MWh (275 M€ for 1 TWh); surplus revenue: 95 €/MWh (= 275 €/MWh - 180 €/MWh); Revenue to MS: 95 M€ ; Net income = 180 M€

In conclusion, to avoid that such measure harms producers who do not actually benefit from the current high electricity prices because they have hedged their revenues against fluctuations in the wholesale electricity market, the following considerations are key:

1. **Do not underestimate the complexity to estimate "market revenues".** Different structural organizations might yield different challenges

2. **Allow for a proper estimation of "market revenues" taking into account:**

   - **Allow for a sufficiently broad definition/understanding of "hedging operations"** in the definition of "market revenues" (Art. 2.5.) & related provisions on the cap (Art. 6.1 & 6.2) to take into account various revenue streams across timeframes, across transactional instruments and taking into account corporate structures and jurisdictions.
   - **Apply the cap on average revenue value for given time period** (minimum one month or ideally the foreseen delivery period of the measure). The application of

the cap will consider the net market revenue that a producer receives as a result of all electricity physical and financial transaction for that given period.

- **Ensure that intragroup transactions are recognised as a hedging measure and therefore and included in the assessment of producers' revenues, as explained above.** The application of the cap should allow sufficient flexibility to adapt to the corporate structure to correctly assess the actual revenues of the producers and avoid that the same revenue is "taxed" twice"

➔ **See amendments 2, 3, 4, 5 in Annex II**

3. **Ensure the right balance between guidance provided for implementation on a portfolio hedging structure** (e.g. allocation of the allocate portfolio hedges to the right asset type, region etc) to avoid patchwork of "uncaptured/allowed" revenues **& allowing sufficient flexibility to adapt to the different corporate and national realities** to avoid that the same revenue is "taxed" twice": we recommend **a system based on a monthly self-assessment/declaration of the electricity producers and audit by NRAs** ➔ **See amendment 5 in Annex II** **& further details below**

The lessons learned from Spain, which has implemented a similar mechanism[5] since September 2021, could be of inspiration for the EU harmonized methodology on how to allocate portfolio hedges to the right asset type, region, etc…:

Ideally, the administrative burden and the costs of computing the market revenues of producers and of applying the revenue cap should be kept as low as possible for all stakeholders. As mentioned above, the necessary computations are not necessarily straightforward in order to take into account appropriately the various transactions across all timeframes.

Therefore, the Regulation should set forth that Member States shall apply the cap maximum on a monthly basis, or even only once for the entire period (1 Dec – 31 March), based on average hedge prices.
The system shall be based on a monthly self-assessment/declaration of the electricity producers and ex-post audit by NRAs

a. Electricity producers submit a monthly detailed statement to [their respective NRA] with:
   - **The production of their inframarginal plants during the month** (per group of technology and per country)
   - **Hedged volumes and average hedge price** (total volume sold/bought in the different markets, to end customers, to wholesale counterparties or via intragroup transactions, **with corresponding weighted average price** per group of technology, per country, per month.
   - **The comparison and settlement to assess contracts subject to the cap or not are hence performed by electricity producers on a monthly basis**. Making such assessment on a more frequent basis is extremely complex and burdensome as producers need to include not only transactions at different prices but also loss-making transaction (e.g. if to the actual production is lower than the energy sold

[5] Royal Decree Law 17/2021

forward there could be a loss when the energy is bought on the market - such loss should compensate the profit).

b. Electricity producers shall have the right to correct the self-declared data within a period of [3] months in order to accommodate for booking or administrative errors.
c. Electricity producers' statements may be audited by a third party
d. The national regulatory authority verifies the self-assessment based on a sample of contracts/customer bills.

Some specific comments/questions about the proposed definition of "market revenues" in Art. 2.5 and proposed cap in Art. 6:

- **An explicit definition of "support granted by State" is needed.** This should not be limited only to support schemes promoting RES (e.g. feed-in tariffs and two-way CfD), but also r**emuneration coming from capacity remuneration or strategic reserve schemes should be excluded** from the computation of "market revenue".
- **Any levy on the energy prices (like concession-type contributions, other contribution schemes, taxes and levies, etc.) should be excluded** from the 180€/MWh threshold

Need for a revised scope of application (Art. 7)

The recognition of the value of flexible technologies, such as hydropower plants, for security of supply and their exemption from the price cap is welcome.

