

renewable energies

March, 2012

CURRENT SITUATION AND POSSIBLE REGULATORY AUSTERITY MEASURES IN THE SPANISH RENEWABLE ENERGY INDUSTRY

The purpose of this Note is to briefly summarize the current regulatory framework that, from a legal and financial perspective, applies in Spain to electricity generation facilities using renewable energy sources included in the “*special regime*” because of the continuous modifications that are taking place. Specifically, this Note focuses on the rules applicable to photovoltaic, thermal solar and wind power technologies.

Furthermore, this Note explains the main regulatory austerity measures relating to such facilities which were proposed in a report prepared by the Spanish National Energy Commission (*Comisión Nacional de Energía* or “**CNE**”), dated March 7, 2012, on the Spanish energy industry and the decrease of the tariff deficit (“**Report on the Spanish energy industry**” or “**Report**”).

Lastly, this Note examines the main observations made by the Ministry of Industry, Energy and Tourism in relation to the publication and the content of the abovementioned Report.

1. CURRENT REGULATORY SITUATION IN THE SPANISH RENEWABLE ENERGY INDUSTRY

At present, the legislative framework in Spain supports renewable energy and cogeneration, which is based on the concept of generation under the special regime set forth in Spanish Electricity Industry Law 54/1997, of November 27, 1997 (*Ley del Sector Eléctrico* or “**LSE**”). Indeed, the special regime involves the generation of electricity using renewable energy and cogeneration, as well as the combustion of biomass and biogas, and the recovery of various residues, subject to the installed capacity threshold of 50 MW.

The rules currently in force on the special regimen cover three different areas: a) legal and financial regulation; b) regulation of access and connection to the grid; and, c) regulation of guarantees of origin and electricity labeling. As indicated above, this Note will only examine the legal and economic regulation of this unique regime.

Royal Decree 661/2007, of May 25, 2007, regulating electricity generation under the special regime (“**RD 661/2007**”) is the point of reference for legal and financial regulation of the special regime. However, the rules on remuneration contained in this instrument

have been amended significantly in recent years due to the impact that the growing number of these facilities¹ has had, and continues to have, on the real cost of the regulated part of the electricity tariff.

In this regard, reference must be made to the following legal instruments, as instruments that introduce important modifications to the rules on remuneration in the renewable energy industry in Spain:

- Royal Decree 1578/2008, of September 26, 2008, on remuneration for the generation of electricity using photovoltaic solar technology for facilities after the deadline date for maintaining the remuneration for such technology under Royal Decree 661/2007, of May 25, 2007 (“**RD 1578/2008**”). The rapid growth of photovoltaic solar technology in 2007 and 2008, far higher than expected, made it necessary for RD 1578/2008 to be passed, the main aim of which was to streamline remuneration and, to that end, it modified the economic regime applying to photovoltaic facilities downwards, where those facilities had obtained definitive registration in the administrative register of special-regime generation facilities (*registro administrativo de instalaciones de producción en régimen especial* or “**RIPRE**”) after September 29, 2008. Furthermore, in order to properly monitor planned photovoltaic generation facilities under the special regime, RD 1578/2008 establishes the register for the pre-allocation of remuneration (*registro de preasignación de retribución* or “**RPR**”), and registration in this register is necessary in order to be able to receive premium remuneration under the reference legislation.
- Royal Decree-Law 6/2009, of April 30, 2009, adopting various energy sector measures and approving the social subsidy (“**RD-L 6/2009**”). In addition to austerity mechanisms regarding the remuneration provisions for special-regime facilities (except for photovoltaic solar technology already regulated by the abovementioned RD 1578/2008), this instrument establishes a series of limits to contain increases in the tariff deficit, defined as the difference between the amounts collected from regulated tariffs set by the authorities, which are paid for by consumers by means of their regulated supplies, and those collected from access tariffs, which are set on the liberalized market, and the real costs associated with such tariffs.

