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CHANGES TO THE ENERGY SECTOR INTRODUCED BY ROYAL DECREE-LAW 9/2013, OF JULY 12, 2013, ADOPTING URGENT MEASURES TO GUARANTEE THE FINANCIAL STABILITY OF THE ELECTRICITY SYSTEM

Royal Decree-Law 9/2013, of July 12, 2013, adopting urgent measures to guarantee the financial stability of the electricity system (“**Royal Decree-Law 9/2013**”) was published in the Official State Gazette (the “**BOE**”) on July 13, 2013 and entered into force the day after, on July 14, 2013.

This update describes the key features of Royal Decree-Law 9/2013, intended to lay down a raft of urgent measures aimed at guaranteeing the financial stability of the Spanish electricity system.

1. CONTEXT OF THE APPROVAL OF ROYAL DECREE-LAW 9/2013

For the past decade, the Spanish electricity system has recorded a tariff deficit that has become structural, because the real costs associated with regulated activities and with the operation of the electricity industry are higher than the revenues collected from the fees set by the government and paid by consumers.

To correct these gaps, in recent years a raft of urgent measures have been adopted which affect both the cost and revenue items of the electricity sector.

Despite the legislative measures approved since 2009, designed to resolve the tariff deficit problem, the shrinking demand (with the resulting reduction in access fee revenues), the increase in the number of operating hours of facilities entitled to the premium system, with respect to the scenarios initially considered, and the inability of the General State Budget for 2014 to cover all of the amounts relating to 2013 because of the cost overrun of the island and nonmainland systems means that the system is probably heading for a new deficit.

In addition to all of the above, the National Reform Programme, submitted by the Spanish government to the European Commission on April 30, 2013, contained an undertaking to submit, in the first half of this year, a package of legislative measures aimed at guaranteeing the financial stability of the electricity system.

It is against this backdrop that on July 12 the Council of Ministers approved a package of measures to reform the electricity industry, including the Preliminary Bill for the Electricity Industry Law which, after going through the parliamentary stage, will foreseeably repeal the Electricity Industry Law (Law 54/1997, of November 27, 1997) and Royal Decree-Law 9/2013 implementing, on an urgent basis, a raft of measures affecting all of the activities of the electricity industry, with a view to guaranteeing the financial stability and economic sustainability of the electricity system.

2. CHANGES TO THE REMUNERATION SYSTEM FOR CERTAIN ACTIVITIES OF THE ELECTRICITY SECTOR

Following is a summary of the main measures laid down by Royal Decree-Law 9/2013 having an impact on the remuneration system for electricity production facilities using renewable energy sources, cogeneration and waste, and facilities for the transmission and distribution of electricity.

2.1 Electricity generation facilities using renewable energy sources, cogeneration and waste

- (i) *Remuneration system applicable to new electricity production facilities using renewable energy sources, cogeneration and waste receiving premium remuneration.*

Royal Decree-Law 9/2013 has amended subarticles 30.4 and 30.5 of the Electricity Industry Law to authorize the government to approve a new legal and economic regime for electricity production facilities using renewable energy sources, cogeneration and waste which will supersede the current regulated tariff system and will be based on the following principles:

- Remuneration for electricity production facilities falling under the special regime (for facilities using renewable energy sources, cogeneration and waste) will be determined by (i) the sale of generated energy valued at the market price and (ii) a specific remuneration item composed of a term for each unit of installed capacity which, if necessary, covers the investment costs of a standard facility that will not be recovered from the sale of energy on the market, as well as a term for operation that covers, if applicable, the difference between the operating costs and the revenues for participation in the market of the standard facility.

- The specific remuneration will be calculated for a standard facility and over its regulatory useful life and with regard to the activities of an efficient and well-managed efficient and well-managed enterprise,¹ by reference to (i) the standard revenues from the sale of generated energy valued at the market price for production, (ii) the standard operating costs of the resources necessary to carry on the activity, and (iii) the standard value of the initial investment in the standard facility.
- The remuneration system that is determined for each standard facility must not exceed the minimum level needed to cover the costs that enable these facilities to compete on an equal footing in the electricity market and to be able to earn a “fair return” with regard to each standard facility. This fair return will be based, before taxes, on the average yield of Spanish 10-year Government Bonds (“*Obligaciones del Estado*”) in the secondary market, plus an appropriate spread.
- Under no circumstances will the calculation of the specific remuneration for a standard facility take into consideration costs or investments determined by rules or administrative decisions that do not apply throughout Spain. In addition, only costs and investments that relate solely to power generation will be taken into account.
- Royal Decree-Law 9/2013 allows the parameters of this remuneration system to be reviewed every six years.
- Facilities with over 50 MW of installed capacity are excluded from the remuneration system, although the government, after consulting with the governments of the autonomous communities and the cities of Ceuta and Melilla, can grant electricity production facilities based on cogeneration or that use as their primary energy, non-consumable and non-hydraulic renewable energy, biomass,² biofuels or agricultural, livestock or services-related waste, whose installed capacity exceeds 50 MW, based on the same principles as those established for the facilities under the special regime (using cogeneration, renewable energy sources and waste) included in article 30.4 of the Electricity Industry Law.