However, we believe that the following points should be taken into account when it comes to the electricity generation sources subject to the cap:

<u>Dealing with technologies' costs above the cap</u>

As correctly underlined in recital 34, the cap on revenues should not apply to electricity generation technologies with high variable costs above the cap to avoid significantly distorting the merit order, as it can lead to:

- impacts on the forward market and changes to the value of financial hedges;
- distortion of cross-border flows;

This is particularly the case for biomass, oil and lignite plants because certain plants using them have variable costs - and *a fortiori* complete costs – way higher than 180 €/MWh.

A specific provision should therefore be added to handle the case of energy sources that are on the inclusion list (see Art 7(1)) but for which the associated production costs is nevertheless above the threshold. In case such a new provision would not be included, the associated capacities would not have any incentive to operate (since they would have negative margins) and such a situation would endanger security of supply (especially in a tense supply-demand balance).

An example of this issue is **biomass**. The equal treatment of biomass plants with other renewable energy technologies (such as wind, PV, hydro) should be avoided. Biomass plants are affected by sharply rising fuel costs and significantly higher maintenance costs. In any case, the marginal costs

of the technology are above the announced revenue threshold of EUR 180/MWh. As a result, the economic operation of biomass plants - which is necessary to ensure security of supply in the upcoming winter - would no longer be guaranteed. Therefore, biomass plants, as well as biogas plants, should be exempted from the revenue cap.

The same applies for **lignite** where the proposed fixed cap of 180€/MWh is not sufficient to cover variable costs. The situation can worsen considering a possible rise in the CO2 emission's price.

S**uch technologies should be excluded from the application of the cap provided for in Article 6(1)** **.** Adding the possibility for MS to set a specific revenue cap for producers producing from the sources listed in Article 7(1) who demonstrate to the regulatory authority that their current levelized costs of energy produced exceed the maximum set in Article 6(1) would be counterproductive. It would lead to distortion, and if applied, such cap should be variable to be able to adapt to the evolution of commodity prices, notably EUA price. Hence, a simple exclusion in this case from the list in Article 7(1) is preferable.

➔ **See amendments 6 & 7 in Annex II**

Updating EU legislation to meet the aim of the 'Save Gas for Winter' plan

The European Commission's 'Save Gas for Winter' Communication from July 2022 notes there is existing flexibility within the EU Industrial Emissions Directive (IED) for gas-fired electricity generation to switch to oil, which would help displace gas use while ensuring security of supply. This is welcome, but oil-fired electricity generation that could be used to displace gas but is under restricted operating hours under Limited Life Derogations in the IED, which comes to a complete end by 31 December 2023.

To meet the objectives of the EU's Save Gas for Winter plan, greater flexibility should be given to **Member States to allow for oil-fired generation to continue to operate during this winter, and upcoming winters if needed.**

➔ **See amendments 8, 9 & 10 in Annex II**

Use of revenues and retail price regulation (Art. 11 & 12)

We are particularly worried by the EC proposal that would allow Member States to re-introduce public interventions in setting retail prices beyond the existing EU legal framework: as such, the new proposal allow the limitation of end-user prices even below cost and not only to certain vulnerable households, but to all households as well as small and medium enterprises (SMEs).

We urge Member States to use the revenues collected through the revenue cap in order to provide **targeted relief to the most exposed customers**, i.e. vulnerable consumers but also enterprises. This could be done preferably through i) lump-sum direct payments, ii) by supporting investments in low-carbon and energy efficiency solutions, or iii) financing demand response/demand reduction schemes e.g. reverse auctions. In particulier, for companies, Member States could be given the option to finance a state guarantee fund allowing these customers, where appropriate, to provide suppliers with the financial guarantees necessary for the conclusion of a supply contract.

