Ordinance pursuant to section 26 of the Energy Security Act on a financial compensation by means of a balanced price adjustment

I. Background

The tense situation on the energy markets has taken a sharp turn for the worse as a result of Russia's attack on Ukraine in violation of international law. As a result, gas import volumes from Russian suppliers to Germany have already been reduced in recent months. The federal government believes further reductions in supply volumes are likely to be imminent. This situation is correlated with a huge increase in the price of gas.

As gas importers remain obligated to deliver to their customers in the event of a supply disruption and cannot pass on their costs for procuring alternative supplies to their customers in the absence of contractual agreements to that effect, they are facing challenges. In order to protect such importers from the risk of becoming insolvent and thus ensure the continued proper functioning of the energy market, the Energy Security Act (***EnSiG***) has been amended twice in recent months. In the form of section 24 EnSiG, the Act Amending the 1975 Energy Security Act and Other Energy Industry Regulations, which entered into force on 22 May 2022, establishes a statutory right to adjust prices. Accordingly, gas importers can pass on costs for procuring alternative supplies to their customers, irrespective of their contractual agreements, provided the federal government triggers an alert or emergency level and a significant reduction in gas import volumes to Germany is determined by the Federal Network Agency (*BNetzA*). This regulation has met with harsh criticism from the energy industry. Hence, effective 8 July 2022, the EnSiG has been amended again. Section 26 EnSiG as amended now enables the federal government to regulate by ordinance that the statutory right to adjust prices pursuant to section 24 is replaced by financial compensation to be paid to affected gas importers, with such compensation in turn being financed by a balanced price adjustment, i.e., by a charge on gas consumption. The federal government has the authority to issue an ordinance as early as a significant reduction in imported gas volumes is imminent.

The federal government has now identified such a situation and has therefore, on the basis of section 26 EnSiG, adopted a Gas Price Adjustment Ordinance (***GasPrAnpV***), which was promulgated on Monday, 8 August 2022, and will come into force on 9 August 2022.

II. Provisions of the Gas Price Adjustment Ordinance

The Gas Price Adjustment Ordinance establishes a compensation mechanism based on two legal obligations. Firstly, there is the legal obligation between the importers concerned and the market area manager, which aims at financial compensation; secondly, there is the legal obligation between the market area manager and the balancing group managers concerned, which aims at the payment of the gas procurement neutrality charge.

Financial compensation

Section 2(1) GasPrAnpV establishes a compensation claim aimed at financial compensation for the additional costs incurred for procuring gas from alternative sources.

Pursuant to section 2(1) sentence 1 GasPrAnpV in conjunction with section 26(5) EnSiG, the persons **entitled to claim** such compensation are energy supply companies (gas importers) directly affected by the significant reduction in gas volumes imported to Germany. Pursuant to section 2(1) sentence 3 GasPrAnpV, these must also have had their registered office in a member state of the European Union or the European Economic Area, in the United Kingdom of Great Britain and Northern Ireland or in the Swiss Confederation since 1 May 2022 and at the time the relevant compensation claim is asserted. Pursuant to section 2(1) sentence 2 GasPrAnpV, those gas importers are excepted who themselves also supply other gas importers and contribute to the reduction of gas import volumes because they fail to deliver gas volumes that are subject to binding contracts to other gas importers. This is to prevent those stakeholders who (also) make the gas procurement neutrality charge a necessity from benefitting from it.

Pursuant to section 2(3) GasPrAnpV, the **party liable to make a claim** is Trading Hub Europe GmbH (THE) as the market area manager.

The **subject matter of the claim** is financial compensation for the additional costs of procuring alternative supplies that a gas importer must incur in order to comply with a continuing delivery obligation to its customers or to meet an obligation to minimise damage. The compensation claim does not apply to all costs for procuring alternative supplies but is subject to a **double time limitation**: Firstly, pursuant to section 2(1) sentence 2 GasPrAnpV, it only covers the fulfilment of contractual supply obligations for the physical delivery of gas in the German market area that has been contractually fixed prior to 1 May 2022. Secondly, section 1(2) GasPrAnpV prescribes a balancing period between 1 October 2022 and 1 April 2024. The time restriction is based on the federal government's assessment that the market will re-consolidate by 1 April 2024, eliminating the need for the allocation of costs. Furthermore, the compensation claim is not granted to gas importers in full, but a lump sum of 10 percent is deducted as the gas importer's personal contribution. According to the explanatory memorandum to the Ordinance, this risk sharing is intended to create an additional incentive for procuring alternative supplies in a cost-efficient manner.

