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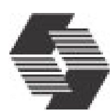
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New Regulatory Framework For Renewables In Spain

By Francisco Solchaga

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Past policies regarding renewable energies have been very successful in Spain, permitting a significant development of such technologies, making Spain one of the global leaders in this field. However, in recent years, due to the economic crisis and tariff deficit, a period of regulatory and legal uncertainty commenced, characterised by continuous legislative changes. These changes have substantially reduced the remuneration received by renewable energy plants. Since 2010, three Laws, seven Royal Decree-Laws and seven Royal Decrees that directly or indirectly affect the remuneration of renewable energy plants (for example, limitation of rate hours, creation of new taxes, limitation on the deductibility of interest, modifications in the feed-in tariff update regime, etc.) have been approved.

Electric Sector Reform

On 12 July 2013, the Spanish Government announced the legislative reform of the electricity sector and the main guidelines for a series of new pieces of legislation (the "Electric Sector Reform"). As with all other previous attempts to reform the electricity sector, the purpose of the Electric Sector Reform is tackling once and for all the enormous electricity tariff deficit and laying the foundations for a new electricity system.

Technically, for renewable projects, the Electric Sector Reform package is made up of a series of different pieces of legislation: (i) a royal decree-law ("RDL 9/2013") approved in July 2013, (ii) a new Electricity Sector Law ("Law 26/2013") approved in December 2013; (iii) a Royal Decree on renewable energy ("RD 413/2014") approved in June 2014; (iv) a Ministerial Order establishing the economic parameters for calculating the remuneration of each type of renewable installation ("MO 1045/2014") approved in June 2014; and (v) a series of draft royal decrees and several ministerial orders expected to be approved before the end of 2014.

The solution for the tariff deficit (basically, electricity system costs do not have an effect on electricity prices for consumers) is the central element of all the regulatory changes. The Spanish government has been trying to reduce the deficit accumulated over the years in which the regulated costs (such as remuneration for distribution and transport, debt service for funding the tariff deficit, the non-mainland costs and renewable energy premiums, etc.), exceeded the regulated revenues (basically, tolls from network access), with a particular emphasis on reducing renewable energy premiums and tariffs. However, some experts question this diagnosis as well as the real impact of measures directly affecting renewable energies in the solution of the problem.

New Remuneration System for Renewable Projects

The core of the Electric Sector Reform is the total overhaul of the remuneration scheme for renewable energy facilities. Renewable energy facilities (we will refer to all of them as "Renewable Projects" for convenience) will be entitled to compensation until they are capable of competing in the market.
The former regulatory framework applicable to Renewable Projects (a feed-in tariff regime) has been repealed and the new rules approved by the Government are applicable from the entry into force of RDL 9/2013 (i.e., 14 July 2013).

The new approach is fundamentally different: Renewable Projects will be remunerated on the basis of a "*reasonable return*" calculated according to their installed capacity investment cost and their O&M costs, rather than on their production (provided that a certain minimum number of operating hours is achieved).

The meaning of "*reasonable*

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return" on the investments made by renewable energy sponsors is defined. RDL 9/2013 provides that a reasonable return, pre-tax, is a given margin over the average yield, for some period to be established by the Government before the start of a 6-year regulatory period, of the Kingdom of Spain's 10-year bonds. The Spanish Government may change the margin and the average yield per each regulatory period (see below).

Renewable projects' remuneration will be the sum of three different concept; (i) the price obtained in the market by selling the electricity generated at market price just like any other power generator (ii) an annual regulated remuneration for investments in capacity established by the Government, and (iii) an annual regulated remuneration for operation established by the Government.

An additional remuneration exists for projects located in the Spanish territories out of the Iberian Peninsula (Canary Islands, Balearic Islands and the African cities of Ceuta and Melilla).

Such remuneration shall be calculated for installations in accordance with their type and each project shall be included into a particular type. Therefore, each project shall receive the remuneration corresponding to the type of installation where it is allocated.

The regulated remuneration, which is paid during the entire regulatory useful life of the facilities, will afford the facilities a reasonable return.

The remuneration paid for investments is designed to compensate for investments in capacity that cannot be recovered through sales of electricity in the market and is to be determined by reference to the net asset value of a standard generation facility of an efficient and well-run undertaking.

In order to fix the cost of the investments used for calculating the reasonable return, the Spanish Government will determine the exact values of standard generation facilities by an efficient and well-run undertaking, taking into account the different technologies, size, age, electricity system (mainland, islands etc.) and any other factors deemed necessary.

It is understood that the renewable projects obtain a reasonable return with the sum of the price collected in the market and the remuneration paid of investment in capacity.

The remuneration for operation is designed to compensate operation costs when the O&M costs for a given technology per unit of electricity generated exceed the estimated electricity sales proceeds (less any capacity payments) for that same unit. The O&M costs will again be determined by reference to a standard type of facility managed by an efficient and well-run undertaking.

An efficient and well-run undertaking is a concept developed by the European Commission as representative of an undertaking under satisfactory management, in the context of the analysis of public aid when granting compensation for the provision of services of general economic interest (see "*Communication from the Commission on the application of the European Union state aid rules to compensation granted for the provision of services of general economic interest*", 2012/C 8/02). It is not the same as simply an undertaking generating profits. Consideration must also be given to compliance with accounting standards and productivity.