We strongly **oppose to any form of retail price regulation, in particular below cost, which would water down incentives to consume efficiently.** This across-the-board subsidy which is counterproductive to demand reduction measures (could even lead to higher consumption) and could therefore further jeopardize security of supply. We have well noted that the Commission proposes to allow retail price regulation below cost only if suppliers are "compensated". However, we believe that there is a high risk that such compensation could materialize too late and raise additional financial and operational burden for suppliers, who are already dealing with high costs and risks (e.g. insolvency risk of customers). Hence, it is very important to avoid triggering any domino effect that would **increase the risk of suppliers' failures, which would have serious systemic consequences**.

We suggest clarifying in art. 12 that if MSs allow retail price regulation below cost, then **suppliers should be fully and timely compensated through a clearly defined compensation plan (under the oversight of the competent authority) so as to fully cover suppliers' financial exposure.** → **See amendment 10 in Annex II**

Regarding the calculation formula proposed for the capped volume to be supplied to SMEs (based on an 80% of the highest consumption over the previous 5-year period), this approach is particularly burdensome and costly for suppliers (who would have to set up personalized retail tariff schemes for each SME, even though they might simply not have such data available). Furthermore, such approach would be also particularly unpredictable and distortive for SMEs. It would be much more efficient and less distortive that Member States directly provide direct **targeted payments to customers, for instance covering a small basic consumption level** (fixed, to be determined by Member States to cover the typical consumption of a vulnerable household). We suggest to **remove from article 11(a) of the EC proposal the following too prescriptive wording**: ~~*"be limited to 80% of the beneficiary's highest annual consumption over the last 5 years and".*~~

→ **see amendment 11 in Annex II**

Annex I – Key considerations about hedging

What is a portfolio hedging/risk management strategy and why it is needed?

It is essential to understand what a hedging strategy is to assess the implementation of this cap on revenues. Any producer, especially the ones that own inframarginal technologies (normally high CAPEX, low OPEX), will look at different tools available in the market to stabilise its long-term incomes.

Without trying to be exhaustive, here are the main risks that need to be managed:

- Obviously, there is the price risk. As we are all unfortunately very aware, the hourly energy price on the day-ahead market does vary considerably. Producers (and suppliers) have therefore an incentive to sell/buy energy in advance at pre-agreed prices.
- There is also the volume risk, which is significant for technologies such as wind and solar. Volume here can be referred to as the amount of energy actually produced in a specific time window (typically a year), but also subject to the hourly volume production variation.
- The combination of both aspects creates other types of risks related to the value of the energy during a specific time window (again, typically a year) for each technology. When there is a difference between the baseload profile (average price, figure commonly used in most of the hedging tools and forward markets) and the as-generated profile (production weighted average), the difference will usually be linked to the market price as a %. It is sometimes referred to as cannibalisation effect.
- And there are still other price-related risks, such as the balancing costs (usually defined as a % of the market price).

The hedging tools available are very varied:

- There are “natural” hedges, like building a diversified portfolio of technologies and assets, that will help reduce the volume and profile risks.
- There are contract hedges that usually try to transfer risk between counterparties. These contracts can be financial or physical, short or long term, with all kinds of variations in amount and type of risk transfer.

Non-electricity hedges or “Proxy hedges”

It is important to note that not all hedges are electricity contracts and thus the Regulation should also take into account different trading strategies, including non-electricity hedges or “proxy hedges”. Electricity producers will trade other more liquid commodities such as gas, coal or carbon as an implicit fuel hedge to act as a proxy for electricity due to limited forward liquidity in electricity markets. As electricity market liquidity increases nearer to the point of generation, producers will buy back their proxy hedges at the same time as they were able to sell their electricity output, which could be right up to the day ahead market.

A broad definition of hedging operations in Art. 2.5 is needed to include non-electricity hedges or producers could incur significant losses as their electricity market revenue is capped, but they will still need to buy back other commodities sold as a proxy for electricity.

Intragroup transactions and contracts/hedges entered into by other units of the group

Also, the Regulation should take into account that sometimes hedging is not carried out by the producer itself, but through other companies of the same group, such as trading or retail subsidiaries, for the benefit of consumers.