¹ According to information contained in the Report on the Spanish energy industry, 31,000 MW of new renewable or cogeneration capacity was installed in Spain between 1998 and October 2011. Following this same trend of growth, according to data also published by the CNE in a report dated December 28, 2011 (Report 39/2011), general total capacity as of December 31, 2011 stood at 35,913 MW, and would reach 39,126 MW by December 2012. Specifically, with respect to photovoltaic, thermal solar and wind power technologies, expected growth is as follows:

	CAPACITY AS OF DECEMBER 31, 2011	CAPACITY AS OF DECEMBER 31, 2012
Photovoltaic solar	4,188 MW	4,296 MW
Thermal solar	856 MW	1,554 MW
Wind power	20,658 MW	22,664 MW

Specifically, as regards the austerity measures relating to the provisions on remuneration for special-regime facilities, in order to plan for the growth of such facilities, RD-L 6/2009 establishes that these must first be registered in the register for the pre-allocation of remuneration (“**RPR**”) in order to be able to avail themselves of the appropriate economic regime, which will be the one set forth in RD 661/2007 until special-regime facilities have met the capacity targets for each technology. However, even if the capacity targets have not been met for all technologies, as we will discuss below, this economic regime has been suspended pursuant to Royal Decree-Law 1/2012.

Moreover, as regards special-regime technologies that had already met the installed capacity targets for this regime by the date on which RD-L 6/2009 came into force, which was the case for wind power and thermal solar technologies, RD-L 6/2009 established a specific transitional regime pursuant to which remuneration under RD 661/2007 would only apply to facilities using these technologies which met the requirements for access to the RPR as of the date it came into force. For other facilities using these technologies, RD-L 6/2009 provides for the approval of a new legal-economic framework – not only has this not been approved, it had been temporarily suspended pursuant to Royal Decree-Law 1/2012, referred to above.²

With respect to the tariff deficit, this legal instrument establishes a roadmap for the progressive sufficiency of access fees in order to meet all of the costs of regulated activities with a view to eliminating the tariff deficit by 2013. It also made provision for a mechanism to finance this deficit.³

- Royal Decree 1565/2010, of November 19, 2010, regulating and amending certain aspects relating to electricity generation under the special regime (“**RD 1565/2010**”). Among other measures, this Royal Decree introduces additional technical requirements necessary in order to receive the premium or equivalent premium, for

² In application of the transitional provisions of RD-L 6/2009, reference must be made to the Decision of November 19, 2009, the Secretary of State for Energy publishing the Resolution of the Council of Ministers of November 13, 2009, on organization of the projects or facilities submitted to the administrative register for pre-allocation of remuneration provided for in that piece of legislation for electricity generation facilities affected by it, with a view to establishing the progressive entry into operation (by phases) of those facilities.

³ In this regard, with respect to the tariff deficit, RD-L 6/2009 establishes that as from January 1, 2013, access fees will be sufficient to meet all of the costs of the regulated activities and lays down provisions for the transitional period up to that date. Moreover, as regards financing the deficit, RD-L 6/2009 provides for the assignment of the appropriate collection rights to a securitization fund – the Electricity System Deficit Securitization Fund (*Fondo de Titulización del Déficit del Sistema Eléctrico* or FADE) – established for that purpose which, in turn, will issue the appropriate liabilities using a competitive mechanism on the financial market with a State-backed guarantee.

In relation to financing the tariff deficit, Royal Decree-Law 6/2010, of April 9, 2010 on measures to boost economic recovery and employment must also be borne in mind.

existing facilities as well as new ones, and amends the provisions on remuneration for photovoltaic solar facilities covered by RD 661/2007, limiting such facilities' entitlement to receive the regulated tariffs indicated therein to 25 years. Notwithstanding, this time limit was subsequently extended to 28 years by Royal Decree-Law 14/2010, of December 23, 2010, establishing urgent measures to correct the electricity industry's tariff deficit and, lastly, to the current 30 years by Sustainable Economy Law 2/2011, of March 4, 2011.