¹ According to the preamble to Royal Decree-Law 9/2013, the definition of “efficient and well-managed enterprise” has been determined by EU case law, meaning “*an enterprise equipped with the necessary resources to carry on its activity, the costs of which are those of an enterprise that is efficient in the activity and considering the related revenues and a fair profit from the performance of its functions.*”

² The new legislation includes a definition of biomass as follows: “*the biodegradable fraction of the products and waste of biological origin resulting from agrarian activities, including substances of vegetable origin and of animal origin, from forestry and from connected industries, including fisheries and aquaculture, as well as the biodegradable fraction of industrial and municipal waste*” (article 30.8 of the Electricity Industry Law).

- Lastly, the royal decree-law lays down the following special rules for the facilities that are developed in island and nonmainland electricity systems: (i) specific standard facilities may be defined exceptionally; (ii) the remuneration system for these facilities may include, as an exception, an incentive for investment and for them to be completed in a given period, where their installation leads to a significant reduction in costs in those systems.

To grant and oversee the specific remuneration that is granted to production facilities using renewable energy sources, cogeneration and waste in accordance with the regime laid down by regulations, the royal decree-law has created at the Ministry of Industry, Energy and Tourism a specific remuneration system register, which will include the remuneration parameters applicable to these facilities. Registration on that register will be a necessary requirement to apply the specific remuneration system to the facility.

(ii) *Remuneration system applicable to existing facilities with the premium economic system*

Royal Decree-Law 9/2013 repeals the rules that hitherto regulated the legal and economic system applicable to existing electricity production facilities using renewable energy sources, cogeneration and waste receiving premium remuneration,³ while at the same time giving the government a mandate, following a proposal by the Ministry of Industry Energy and Tourism, to approve a royal decree establishing a new remuneration model for these facilities in order to bring it into line with the principles established in the new wording of article 30.4 of the Electricity Industry Law, that is, (i) participation in the market, (ii) fair return and (iii) efficient and well-managed enterprise. For these purposes, it is established that for facilities that, on the date on which Royal Decree-Law 9/2013 entered into force, were entitled to a premium-based economic system, fair return will be based, before taxes, on the average yield of Spanish Government Bonds (“*Obligaciones del Estado*”) on the secondary market over the ten years preceding the entry into force of the Royal Decree-Law, plus 300 basis points, reviewable every six (6) years.

³ Sole Repealing Provision, subprovision 2, of Royal Decree-Law 9/2013 repeals:

- (a) Royal Decree 661/2007, of May 25, 2007, regulating the generation of electricity under the special regime (using renewable energy sources, cogeneration and waste).
- (b) Royal Decree 1578/2008, of September 26, 2008, on remuneration for the generation of electricity using solar photovoltaic technology for facilities after the deadline date for maintaining the remuneration for such technology under Royal Decree 661/2007, of May 25, 2007.
- (c) Article 4, additional provision one and subprovision 2 of transitional provision five of Royal Decree-Law 6/2009, of April 30, 2009, adopting certain measures in the energy industry and approving energy assistance relief.

The new remuneration model for these facilities will apply from the entry into force of Royal Decree-Law 9/2013, that is, from July 14, 2013. However, until the provisions needed for the royal decree regulating the new legal and economic system applicable to facilities to be fully applicable are approved, the rules repealed by the royal decree-law will continue to apply, save for certain exceptions (the collection of the supplement for efficiency and of the reduction envisaged in relation to the reactive energy regime has been abolished with immediate effect).

Accordingly, the facilities will receive settlements in respect of the computable items earned under this transitional system and, subsequently, once the legislative provisions needed for the new economic system to apply are approved, the appropriate adjustment will be made based on the collection rights and payment obligations resulting from the application of the new methodology, with effect from the entry into force of the royal decree-law (that is, from July 14, 2013).

