Impact of the Circular (Official Notice) on the remuneration of electricity transmission grids required for the Energy Transition and the National Integrated Energy and Climate Plan

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The Proposed Circular (Official Notice) issued by the Spanish National Markets and Competition Commission (CNMC) on 5 July, establishing the methodology for calculating the remuneration of the electrical energy transmission activity, introduces a series of relevant modifications to current regulations that do not favour the fulfilment of the strategic priorities established by the Government in energy matters.

This Circular introduces a high level of uncertainty regarding the remuneration of investments and incorporates a high degree of discretion regarding critical actions for the deployment of the energy policy and is discriminatory with the electricity transmission activity.

In addition, it could hinder the energy transition and the fulfilment of the National Integrated Energy and Climate Plan, since it does not establish a clear, stable or predictable regulatory environment.

Lastly, it does not recognize the incorporation of new technologies and innovation in the maintenance activity as an incentivising factor.

1. Differences with the MITECO's energy policy guidelines

The Ministry for Ecological Transition established in Order TEC/406/2019, of 5 April, the energy policy guidelines for the Spanish National Markets and Competition Commission (CNMC).

In these guidelines, and with regard to the Circular on the Methodology for the Remuneration of Electricity Transmission, it is stated, among other things, that:

a) To ensure the sustainability of the electricity system and the security of supply, the new methodology should ensure that changes introduced in the methodology are accompanied by mechanisms that allow they be gradually absorbed (Article 6, 1)

b) With the objective of enabling renewable energy penetration within the electricity system and thus be able to meet the energy and climate targets, the methodology should adequately remunerate the new investment needs that derive from the 2021-2026 Planning, both in terms of volume and in terms of their nature (assets for smart grid management) (Article 6, 2)

c) It is also stated that the remuneration should incentivise extending the operation of those facilities that have exceeded their remunerated useful life, in order to contribute to the optimal management of national resources (…) and keep the assets already built and amortized in conditions suitable for operation, avoiding having to replace them at a higher replacement cost. (Article 6, 4)

Red Eléctrica considers that the Proposed Circular on the Methodology for the Remuneration of Electricity Transmission could represent an infringement of points 1, 2 and 4 of Article Six of Order TEC/406/2019, of 5 April, which establishes the energy policy guidelines for the Spanish National Markets and Competition Commission.

2. Measures that do not favour the fulfilment of the energy transition and the National Integrated Energy and Climate Plan

a) New calculation of the maximum investment limit

One of the changes foreseen in the Proposed Circular is the incorporation of a new formula for calculating the maximum annual investment limit for the electricity transmission activity. In the previous model, the reference indicator was GDP, while the new methodology puts forward the use of a combination of variations in demand (70% increase) and in forecasting the penetration level of renewable energy (30% of increase).

This change represents a reduction (with respect to Royal Decree 1047/2013, of 27 December, which established the methodology for calculating the remuneration for the electricity transmission activity) of its maximum amount, as indicated in the Draft of the Circular on page 24:

"The sectoral limits that would be obtained by applying the new methodology would be lower than those resulting from the application of Royal Decree 1047/2013".

b) Remuneration and return on investments

The return on investments (both past and future) will be reduced during the next regulatory period by the new financial remuneration rate contemplated in the Proposed Circular that establishes the methodology for calculating the financial remuneration rate published by the CNMC. The new rate entails reducing the return on investments from 6.503% to 5.58% as of 2021, although the rate in 2020 would be 6.003% as a result of Royal Decrees 1047/2013 and 1048/2013 (remuneration models for electricity transmission and distribution, respectively) which established that "in no case may the proposed variation of the financial remuneration rate used between two consecutive years be greater than 50 basis points in terms of absolute value".

c) Decrease in remuneration for maintenance of facilities (O&M)

The revenues related to the maintenance of the assets is expected to be adjusted by means of an additional Circular that will establish the investment and maintenance unit values to be applied in the next regulatory period. Despite this, the Draft of the current Proposed Circular sets out a significant reduction in revenues in this field. Specifically, section 8.1.2 of the Circular states that remuneration for maintenance will decrease from €430 million in 2019 to €364 million in the first year of application of the Circular.

On the other hand, the Circular establishes a reduction in O&M revenues based on the costs incurred in the last year for which information is available. An activity with a high cyclical component would advise to carry out an analysis of the costs of the O&M activity taking as reference a broad multi-year period.

d) Remuneration of assets that end their useful life

The Proposed Circular does not consider the investment remuneration for assets that end their useful life in 2023.

The Proposed Circular, in order to incentivise extending the operation of those facilities that have exceeded their remunerated useful life, maintains what was already set out by Royal Decree 1047/2013 and which consists of an increase in the remuneration for maintenance (starting with a percentage of 15% during the first 5 years and that then increases year by year by 1%, 2% or 3% as appropriate).

This remuneration, conceptually, simply returns the additional maintenance cost incurred by the transmission agent in order to keep in service facilities that have exhausted their useful life. However, extending the operation of facilities that have exceeded their remunerated useful life and that continue to provide service to the system cannot be considered an economic incentive.

On the other hand, it contemplates the possibility of renovating facilities that have surpassed, or are close to exceeding their useful life, according to their date of commissioning. However, requirements and deadlines for carrying out renovations are introduced, which will prevent them from being carried out with the necessary agility in order to guarantee that the facilities can provide service under the conditions required by the Energy Transition. Additionally, the Circular incorporates a level of discretion on the part of the CNMC for the approval of this type of investment, which in turn introduces a high level of uncertainty regarding the viability of the renovation actions.

e) Non-remunerated investments

The Proposed Circular indicates in Article 14.4 that:

"In general terms, the system will not assume any remuneration cost for investments for those facilities included in the Planning by means of Agreement of the Council of Ministers, given that their inclusion in the Planning necessarily requires that said facilities be financed and assigned by third parties, being the promoter who must assume the investment costs, both of the concrete action and of all those facilities and reinforcements necessary to comply with the regulations of the sector".

f) Remuneration limit of European Union subsidies

Article 12 of the Proposed Circular establishes a remuneration limit of €5 million regarding the subsidies that come from the European Union. In particular, it states:

"In the event that these public aids come from European Union bodies, this value will be 90 percent of the amount received. In no case may the margin of 10% to be considered for the electricity transmission companies be greater than €5 million."

The previous model allowed the transmission agent to retain 10% of such subsidies, as an economic incentive to obtain them. The Proposed Circular maintains this percentage, although it limits the amount to be retained by the transmission agent to 5 M € (per project). This measure again reduces the return on the investments with respect to the previous model and disincentivises the transmission agent from obtaining such subsidies. Far from increasing the efficiency of the Spanish transmission agent, this measure will be increasing the efficiency of European transmission agents that will be able to benefit from the funding that Red Eléctrica will not receive and consequently will increase the cost that Spanish consumers will have to bear.

g) Economic Incentive for grid availability

The Proposed Circular maintains the same methodological basis for the economic incentive for grid availability set out in Royal Decree 1047/2013. The methodology consists of comparing the availability of each year with the average availability of the 3 previous years (0.5 was subsequently subtracted from the final figure) and with an 'availability target'. However, the Proposed Circular increases the availability target from 98.5% to 99% and eliminates the reduction of 0.5 from the average availability of the previous 3 years.

This mechanism is not justified, as obtaining good availability rates in a given year penalises future incentives, resulting in a financially inefficient relationship between the cost overrun associated with achieving these rates and the low economic incentive or even the penalisation it may entail.

The Draft of the Circular (article 8.1.5) estimates the impact of the change of this parameter, reducing the estimated economic incentive from 8 to 2 million euros.

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