For example, a possible structure could be a generation and a retail/trading arm, linked by a contract at a given transfer price. In this case, intragroup transactions are netted out (e.g. the revenues of the generator would be offset by the payments of the trader/retailer, and the actual hedge would be provided by the contracts with third parties).

Therefore, compliance of market revenues of producers with the revenue cap could be demonstrated by any contracts and hedges of the generation unit or, when appropriate, with the contracts and hedges of other subsidiaries.

Any transaction at fixed prices, even if intragroup or with trader/retailer, should be considered as a hedge.

This illustrates the importance of adapting the process to the diversity of corporate structures and of underlying operational processes.

Hedges in the short-term markets

Example: For renewables projects hedging is realised in advance to secure visibility on cash flow. In a situation where volume produced is below estimated volumes (due, for instance, to lack of wind), the RES producer must buy on the market to deliver volumes sold forward. In such a situation the price paid by the RES producer can exceed significantly the 180€/MWh while revenues cannot exceed 180€/MWh. This would put many projects at risk.

The EC proposal mentions that market revenues should cover all timeframes. The computation of market revenue should allow the producer to include costs of buy backs they perform in day-ahead or intraday markets, in case of outages or lower production than expected.
We want to highlight that for activities in the intraday markets, it is very unlikely that producers will be able to link specific transactions to specific technologies: in general, the intraday activities are done for the portfolio (on a high-level country basis) as a whole and one cannot allocate transactions to specific assets (other than on a high-level country basis).

Therefore, a solution will need to be found, allowing producers to include revenues and costs for the intraday activities, keeping in mind the following issues:

- simply excluding the intraday would lead to market distortion (giving incentives to market participants to not participate in the day-ahead market and wait for the intraday, …).
- applying a normative approach would lead to risk for the producers in case they face important outages.
- applying a "per asset" strategy is unfeasible for intraday activities

Hedging & other contracts based on peak load price (PPAs, contracts with end customers)

It must be noted that not all the contracts and hedges have a baseload profile (i.e., the average of all hourly prices in the DA). This is particularly the case for power purchase agreements and contracts with end customers, which have a consumption profile that is not necessarily baseload. Moreover, the energy price in power purchase agreements can also cover the cost of imbalances, grid tariffs, etc.

The impact of a badly applied cap can be very negative on the retail market in general and on the PPA market in particular,

A very common type of PPA is a fixed price baseload contract. This is an agreement where the seller agrees to sell a fixed amount of energy evenly distributed along the contract duration (hence baseload contract) for a fixed price of €/MWh for every single MWh. With this structure, the seller still keeps some of the risks:

- Volume risk: if the underlying asset is a variable production asset (e.g., wind or solar), then the seller is at risk of not having enough energy (need to buy in the market) or having too much energy (need to sell in the market).
- Price risk: although the agreed price is fixed, the price risk is associated with the cannibalisation effect.

On top of that, depending on what has been agreed upon, there is also the matter of balancing costs, which are usually characterised as a % of the market risks.

It is common that when using this type of hedge, the agreed volume is less than the expected energy production (for example, 70%). This way, the volume risk is lower, and part of the other price-related risks (cannibalisation risk, balancing costs) are naturally hedged with some market-indexed income. Once the PPA is signed, the risk lies in high prices, not low prices. This volume can be associated with a specific asset or, more commonly, to the energy available to the seller in his portfolio.

Every hour, depending on the energy produced by the asset, the seller will have to buy from the spot market the missing energy or sell the excess energy to the spot market. Without a cap, both buying and selling are meant to lead to an estimated overall market cost that was assumed when signing the contract: the cannibalisation cost. As stated before, this is usually characterized as a % of the average energy price. Suppose a cap is applied to excess energy and not to the missing energy. In that case, buying the energy will have the same cost, but the value of the excess energy will be much lower, leading to a dramatic increase of the cannibalisation cost, converting the PPA into a liability instead of a hedging tool.