However, it should be noted that final provision two of Royal Decree-Law 9/2013 excludes application of the new remuneration model that is approved for existing facilities, to the thermosolar facilities awarded the system envisaged in additional provision three of Royal Decree-Law 1565/2010 and, accordingly, their remuneration system will be made up of a single term for operation whose value will be that resulting from the economic bid on which the award was made.

2.2 Measures relating to the new remuneration system for the distribution and transmission facilities

Royal Decree-Law 9/2013 lays down a raft of measures having an impact on the remuneration system for distribution and transmission activities. On the one hand, the Electricity Industry Law has been amended to introduce a number of additional remuneration principles for the transmission and distribution of electricity and, on the other, a transitional methodology has been established for calculating the remuneration for these activities until the government approves a royal decree governing this subject, in accordance with the mandate contained in articles 5 and 6 of Royal Decree-Law 13/2012.

Lastly, Royal Decree 325/2008, of February 29, 2008, establishing the remuneration for the transmission of electricity for facilities brought into operation on or after January 1, 2008 (“**RD 325/2008**”) was amended to introduce certain special rules for transmission facilities in island and nonmainland electricity systems.

(i) ***New principles regulating the remuneration system for transmission and distribution activities***

A new subarticle has been included in article 16 of the Electricity Industry Law, which determines the basic principles to establish the remuneration for the activities and functions of the electricity system.

This new subarticle introduces the following additional remuneration principles for transmission and distribution activities:

- In the remuneration methodology for these activities, regard will be had to the costs needed for the activity to be carried on by an efficient and well-managed enterprise, by applying basic standards that will be uniform throughout Spain.
- These economic systems will allow for remuneration commensurate with that of a low-risk activity, and for this purpose the royal decree-law establishes a financial rate of return linked to the average yield of Spanish 10-year Government Bonds in the secondary market, plus a spread.

According to the preamble to Royal Decree-Law 9/2013, remuneration for the transmission and distribution of electricity must be commensurate with that of a low-risk activity, given that (i) grid activities are not directly exposed to the risks inherent in the production market; and (ii) regardless of the demand situation, the remuneration systems grant facilities in operation remuneration for the regulatory useful life of the facilities, provided that they remain operational.

(ii) ***Remuneration method for electricity distribution and transmission activities***

Royal Decree-Law 9/2013 lays down a transitional remuneration methodology which is to be in effect until the start of the first regulatory period under the remuneration royal decrees that may be approved in relation to article 5 and article 6 of Royal Decree-Law 13/2012. However, because the first half of the year has already gone by, it has been chosen to make definitive the proportional part of the remuneration established for 2013 in the legislation in force until the entry into force of this royal decree-law. For this reason, the following scenarios are envisaged:

- Remuneration of electricity distribution and transmission activities from January 1, 2013 to July 14, 2013:

Broadly speaking, this remuneration will relate to the proportional part of the remuneration envisaged in Order IET/221/2013, of February 14, 2013, establishing access fees from January 1, 2013 onwards and the tariffs and premiums for facilities under the special regime (using renewable energy

sources, cogeneration and waste) (“Order IET/221/2013”), which remuneration is definitive.⁴

- Remuneration for electricity distribution and transmission activities for the second period of 2013 (from July 14, 2013 to December 31, 2013):

Following a decision by the government’s economic affairs committee, the Ministry of Industry, Energy and Tourism will approve remuneration for each of the distribution companies and for each of the companies owning the transmission facilities, in accordance with the methodologies laid down in annex I and annex III to Royal Decree 9/2013, respectively. Regardless of the amounts that are calculated and approved in due course in relation to certain remuneration items for the transmission and distribution activities⁵, the remuneration for these activities calculated in accordance with this methodology will be definitive.

The rate of return on assets used to calculate that remuneration will be the average yield of Spanish 10-year Government Bonds on the secondary market in the three months preceding the entry into force of the legislation, plus 100 basis points.

- Remuneration for electricity transmission and distribution activities to be received from January 1, 2014 until the start of the first regulatory period pursuant to the remuneration royal decrees that will be approved under article 5 and article 6 of Royal Decree-Law 13/2012:

Following a decision by the government’s economic affairs committee, the Ministry of Industry, Energy and Tourism will approve remuneration for each of the distribution companies and for each of the companies owning the transmission facilities, in accordance with the methodologies laid down in annex II and annex IV to Royal Decree 9/2013, respectively. As noted in the preceding section, this remuneration will, as a general rule, be regarded as definitive.

The rate of return on assets to be used to calculate that remuneration will be the average yield of Spanish 10-year Government Bonds in the secondary market in the three months preceding the entry into force of the legislation, plus a spread of 200 basis points.