The regulated remuneration will be paid in 14 installments, following the pattern used for the settlement of other regulated activities in the electricity and natural gas sectors: 12 monthly installments, plus another one once the annual figures and data are known (typically in February the following year) and a final one (the fourteenth payment) once all the final data have been verified and corrected.

An important aspect of the new remuneration scheme for Renewable Projects is that the regulated remuneration is in principle

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determined for six-year periods (each, a regulatory period). At the end of each regulatory period, the new remuneration will be determined by updating the sales proceeds forecast, O&M cost forecasts, price forecasts, variable generation costs, the financial remuneration rate and the reasonable return. The first regulatory period will end on 31 December 2019.

Every three years, the remuneration will be revised based on market sales forecasts for the next three years and the market deviation adjustment factors. The remuneration for operation will be updated (increased or decreased) by the Government on an annual basis for those projects whose costs are substantially linked to the price of fuel. The remuneration for investment may be adjusted annually depending on the number of operating hours of the project. Renewable Projects must operate a minimum number of equivalent hours annually, otherwise they lose the right to collect the remuneration for investment.

Competitive Process for New Renewable Projects

For future Renewable Projects, the RD 413/2014 established competitive bid processes called by the Government in order to obtain the right to the remuneration mechanism described below. However, there is no commitment by the Government on the number of MW or when these bid processes will be called.

Application of the New System to the Existing Renewable Projects

Existing Renewable Projects are affected by the Electric Sector Reform and the new remuneration system described above. The amounts already collected via the existing regulatory schemes will not have to be returned, but such amounts will be considered for calculating the amount of the remuneration to be received under the new system.

The new system applies retroactively to all renewable plants. As a consequence, some existing renewable projects will not receive any remuneration in the future (apart from the amounts collected for selling the electricity in the market), such as wind farms in operation before 2005. The reason is that the Government considers that the amounts collected in the past have already provided such projects with a reasonable return for their investments. Nevertheless, any amount already collected via the existing regulatory schemes will not have to be returned; even if the project remuneration under the existing regulatory scheme exceeds the reasonable return the project is entitled to under the new regulation. Once the values for the standard type of facilities have been approved, such standard values will be attributed to each type of facility in operation. The remuneration will be based on such standard values from the facility's commissioning date and taken into account for the purposes of the remuneration payable after 14 July 2013.

It is worth noting that for existing Renewable Projects the reasonable return is still 300 bps on the average yield of the Kingdom of Spain's 10-year bonds, but the average is calculated by reference to the 10 years prior to 14 July 2013. Apparently, this should work out as a (pre-tax) total of 7.39%.

Impact of the New Regulation

Now that MO 1045/2014 has been approved identifying the standard type of facilities and the standard investment values per each, we may conclude that the impact of those numbers on the Renewable Projects is discriminatory, affecting unequally different projects and technologies and have retroactive effects from an economic and legal point of view. The average reduction of incomes suffered by those facilities is around 25%. However, some photovoltaic plants will suffer reduction of around 50% and wind projects under operation before 2005 will not receive any specific remuneration in the future.

Consequently, a number of Renewable Projects will likely run

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into insolvency or will be obliged to restructure their debt with financial institutions in order to survive. As a consequence of that, investors may find interesting business opportunities for acquiring Renewable Projects and/or debt regarding those Projects with relevant price discounts.

Furthermore, a number of actions are expected to be brought against the Spanish Government claiming for damages suffered by Renewable Projects due to the financial effects of the new regulation.

Additionally, foreign investors affected by the new provisions may be interested in carrying out a preliminary analysis of the procedural options existing to file an international arbitration against the Kingdom of Spain. These options are determined by international treaties for the promotion and protection of investments ratified by Spain. There are two ways: (i) specific bilateral treaties for the protection of investors or (ii) multilateral treaties such as, in particular, the Energy Charter Treaty ("ECT") signed in December 1994 in force since April 1998, ratified by Spain and many other countries.

The ECT is a multilateral treaty of the energy sector that ensures, among others, the protection of investments and the resolution of disputes between foreign investors and the State. The Energy Charter Treaty could be invoked to obtain a compensation for damages caused by Spain to foreign investors (but not domestic investors) that are national of a state which has ratified the ECT.

A number of such arbitrations have been commenced in recent years, and more are expected in the near future.

__Francisco Solchaga__ is a partner at Araoz & Rueda since 2007. He joined the firm as an associate in 2000 following two years as an associate at Uría Menéndez.

Francisco is specialised in energy; advising on numerous projects relating to the promotion, acquisition, construction and financing of energy projects in all its contractual and regulatory related matters.

Over the last 10 years he has focused on the renewable energy sector, having a deep knowledge of the regulation affecting this sector, especially of that approved in the last few years greatly affecting the regulatory and benefits frame of the renewable plants. He advises all kind of players involved such as project promoters, contractors, financing banks, project purchasers and/or sellers, managers of the installations, etc.