

# New regulation overhaul of Spanish renewables

As discussed in our earlier briefing (Insights on the Spanish Electricity Reform, July 2013), the Royal Decree-Law 9/2013 dated 12 July (RDL 9/2013), that removed the "special regime" (*régimen especial*) for renewable generators, has been developed pursuant to a ministerial order dated 16 June 2014. The Ministerial Order sets out the standards and parameters (based on capital and operational costs) for the so-called "specific remuneration" available to both existing and future renewable generators.

The Ministerial Order was published in the Spanish Official Gazette (*Boletín Oficial del Estado*) on 20 June 2014 and it develops the economic conditions outlined in the new Royal Decree 413/2014 on renewable generation dated 6 June 2014 and published in the Spanish Official Gazette on 10 June 2014 (the New Royal Decree on Renewables).

Prior to that, Law 24/2013 dated 26 December 2013 on the new Spanish Electricity Act (New LSE) sets out the same regulatory design<sup>1</sup> advanced by RDL 9/2013 and confirmed by the approval of the New Royal Decree on Renewables.

In summary, RDL 9/2013, the New LSE, the New RD on Renewables and the Ministerial Order configure the new legal framework for renewable generators in Spain.

## Key points of the new legal framework

The main goal of the new legal framework is to ensure that the levels of incentives to renewable generators should not exceed the minimum level required to allow a renewable generator to compete with other electricity generators under equal conditions within the wholesale electricity market and enables it to obtain a reasonable return of its investment.

Under the new legal regime, a renewable generator could be entitled to receive the "specific remuneration"

on top of the pool price in order to compensate it for the capital and operational costs that cannot be funded through its participation in the electricity market. Therefore, the amount of the specific remuneration shall be based on two factors: (i) the installed capacity of the generation unit and consequently, the initial investment made by the generator; and (ii) the operation costs of the renewable facility.

Under the new economic regime, the following key points must be taken into account:

- The specific remuneration applies to all renewable energy facilities that are in the same category (*instalación tipo*); that is, they are of the same technology and share similar features. The Ministerial Order sets out several hundreds of remuneration categories for renewable facilities for cogeneration, photovoltaic, for wind and for concentrating solar power (CSP) based on their common features such as installed capacity, fuel, technology, modifications of their original characteristics or date of the start-up authorisation.
- The following standard concepts are considered for the calculation of the specific remuneration for each type of renewable asset operated by an efficient and well managed business company<sup>2</sup>: (a) the income generated by such renewable assets in the electricity market; (b) operational costs; and (c) initial investment of such renewable assets.
- There are regulatory periods of six years<sup>3</sup> (each of them, a Regulatory Period).

At the start of a Regulatory Period, several of the remuneration parameters that are used to calculate the specific remuneration could be reviewed.

Such remuneration parameters include, for a Regulatory Period, the update of the rate of the reasonable return, the estimate of energy sales, estimate of operation costs, the estimate of production hours or adjustments for deviations from the pool price. The estimate of energy sales can also be reviewed in the middle of a regulatory period, based on the evolution on pool prices and

estimated production hours but the other parameters cannot be reviewed until the end of each Regulatory Period.

Having said that, the regulated life cycle period (*vida útil regulatoria*) of a renewable facility (as determined below for each technology) and the standard value of the initial capital costs for a category of renewable assets cannot be subject to further review.

- There are different regulated life cycle periods depending of the renewable technology ranging between 20 years (cogeneration and wind) and 30 years (solar photovoltaic). The CSP regulated life cycle period is fixed at 25 years.

Once a renewable asset reaches its regulated life cycle period, such renewable generator shall no longer be entitled to receive the specific remuneration.

- The concept of reasonable return of investment is defined as return of investment, before taxes, which is the same as the average yield of ten-year Spanish bonds plus an adequate margin. The reasonable return of investment, including the adequate margin, may be reviewed at the start of a new Regulatory Period as long as such review is approved by a law.<sup>4</sup>

RDL 9/2013 regulated that for those renewable generators that would be entitled to receive a premium/regulated tariff under the existing legal regime, the reasonable return shall be, before taxes, the average yield of the ten-year Spanish bonds during the last ten years plus a 300 bps margin (i.e. 7.398 per cent.)

This level of reasonable return results in the sharp reduction of the remuneration of renewable assets, as the yield under the old premium and tariff remuneration system was substantially higher. Pursuant to RDL 9/2013, the new economic regime has been applied since 14 July 2013 taking into account during the first semester of 2014, renewable generator has been receiving their remuneration as an advance payment (*pagos a cuenta*) of the new economic regime set out in detail by this Ministerial Order.

### **Impact of the new renewable regulation on renewable assets that would be entitled to receive premium/regulated tariff under the old economic regime**

The impact of the new legal framework is considerable because, broadly speaking and for the majority of renewable assets, their estimated future income will be substantially decreased<sup>5</sup>.

The remuneration adjustment is split between wind power (€600m), PV power (€400m) and others such as cogeneration and waste (€150–200m for each renewable technology). In particular, hydraulic/mini-hydro are heavily impacted, while cogeneration and waste suffer a reduction of between 79 to 90 per cent in the remuneration for investment (those assets are almost deemed to be amortised in the regulator's eyes).

The renewable industry has already announced that this new legal framework will have a devastating effect on the Spanish renewable energy industry. There are fears that in slashing their revenue, the regime will result in many renewable generators being unable to fulfil their payment obligations to funders, suppliers, service providers and tax authorities, with the end result that some generators may have to file for insolvency, in most cases culminating in the liquidation of such companies due to their lack of economic viability.

Challenges before courts of the new renewable regulation and arbitration claims are expected as a matter of fact including investment arbitration cases under the Energy Charter Treaty that have been published so far. More claims could take place in the near future.

#### **Notes**

- 1 Article 14 of the New LSE.
- 2 Pursuant to the EU jurisprudence an "efficient and well managed business company" shall be deemed to be a company provided with the sufficient resources to carry out its business activities and whose costs are those incurred for an efficient company participating in that activity taking into consideration its income and a reasonable return for its business activities.
- 3 According to the 10th Additional Provision of the New LSE, the first Regulatory Period started on 14 July 2013 and will end on 31 December 2019.
- 4 Article 19 of the New Royal Decree on Renewables.
- 5 Pursuant to CNE's report on the Ministerial Order published on 7 April 2014, the overall reduction is estimated at €1.7bn.

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