⁴ However the following companies could see a change to their remuneration for this first period of 2013: (i) those that before July 14, 2013 applied for a review of the remuneration for 2013 pursuant to the provisions of annex I to Order IET/221/2013; and (ii) as a result of mergers and acquisitions of distribution enterprises or of acquisitions of distribution assets from other companies.

⁵ Namely, (i) incentives for quality and reduction in losses in the case of distribution; and (ii) incentives for the availability and remuneration of investment and for the operation and maintenance associated with investments that are declared to be unique and are in service before December 31, 2011, in the case of transmission.

To determine the remuneration in the last two scenarios envisaged in Royal Decree-Law 9/2013, the median values for the industry will be used if the company in question does not have any of the necessary items of information.

(iii) *Island or nonmainland systems*

Under Article 12 LSE, any electricity supply activities carried on in these territories will have their own specific regulations based on the specific features of the territories in which they take place. For their part, in accordance with Royal Decree 325/2008, the reference unit values used to calculate the remuneration for the transmission activity are a single set of values for the whole of the Spanish territory. In this legislative context, Royal Decree-Law 9/2013 has amended Royal Decree 325/2008 to add an exception to the above which allows, because of the unique characteristics derived from the territorial location of the island or nonmainland systems, another reference unit to be established which may be different for each system or sub system, although there must be single values in each of these subsystems.

3. OTHER CHANGES INTRODUCED BY ROYAL DECREE-LAW 9/2013

In addition to the raft of measures having an impact on the remuneration system for electricity production facilities using renewable energy sources, cogeneration and waste, and electricity transmission and distribution facilities, Royal Decree-Law 9/2013 also contains the following provisions, targeted similarly at guaranteeing the financial stability of the electricity industry:

(i) *Securitization fund for the electricity system deficit*

Through the approval of Royal Decree-Law 29/2012, it was established that any additional deficit that might take place in 2012 would generate collection rights that could be transferred by their holders to the Electricity System Deficit Securitization Fund (“FADE” after its initials in Spanish). The new royal-decree law has quantified in this respect the final amount of the additional revenue shortfall that took place in 2012 at €4,109,213 million, which it sets as the definitive amount for the purposes of the transfer of rights to the FADE fund.

Additionally, for the Spanish government to be able to guarantee the new economic obligations claimable from FADE, derived from the additional issuance needs at the amount referred to above and the envisaged refinancing arrangements, article 54 of General Budget Law 17/2012, of December 27, 2013 for 2013 has been amended, and the total limit on the guarantees to be provided by the Spanish government in 2013 has been raised by 4,000 million, and a specific guarantee limit reserve has been included for that aim.

(ii) ***Funding of the generation cost overrun in the island and nonmainland territories***

Additional provision number four of Royal Decree-Law 9/2013 has restricted the funding of cost overruns relating to electricity production activities carried on in island and nonmainland territories out of the general state budget to 50% of the cost, by repealing additional provision number one of Royal Decree-Law 6/2009, according to which any payments in respect of those cost overruns were funded, generally, in full, out of the general state budget. It also determines that the cost overruns for each year will be included in the general budget laws for the following year.

(iii) ***Measures in relation to capacity payments***

The incentive for long-term capacity investment, which is regulated in Order ITC/2794/2007, of September 27, 2007 reviewing the electricity tariffs in force from October 1, 2007 onwards (“**Order ITC/2794/2007**”) was created to drive the construction and bringing into service of certain generation facilities under the ordinary regime (using traditional energy sources) with an installed capacity equal to or higher than 50 MW. Through Royal Decree-Law 13/2012, a first review has been made on an exceptional basis for 2012, and they have been set at €23,400/MW/year.

Because of the current demand context for electricity and the very low risk of a shortfall in installed capacity, Royal Decree-Law 9/2013 has established: (i) an indefinite reduction to set them at €10,000/MW/year, and; (ii) their elimination for all new production facilities except for any obtaining the definitive entry into service certificate before January 1, 2016, in which case they may have the right to receive €10,000/MW/year for 20 years.

For the facilities that were entitled to that incentive when this new royal decree-law came into force, the period in which they will have the right to receive the sum will be twice the period remaining to cover the ten-year period in which they were entitled to receive that remuneration according to annex III of Order ITC/2794/2007 mentioned above.

(iv) ***Funding the cost of the energy assistance relief***

Royal Decree-Law 9/2013 has also amended the system for distribution of the cost of the energy assistance relief introduced by Order IET/843/2012, of April 25, 2012.

That cost is not charged to consumers as a whole as it has been to date but will be assumed, as a public service obligation, by the parent companies of the companies or groups of companies or, in some cases, companies that simultaneously carry on electricity production, distribution and retail activities.