A concrete example to illustrate this risk:

- *As an example, assume a renewable company concludes a PPA with an industrial offtaker for 10 MWh at a fixed price of 50€/MWh for the next 10 years;*
- *When the renewable company produces – for example – 15 MWh (i.e. 'too much' renewable electricity compared to the contracted amount), it sells 10 MWh for the industrial offtaker and 5 MWh on the market at wholesale price.*

- *Similarly, in another period, when it produces 5 MWh (i.e. 'not enough' renewable electricity compared to the contracted amount), the renewable company must go on the market to purchase 5 MWh at market price.*
- *Without market caps on revenues, the sale of 5 MWh at a price and the purchase of 5 MWh at market price cancel out on average. However, assuming the wholesale price is 450€/MWh (above the cap), the cap would apply as follows,* ***negatively affecting the PPA****:*
    - *When selling, the renewable company would receive 5 times the cap = 5 MWh x 180 €/MWh.*
    - *When purchasing, the renewable company would pay 5 times the wholesale price (not the cap!) = 5 MWh x 450 €/MWh*
    - *This leads to a* ***total loss on average = 5 MWh x 270 €/MWh****.*

It is therefore key that a methodology is developed ideally to calculate the implicit baseload energy price of each contract, to compare it with the cap. This is very relevant, because if you just compare the final price with the cap, there is a risk to overestimate the revenues of the supplier and therefore to apply the cap incorrectly.

The basic elements of such a methodology should ideally be developed at EU level. Implementation at MS level should be based on EU guidelines to limit market distortions. The methodology should consider actual revenues for energy. Hence, it should not consider revenues linked to the passing through of regulated costs (such as grid tariffs), retail margin, etc.

If this is not done, the cap would severely impact the retail market (since a bad application of the cap would lead to additional costs being passed through to customers) and the renewable PPA market. In particular, we foresee the following effects:

- Developers and retailers may want to reopen existing contracts and make amendments to deals
- Competition on the retail market will suffer because of an inadequate allocation of costs.
- Negotiations for new PPAs and the deployment of renewable projects will stall
- Buyers will be disincentivised from signing long-term energy contracts
- Investors will lose confidence in the financial return for current and future renewable energy projects.

Annex II – Amendment proposals

Text proposed by Commission	*Amendment proposal by Eurelectric*
Amendment 1	
Article 6.4	
Original text	Original text +**amendments**
Without prejudice to paragraph 1, Member States may maintain or introduce measures that further limit the market revenues of producers, provided that these measures are proportionate and non-discriminatory, do not jeopardise investment signals, ensure that the investments costs are covered, do not distort the functioning of electricity wholesale markets, and are compatible with Union law.	Without prejudice to paragraph 1 **and article 7.2, Member States shall ensure that existing or planned national measures sharing similar objectives as the mandatory cap on market revenues under this Regulation are consistent with the objectives and critera set in this Regulation. The European Commission shall assess all existing measures to ensure that they are** proportionate and non-discriminatory, do not jeopardise investment signals, ensure that the investments costs are covered, do not distort the functioning of electricity wholesale markets, and are compatible with Union law.
Justification	
Of concern, the proposal leaves the door open to Member States to maintain or introduce measures that further limit the market revenues of producers and even extend the list of eligible technologies. This risks severely distorting the internal energy market. This possibility for Member States should ideally be removed. Or at least, the European Commission should assess existing measures to ensure that they are consistent with this Regulation. We propose to add "without prejudice to article 7.2" in order to exclude double taxation / contribution payments.	

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 2

Article 2.5

Original text	Original text +**amendments**
'market revenue' means realised income a producer receives in exchange for the sale and delivery of electricity in the Union, regardless of the contractual form in which such exchange takes place, including power purchase agreements and other hedging operations against fluctuations in the wholesale electricity market and excluding any support granted by the State;	'market revenue' means **average** realised income a producer receives in exchange for the sale and delivery of electricity in the Union, **net of any other cost pass-through or commercial margin, over a compliance period of one month or/the whole delivery period from 1st Dec 2022 to 31st March 2023**, regardless of the contractual form in which such exchange takes place, including **but not limited to sales to end customers,** power purchase agreements and other hedging operations**, such as hedges through financial or physical markets, intragroup trades, price options, proxy hedges**, against fluctuations in the wholesale electricity market, **carried out directly or through subsidiaries or other companies with the objective of hedging revenues of the producer,** and excluding any support granted by the State **and deducting any levy already paid to the authorities**

