



## PUBLIC LAW | ENERGY AND NATURAL RESOURCES

# Exceptional mechanism for limiting the wholesale price of electricity

[Decree-Law no. 33/2022, of 14 May](#) (“DL 33/2022”), which establishes the exceptional and temporary mechanism for adjusting the costs of electricity production within the scope of the Iberian Electricity Market (“MIBEL”) was recently published.

The diploma was published simultaneously with the publication, in Spain, of [Real Decreto-Ley 10/2022, of 13 de May](#), with a similar scope and content, expressing a unique response to an Iberian common problem: the high and rising prices of electricity.

The Spanish diploma is much more detailed than the Portuguese one, namely because this measure requires a review of the rules of the MIBEL daily and intraday market, operated by OMIE, which is governed by Spanish law (“OMIE”).

**The diploma expresses a unique response to an Iberian common problem: the high and rising prices of electricity.**

**Background:**

DL 33/2022 comes in the context of a sustained and unprecedented spike in electricity prices, motivated by the fast recovery of the economy after the Covid-19 pandemic scenario and the invasion of Ukraine by Russia.

From an average price of €47.67 / MWh in 2019, the OMIE market price reached, in 2021, a value of €111.90 / MWh and, in the first four months of 2022, an average value of €219.19 / MWh.

This led Spain and Portugal to claim before the European Union for the approval of a temporary mechanism for temporarily limiting electricity prices (“**Mechanism**”). Spain led this process, as it is especially affected by the exponential increase in electricity prices, since, unlike in Portugal, in Spain the variation in prices in the OMIE directly affects all consumers, including the especially vulnerable.

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On April 26, 2022, a political agreement was reached between the Iberian countries and the European Commission to create the Mechanism, taking into account the fact that the Iberian Peninsula still functions, due to its deficient interconnection capacity with France, as an energy island.

The Mechanism is adopted in a simultaneous and coordinated manner in the Iberian Peninsula.

### **Purpose:**

The objective of the Mechanism is to “decouple” the wholesale price of electricity from the price of natural gas, with a view to mitigating the current instability in prices.

As OMIE is a marginal market, it is the technology with higher marginal costs of production needed to supply demand at a certain time that determines the price that all production units receive at that time – and that, in the end, consumers will bear.

Due to the peak in the price of natural gas, gas-fired power plants have more frequently acted as a marginal technology, thus raising the price received by the other technologies they sell on the market, at the head of which, in Portugal, the large hydroelectric plant (since most wind farms still sell at a fixed tariff and there is still little installed solar capacity).

Thus, the Mechanism’s purpose is to limit the gains that other electricity producers receive through the high price of natural gas.

### **The Mechanism:**

#### **1. What is it**

The Mechanism consists of setting a threshold on the price of natural gas that the natural gas plants covered must consider when making offers to sell energy on the market.

This threshold is set at €40/MWh of natural gas for the first six months of application of the Mechanism, then increasing by €5/MWh per month until reaching €70/MWh in the last month.

In the mechanics created in the diploma, this threshold is created by the imposition of gas plants to internalize the part in which the cost of acquisition of natural gas exceeds the reference price referred to in the previous paragraph.

A price of €40/MWh of natural gas will form, at current CO<sub>2</sub> prices, a final wholesale electricity price of between €120 and €130/MWh, well below the average market price of OMIE in the first four months of the year.

## 2. To whom it applies

The price threshold applies, in Portugal, to combined cycle plants and cogeneration plants under market regime, as long as they sell the energy generated on the organized market (“Gas Power Plants”).

Portuguese law does not distinguish between the source of cogeneration plants, namely not excluding biomass plants, although the logic of the Mechanism points in this direction. Paradoxically, the Spanish Real Decree-Ley states that only Portuguese natural gas cogeneration plants are included.

In Spain, the Mechanism also applies to plants other than combined cycle plants, namely coal-fired and cogeneration thermoelectric plants.

The Mechanism does not apply to gas and cogeneration plants that sell energy through physical bilateral contracts, with regard to the energy covered by that contract, since this is not decisive for the formation of the price in the OMIE.

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## 3. Effect of the price threshold of Gas Power Plants

The price threshold applicable to Gas Power Plants (and coal plants in Spain) will have the effect of ensuring that, whenever natural gas is the marginal technology (the most expensive unit to cover demand), the OMIE market price does not will exceed this threshold.