The restrictive **substantive preclusive time limits** under the Gas Price Adjustment Ordinance must be observed: Compensation claims can only be asserted if the gas importer concerned has notified THE of the existence of its claims within four working days of the promulgation of the Ordinance pursuant to section 2(8) number 1 GasPrAnpV; in addition, pursuant to section 2(8) number 2 GasPrAnpV, it has to submit, by the fifth working day of a month, for the first time within four working days of the promulgation of the Ordinance, a forecast of the expected amount of its compensation claims for the remaining part of the balancing period, including the values on which this is based, on what is referred to as a forecast survey form published by the Federal Network Agency.

Gas procurement neutrality charge

The costs incurred as a result of the compensation payments are reimbursed to THE in accordance with section 3 GasPrAnpV in the form of a gas procurement neutrality charge. The gas procurement neutrality charge is levied on **physical exit quantities of gas** for exit points with interval-metered load profile (*registrierender Leistungsmessung, RLM*) and for exit points with standard load profiles (SLP), i.e. on physical exit quantities delivered to final consumers. The charge is owed to THE by those balancing group managers to whose balancing groups the relevant physical exit quantities are attributable. The **interim financing** requirements arising from the allocation will be secured by guarantees and loans from KfW. According to the explanatory memorandum to the Ordinance, the federal government currently expects a liquidity requirement of up to 18 billion euros, depending on the volume of alternative supplies to be procured by gas importers and market prices.

The THE is subject to an **economic efficiency requirement**, i.e., when calculating the charge pursuant to section 5(2) GasPrAnpV, it can only take into account those costs incurred by it which are necessary for the implementation of the compensation mechanism. In addition to the payments of the financial compensation, these are, for example, necessary costs for settlement as well as necessary personnel costs.

The balancing group managers are required to pay the charge on the basis of monthly invoices; payments shall be **due** ten working days after invoicing. In the event of payment arrears that are not settled despite reminders and threats to terminate the balancing group contract, the market area manager shall be entitled to terminate the balancing group contract under the conditions set out in section 6(4) GasPrAnpV. It is therefore advisable for balancing group managers to pay the charge (under reserve) even if there are doubts about its legality.

Passing on of costs to final consumers

Unlike section 24(1) sentence 3 EnSiG, the Gas Price Adjustment Ordinance **does not grant** the balancing group manager a **statutory right** to pass on the additional costs resulting from the gas procurement neutrality charge to final consumers along the supply chain. Whether and to what extent a balancing group manager will be able to pass on its costs will largely depend on whether the balancing group manager has agreed effective contractual price adjustment mechanisms with its customers or whether general legal concepts, such as frustration of contract (*Störung der Geschäftsgrundlage*), are applicable.

The **amount of this cost sharing** to be borne by final consumers is still unclear at present. It will depend on the extent and prices of alternative supplies to be procured; in the explanatory memorandum to the draft Ordinance, the German Federal Ministry for Economic Affairs and Climate Action estimates that the costs to be allocated will range from 1.5 to 5 ct/kWh.

According to the current legal provisions, **value added tax** (VAT) at a rate of 19% will additionally be charged on the costs possibly passed on to final consumers. This is due to the concept of the gas procurement neutrality charge outlined above: like in the case of the EEG surcharge, it is not just a 'transitory item' not subject to VAT by which the company collects amounts in the name and for the account of another person. Instead, the energy supply companies calculate prices at their own discretion and responsibility. The passing on of costs in the context of this price calculation results in an increase in the tax assessment basis and is therefore VAT-relevant. In the current political debate, it is being considered to provide relief to final consumers from this additional VAT. However, due to the requirements of EU law (harmonisation of VAT law), changes in law will only be possible under limited conditions.