A procedure has also been established for obtaining the distribution percentage of the sums to be funded for each business group, which will be calculated annually by the National Markets and Antitrust Commission and approved by the Ministry

of Industry Energy and Tourism⁶, in addition to a mandate to review before July 1, 2013 the parameters defining the parties that can take the energy relief assistance⁷.

(v) ***Other measures***

Lastly, Royal Decree-Law 9/2013 contains the following measures, among others:

- To fulfill the principle of financial stability, it is established that the Ministry of Industry, Energy and Tourism, on an exceptional basis and following a decision by the government's economic affairs committee, may review the prices of the capacity and active energy terms for the electricity access fees where circumstances occur that have a material effect on the regulated costs or on the parameters used to calculate them⁸.
- Creation of the administrative electricity self supply register so that the economic system for consumers with electricity self supply arrangements can be properly monitored.
- Some antitrust elements of the transitional system have been clarified to be informed of the taking up of stakes in the energy industry envisaged in additional provision number nine of Law 3/2013, of June 4, 2013 on the creation of the National Markets and Antitrust Commission⁹. It establishes in this respect that until the Ministry of Industry, Energy and Tourism actually has the resources to exercise its power to be informed of acquisitions of shares in the energy industry, the National Markets and Antitrust Commission will be considered to have the power to do so on a transitional basis.

⁶ For these purposes, it is established that, for each business group, their percentage will be calculated as the relationship between a term which will be the sum of the annual averages of the number of supplies connected to the distribution grids of the distribution companies and of the number of customers of the retailers in which the group has an investment, and another term which will be the sum of all the average annual values for supplies and customers of all the business groups that must be taken into account for the purposes of this distribution. That distribution percentage will be calculated annually by the National Markets and Antitrust Commission (that is, by the National Energy Commission until the entry into operation of the National Markets and Antitrust Commission).

⁷ Until that review takes place those parties will be as they are characterized in transitional provision number two of Royal Decree-Law 6/2009, of April 30, 2009 adopting certain measures in the energy industry and approving energy relief assistance, in the Decision of June 26, 2009, of the Secretary of State for Energy, determining the procedure for bringing the energy relief assistance into operation and in the additional provisions numbers four and five of Order IET/843/2012, of April 25, 2012 Order IET/843/2012, of April 25, 2012 establishing the access fees from April 1, 2012 onwards and certain tariffs and premiums for facilities under the special regime (using cogeneration, renewable energy sources and waste)

⁸ Despite this authorization in the law, it is established, as a matter of urgency, that the Ministry of Industry, Energy and Tourism has the obligation to approve within one month from the entry into force of this new royal decree law, a review of the prices of the capacity terms and of the active energy terms for the access fees to the grids defined in the Electricity Industry Law and in its implementing legislation.

⁹ Additional provision number nine of Royal Decree-Law 9/2013.

- Law 38/1992, of December 28, 1992, on excise and special taxes has been amended in relation to the special tax on coal. It must be remembered that Law 15/2012, of December 27, 2012 on energy sustainability measures, raised the rate for coal to 0.65 euros per gigajoule, in line with the provisions on gas for uses other than as fuel. In the case of natural gas, however, a reduced rate of 0.15 euros per gigajoule was established for professional uses that did not take place in electricity generation and cogeneration processes.

In this respect, to help the manufacturing industry that uses coal stay competitive, and place the consumers of this product on an equal footing with consumers of natural gas for those uses and purposes, a reduced rate of 0.15 euros per gigajoule has been put in place for coal to be used for professional purposes, where it is not used in electricity generation or cogeneration processes. A definition of “coal used for professional purposes” has been added for these purposes¹⁰.

- Moreover, in the case of supplies to cogeneration energy and useful heat plants, because it is impossible to have an accurate figure at the time the supply is made for the amount of coal on which the various rates will be applied, a provisional distribution percentage has been set (by reference to the amount that needs to be allocated to the production of electricity and to the production of useful thermal energy) and it has been stated that the relevant procedure will be determined in the implementing regulations (foreseeably based on a notification made by the owner of the plant). In addition, an obligation has been placed to adjust the amounts charged in line with the final percentage of use of the coal (also subject to the implementing regulations) and a new infringement has been defined for the coal supplier for incorrect notification of information for these purposes.

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¹⁰ Supplies used at manufacturing plants and facilities, with the exception of any used to produce useful thermal energy which is finally used at establishments or premises not regarded as manufacturing plants and facilities. Utilization for growing agricultural crops is also a use for professional purposes.