Justification

The proposed cap mechanism should take into account that, in many cases, there is not a direct link between the production of a given plant and a specific contract or hedge, therefore the assessment of the market revenues from producers should consider the whole portfolio. It means that the application of the cap should consider all revenue streams across timeframes , across transactional instruments (including but not limited to sales to end customers, forward/future hedging, OTC contracts, long-term bilateral contracts, internal transactions, proxy hedging, PPAs or any other transactions with suppliers/clients, etc.), taking into account different corporate structures (The application of the cap has to take into account the different corporate organisations to ensure that only the actual revenues are taxed and no revenues are taxed twice. For instance, in some cases, not all risk hedging is carried out by the entity owning the generation assets.) and different jurisdictions. The cap should apply on the average net market revenue value for given time period (ideally one month or the foreseen delivery period of the measure) as a result of all electricity physical and financial transaction for that given period.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 3

Article 6.1

Original text	Original text +**amendments**
Market revenues of producers obtained from the generation of electricity from the sources referred to in Article 7(1) shall be capped to ***a maximum of*** 180 EUR per MWh of electricity produced.	Market revenues of producers obtained from the generation of electricity from the sources referred to in Article 7(1) shall be capped **on average over each compliance period** to 180 EUR per MWh of electricity produced.

Justification

As mentioned above, this amendment aims at ensuring that the assessment of the market revenues from producers should consider the whole portfolio and should apply on the average net market revenue value for given time period (ideally one month or the foreseen delivery period of the measure) as a result of all electricity physical and financial transaction for that given period. We suggest removing "to a maximum of" to avoid 27 different sets of clawback rules to avoid deadweight effects and set strict rules for a truly harmonised mechanism.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 4

Article 6.2

Original text	Original text +**amendments**
Member States shall ensure that the cap targets all the market revenues of producers, regardless of the market timeframe in which the transaction takes place and of whether the electricity is traded bilaterally or in a centralised marketplace.	Member States shall ensure that the cap targets all the **net** market revenues of producers **resulting from all transactions, including financial transactions**, regardless of the market timeframe in which the transaction takes place and of whether the electricity is traded bilaterally or in a centralised marketplace.

Justification

Same justification as above: this amendment aims at ensuring that the assessment of the market revenues from producers should consider the whole portfolio and should apply on the average net market revenue value for given time period (ideally one month or the foreseen delivery period of the measure) as a result of all electricity physical and financial transaction for that given period.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 5

Article 6.X (new)

Original text	**Original text +amendments**
	(New) Member States shall apply the cap on market revenues on a monthly basis, or even only once for the entire period (1 Dec – 31 March), based on average hedge price, and based on a self-declaration of the electricity producers. Evidence of physical or financial contracts for electricity or other commodities used to act as a proxy to electricity shall be provided by electricity producers on a monthly basis / at the end of the application period and assessed by the relevant National Regulatory Authority to determine net revenues received. Revenues under assessment shall be retained by the producer during the assessment period to support liquidity of the sector

Justification

On top of the reasons mentioned above, this new paragraph aims at providing guidance on how to implement the measure on a portfolio hedging structure to avoid patchwork approach while allowing for sufficient flexibility to adapt to the different corporate structure: a system based on a self-assessment/declaration of the electricity producers and audit by NRAs is the way to go.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 6

Recital 34

Original text	Original text +**amendments**
The cap should not apply to technologies with high marginal costs relating to the price of the input fuel necessary to produce electricity, such as gas and coal-fired power plants, as their operating costs would be significantly above the level of the cap and its application would jeopardise their economic viability. To maintain the incentives to overall decrease of the consumption of gas, the cap on revenues should not apply either to technologies which directly compete with gas-fired power plants to offer flexibility to the electricity system and bid in the electricity market based on their opportunity costs, such as demand-response and storage.	The cap should not apply to technologies with high marginal costs relating to the price of the input fuel necessary to produce electricity, such as gas, **oil, lignite, biomass** and coal-fired power plants, as their operating costs would be significantly above the level of the cap and its application would jeopardise their economic viability. To maintain the incentives to overall decrease of the consumption of gas, the cap on revenues should not apply either to technologies which directly compete with gas-fired power plants to offer flexibility to the electricity system and bid in the electricity market based on their opportunity costs, such as demand-response and storage.