III. Conclusion and outlook

Even after the enactment of the Gas Price Adjustment Ordinance, there are still open questions. This concerns, first of all, how things will actually develop independently of the Ordinance: it is currently uncertain whether and to what extent there will be further reductions in gas import volumes from Russian suppliers to Germany. On the one hand, this uncertainty poses challenges for the companies affected; on the other hand, the impacts on society as a whole cannot yet be predicted. In the event that importers will be affected more severely, for example due to a rapid price increase or acute gas shortage, further measures can be expected.

In this context, the German Federal Ministry for Economic Affairs and Climate Action and the German Federal Network Agency have already announced to introduce a gas auction model as a new additional balancing gas product: the plan is that balancing group managers will be able to make offers to provide gas volumes via THE's balancing gas platform and that THE will be able to make use of these offers in the event of restrictions. The lowest bids will be successful, as in an auction. The idea is to give industrial consumers for the first time the opportunity to make their shut-down potential available to the balancing market and thus provide as much gas as possible for any situations this winter when restrictions could arise. The auctions are planned to be launched at the end of summer/beginning of autumn, i.e., before the start of the heating season. The balancing gas product can be introduced without legal amendments and is not subject to approval from the Federal Network Agency. Furthermore, according to the explanatory memorandum to the Ordinance, the federal government has agreed that further relief measures for the benefit of final consumers shall be implemented.

Moreover, there is an urgent need to take action in legal matters resulting directly from the Ordinance:

- On the part of the gas importers, this concerns the question of pro rata cost bearing, the substantive preclusive time limits which are partly restrictive, and the obligation to enforce claims for damages, including the repayment obligation, in the event of a breach of duty if such claims are more likely than not to be successful.
- Balancing group managers should assess whether they are contractually entitled to pass on the costs of the neutrality charge to their customers and whether they have sufficient funds to settle pending claims of market area managers without falling into arrears. In this respect, default suppliers face particular challenges because, due to section 5(2) sentence 1 of the German Gas Default Supply Ordinance (*Gasgrundversorgungsverordnung - GasVV*). they must inform final consumers of price adjustments six weeks in advance (before 1 October 2022). Since the GasVV stipulates that final consumers must be notified by letter, printing companies are said to have already expressed doubts as to whether it will be possible to send the mailings to almost 25 million customers on time in the coming weeks, as we understand from the Federal Ministry for Economic Affairs and Climate Action.
- In addition to the uncertainty about how things will actually develop and the urgent need to take action in legal matters, there are discussions about whether the neutrality charge can be passed on to final consumers who have entered into fixed-price contracts or contracts with special clauses on government-imposed surcharges. According to consistent media reports, another amendment of the EnSiG after the end of the summer recess of the German parliament in September is being considered as a solution.

The full text of the Gas Price Adjustment Ordinance is available here (German version).

IV. Update 15.08.2022

On Monday, August 15 2022 the THE determined the amount of the gas procurement neutrality charge pursuant to Section 4(1) GasPrAnpV for the first time. The amount will be **2.419 ct/kWh** (24.19 EUR/MWh) and will be charged from October 1 2022 on all gas quantities withdrawn daily from a balancing group for withdrawal points with registered power metering (RLM) and for withdrawal points with standard load profiles (SLP). According to the Federal Ministry for Economic Affairs and Climate Action, **twelve gas importers have staked out claims for a total of 34 billion Euros** to offset their gas replacement procurement costs as part of the forecast pursuant to Section 2(8) number 1 and number 2 GasPrAnpV for the levy period ending on April 1 2024 and will consequently participate in the levy procedure.

German Finance Minister Christian Lindner has asked EU Economic Commissioner Paolo Gentiloni to exercise his **initiative right** and **exempt Germany from the obligation to levy VAT on the gas procurement neutrality charge**. Regardless of the outcome, Lindner announced that he would **apply for the introduction of special measures for derogation** in accordance with Article 395(1) of the Value Added Tax Directive (***VAT Directive***, RL 2006/112/EC).

Moreover, the Federal Ministry for Economic Affairs and Climate Action is examining how to deal with **fixed contracts** that do not allow additional charges or increases, as well as **extending the gas procurement neutrality charge to district heating customers**. Besides the GasPrAnpV, the federal government is planning **further ordinances on short term measures**, including energy-saving measures for residential tenancies, companies and public buildings, to be applied as of September 1 2022 - **as well as on medium term measures**.

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