As a result, the gains of the other plants that sell energy on the market (inframarginal plants) are limited and, globally, the wholesale price of energy is reduced – considerably, if we consider the average prices of the first four months of 2022. electric.

In Portugal at least, the Mechanism does not seem to prevent other power plants, including large hydroelectric plants, from offering above the price offered by gas-fired power plants. However, considering that large hydroelectric plants normally offer at a price close to that of the plant with higher marginal costs (in this case, gas power plants), the Mechanism is expected to lead, indirectly, to the reduction of the offer price of the hydroelectric plants by setting the gas price ceiling to be considered in the offers on the market.

#### 4. Right of Gas Power Plants to receive the Adjustment

Gas Power Plants (as well as other plants covered by the Mechanism) are entitled to receive the additional costs of natural gas acquisition, in a parallel assessment. Said amount result from the difference between the natural gas market price in each day and the price threshold regarding the units sold (the “Adjustment”).

The Adjustment ensures that the marginal prices of Gas Power Plants are covered (although it does not cover the amortization of the fixed costs of these power plants, insofar as the producers wanted to pass it through the consumers).

The member of the Government responsible for the energy sector is given the power to change the value or methodology for calculating the relevant natural gas market price for the purposes of the Adjustment.

#### 5. Payers of the Adjustment

The Adjustment is paid by the market agents operating in the buyers’ market (retailers or customers who buy directly in the wholesale market) and benefit from the market price reduction, which are all those who are exposed to variations in the daily market price (OMIE).

**Buyers who have fixed value forward contracts are exempt from the payment of the Adjustment.**

Thus, buyers who have fixed value forward contracts entered into until 26 April 2022 with other market agents or with final consumers (concluded in the organised market or over-the-counter) shall be exempt from this obligation in the part in which they are covered or have ensured the coverage of their clients, because they do not immediately benefit from the reduction of the market price. This situation remains until the amendment or expiry of the contracts.

This is to ensure that the Mechanism is financed only by those who benefit from it and does not harm those who prevented themselves before knowing the Mechanism would be enacted.

Although the market players financing the Mechanism are expected to pass it on to the final customers, the overall final price will still be lower because only the plants covered by the Mechanism receive the additional cost of gas compared to the reference price.

Electricity consumption for storage (including pumping) and auxiliary systems of power plants are exempt from the payment of the Adjustment, in order to avoid a double penalisation of producers.

#### 6. Responsible for the assessment of the Adjustment

The assessments of the Adjustment are performed by the daily market operator (OMIE), which will also collect the payment of the Adjustment from the buyers’ that are subject to said payment as well as pay the Gas Power Plants the corresponding amounts.

The parties responsible for the payment of the Adjustment must provide OMIE with guarantees covering the expected costs of the Adjustment.

**Market agents must communicate the fixed price  
contracting instruments within 5 business days.**

### 7. System services

The Spanish diploma sets forth that the offers made by the Gas Power Plants in the system services market shall also be subject to the price threshold. The Portuguese diploma merely refers, on this point, to the Manual of Procedures for the Global Management of the System.

### 8. Next steps – disclosure on existing contracts

Within 5 business days of the entry into force of the Decree-Law, that is, by 20 May, any market agents with fixed price contracting instruments (bilateral or on the organised market) must provide OMIE and Rede Eléctrica Nacional, S.A. with the information on the contracting, and they must specify the instruments, maturity and associated volumes.

The format of the communication was approved by the Energy Services Regulatory Entity (ERSE) through [Directive no. 11/2022](#) of 14 May and, in the case of the Spanish law, the format of the declaration and its annex were made part of Annex II of Royal Decree-Law 10/2022 of 13 May.

### Entering into force

Decree-Law no. 33/2022 entered into force on 15 May 2022.

Although the Portuguese law does not provide for it, it is expected that the Mechanism will only begin to operate following its official approval by the European Commission, in terms of its compatibility with the internal market, in accordance with Article 1 and the First Final Provision of Real Decreto-Ley 10/2022, which is an indispensable condition for OMIE, governed by Spanish law, to begin applying the Mechanism.

The Mechanism shall be in force until 31 May 2023, except if the Portuguese and Spanish Governments agree in an earlier date for such. ■