Justification

As correctly underlined in recital 34, the cap on revenues should not apply to electricity generation technologies with high marginal/opportunity costs above the cap to avoid significantly distorting the merit order, reduce incentive to operate (cf. negative margins) and as a consequence endanger security of supply (esp. in a tense supply-demand balance). This is particularly the case for oil, lignite and biomass plants because certain plants using them have marginal costs - and a fortiori complete costs – way higher than 180 €/MWh. Such technologies should be excluded from the application of the cap provided for in Article 6(1). Adding the possibility for MS to set a specific revenue cap for producers producing from the sources listed in Article 7(1) who demonstrate to the regulatory authority that their current levelized costs of energy produced exceed the maximum set in Article 6(1) would be counterproductive. It would lead to distortion, and if applied, such cap should be variable to be able to adapt to the evolution of commodity prices, notably EUA price. Hence, a simple exclusion in this case from the list of sources in Article 7(1) is preferable.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 7

Article 7.1

Original text	Original text +**amendments**
The obligation in Article 6 shall apply to the market revenues obtained from the sale of electricity produced from the following sources: (a) wind energy; (b) solar energy (solar thermal and solar photovoltaic); (c) geothermal energy; (d) hydropower without reservoir; ***~~(e) biomass fuel (solid or gaseous biomass fuels), excluding bio-methane;~~*** (f) waste; (g) nuclear energy; ***~~(h) lignite;~~*** ***~~(i)crude oil and other oil products~~***	The obligation in Article 6 shall apply to the market revenues obtained from the sale of electricity produced from the following sources: (a) wind energy; (b) solar energy (solar thermal and solar photovoltaic); (c) geothermal energy; (d) hydropower without reservoir; **(e)** waste; **(f)** nuclear energy;

Justification

As correctly underlined in recital 34, the cap on revenues should not apply to electricity generation technologies with high marginal/opportunity costs above the cap to avoid significantly distorting the merit order, reduce incentive to operate (cf. negative margins) and as a consequence endanger security of supply (esp. in a tense supply-demand balance). Same justification as above.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 8

Article 7.2

Original text	Original text +**amendments**
The cap provided for in Article 6(1) shall not apply to demonstration projects or to producers whose revenues per MWh of electricity produced are already capped as a result of State measures.	The cap provided for in Article 6(1) shall not apply to demonstration projects or to producers whose revenues per MWh of electricity produced are already **directly or indirectly** capped as a result of State measures.

Justification

Amendment proposed to ensure that any kind of State measures are covered since this should not be limited only to support schemes promoting RES (e.g. feed-in tariffs and two-way CfD), but also remuneration coming from capacity remuneration or strategic reserve schemes) *in line with recital 37 stipulating that existing producers that are already subject to that type of State measures should be excluded from the application of the cap on revenues.*

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 9

Article 7.X (new)

Original text	Original text +**amendments**
	(new) By way of derogation from the EU rules on emissions limits pursuant to Article 33 of Directive (EU) 2010/75/EU, Member States may exceptionally and temporarily allow electricity produced from crude oil and other oil products to ensure security of energy supply

Justification

The European Commission's 'Save Gas for Winter' Communication from July 2022 notes there is existing flexibility within the EU Industrial Emissions Directive (IED) for gas-fired electricity generation to fuel switch to oil which would help displace gas use while ensuring security of supply. This is welcome, but currently there is oil-fired electricity generation that could be used to displace gas while ensuring security of supply but is under restricted operating hours under Limited Life Derogations in the IED, which comes to a complete end by 31 December 2023. To meet the objectives of the EU's Save Gas for Winter plan, greater flexibility should be given to Member States to allow for oil-fired generation to continue to operate during this winter, and upcoming winters if needed.

Text proposed by Commission | *Amendment proposal by Eurelectric*

Amendment 10

Article 12

Original text

By way of derogation from the EU rules on public interventions in price setting, when applying public interventions in the price setting for the supply of electricity pursuant to Article 5(6) of Directive (EU) 2019/944 or Article 11 of this Regulation, Member States may exceptionally and temporarily set a price for the supply of electricity which is below cost provided that all of the following conditions are fulfilled:

(a) The measure covers a limited amount of consumption and retains an incentive for demand reduction;

(b) There is no ~~***discrimination***~~ between suppliers;

(c) Suppliers are compensated for supplying below cost;

(d) All suppliers are eligible to provide offers at the regulated price on ~~***the same***~~ basis.

Original text +**amendments**

By way of derogation from the EU rules on public interventions in price setting, when applying public interventions in the price setting for the supply of electricity pursuant to Article 5(6) of Directive (EU) 2019/944 or Article 11 of this Regulation, Member States may exceptionally and temporarily set a price for the supply of electricity which is below cost provided that all of the following conditions are fulfilled:

(a) The measure covers a limited amount of consumption and retains an incentive for demand reduction;

(b) There is **no distortion of competition** between suppliers;

(c) Suppliers are **fully and timely** compensated for **the revenue losses they incur for** supplying below cost **and for all types of offers (indexed or fixed price) under the oversight of the Competent Authority;**

(d) All suppliers are eligible to provide **all types of offers** at the regulated price on **a fair** basis.

Justification

We understand the need to set a temporary extension of public intervention to the benefit of SME to protect customers against the exceptional energy price crisis. However, the method for calculating regulated tariffs shall take forward prices into account. The main risk is not to be able to find suppliers as they will no longer be able to provide the necessary guarantees to sign contracts considering at such price levels. Therefore, suppliers should be fully and timely compensated

through a clearly defined compensation plan (under the oversight of the Competent Authority) so as to fully cover suppliers' financial exposure.

Text proposed by Commission	*Amendment proposal by Eurelectric*

Amendment 11

Article 11.a

Original text	
By way derogation from the EU rules on public interventions in price setting, Member States may apply public interventions in price setting for the supply of electricity to small and medium-sized enterprises. Such public interventions shall: (a) ~~***be limited to 80% of the beneficiary's highest annual consumption over the last 5 years and retain an incentive for demand reduction;***~~ (b) comply with the conditions of Article 5(4) and (7) of Directive (EU) 2019/944; (c) where relevant, comply with the conditions of Article 12 of this Regulation.	By way derogation from the EU rules on public interventions in price setting, Member States may apply public interventions in price setting for the supply of electricity to small and medium-sized enterprises. Such public interventions shall: **(a)** comply with the conditions of Article 5(4) and (7) of Directive (EU) 2019/944; **(b)** where relevant, comply with the conditions of Article 12 of this Regulation.

Justification

Regarding the calculation formula proposed for the capped volume to be supplied to SMEs (based on an 80% of the highest consumption over the previous 5-year period), this approach is particularly burdensome and costly for suppliers (who would have to set up personalized retail tariff schemes for each SME, even though they might simply don't have such data available). Furthermore, such approach would be also particularly unpredictable and distortive for SMEs. It would be much more efficient and less distortive that Member States directly provide direct targeted payments to customers, for instance covering a small basic consumption level (fixed, to be determined by Member States to cover the typical consumption of a vulnerable household).

Eurelectric pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Social Responsibility

- Transparency, ethics, accountability

Union of the Electricity Industry - Eurelectric aisbl
Boulevard de l'Impératrice, 66 – bte 2 - 1000 Brussels, Belgium
Tel: + 32 2 515 10 00 - VAT: BE 0462 679 112 • www.eurelectric.org
EU Transparency Register number: 4271427696-87