- Royal Decree 1614/2010, of December 7, 2010, regulating and amending certain aspects relating to thermal solar and wind power generation (“**RD 1614/2010**”). This Royal Decree regulates certain aspects of an economic nature for existing and new wind power and thermal solar facilities, notably limiting the number of operating hours entitled to the equivalent premium or premium at such facilities.
- Royal Decree-Law 14/2010, of December 23, 2010, establishing urgent measures to correct the electricity industry's tariff deficit (“**RD-L 14/2010**”) which, for the purposes of this Note, limits the number of operating hours entitled to the premium economic regime that have recognized at photovoltaic solar facilities. Furthermore, it also obliges electricity producers to pay fees in order to access transport and distribution networks. In this regard, RD-L 4/2010 provides that until such time as those fees were developed by regulation, transporters and distributors will charge producers connected to their networks €0.5/MWh fed into their networks or such amounts as may be set by the Ministry within the limits established, as the case may be, by EU legislation.⁴

In short, since RD 661/2007 was passed, a series of rules have been established in the renewable energy industry which, in the main, have amended the provisions on remuneration applicable to special-regime facilities due to their growing impact on the tariff deficit. Furthermore, as discussed, mechanisms for financing this deficit have been put in place although, as illustrated by the Preamble to Royal Decree-Law 1/2012, of January 27, 2012, suspending the pre-allocation of remuneration procedures and eliminating financial incentives for new electricity generation facilities using cogeneration, renewable energy sources and waste (“**RD-L 1/2012**”), the measures adopted to date have not been sufficient, thereby endangering the ultimate objective of eliminating the tariff deficit by 2013.

As mentioned above, this is why the Government considered it necessary to pass urgent measures, such as RD-L 1/2012, the aim of which is to eliminate incentives for the construction of special-regime facilities for an indefinite term, *“at least until the main problem threatening the economic sustainability of the electricity system has been solved:*

⁴ The entry into force of this urgent measure was justified by the appearance of circumstances such as the significant fall in demand and the increase of electricity generation using renewable sources due to favorable weather conditions.

the electricity system tariff deficit” and the suspension of the pre-allocation of remuneration procedures for application of the premium economic regime under RD-L 6/2009 and RD 1578/2008.⁵

Thus, the remuneration framework for the special-regime technologies indicated above has been temporarily suspended, although only for generation facilities entitled to avail themselves of this regime which had not been registered in the registers for pre-allocation of remuneration referred to as of the date on which this legislation came into force. In other words, as expressly stated in the Preamble of RD-L 1/2012, the reference legislation maintains the remuneration regime as it is established in Spanish law for facilities in operation and for those registered in the appropriate RPR.

Nonetheless, RD-L 1/2012 provides that the Government may, by regulation, reestablish registration in the RPR when the energy context so requires. Moreover, RD-L 1/2012 enables the Government to establish, by regulation, specific economic regimes for certain special-regime facilities, including those that use inconsumable and non-hydraulic renewable energies. The factors that may be taken into account for the purpose of determining these regimes include the installed capacity, investment costs and the type of primary energy used etc., on the basis of reasonable rates of return by reference to the cost of money on the capital market.⁶

In this energy context, the Secretary of State for Energy of the Ministry of Industry, Energy and Tourism commissioned the CNE, by letter dated January 27, 2012, to prepare a report on regulatory austerity measures that could be adopted in the energy industries and which were aimed at, in particular, containing the tariff deficit. Below you will find a description of the main measures proposed by the regulatory authorities for the special regime.

Lastly, before moving on the next issue covered by this Note, mention should be made of the targets for electricity generation using renewable energy established in Spanish law. Directive 2009/28/EC, of April 23, 2009, on the promotion of the use of energy from renewable sources (“**Directive 2009/28/EC**” or the “**renewable energy Directive**”), established the binding target for Spain that 20% of its gross final consumption of energy must come from renewable sources by 2020. In addition, the 2011-2020 Spanish Renewable Energy Plan (*Plan de Energías Renovables 2011-2020* or “**PER 2011-2020**”), approved by Resolution of the Council of Ministers (on November 11, 2011), proposed that

⁵ In particular, in connection with photovoltaic facilities the registration procedure has been suspended for applications filed in calls for applications relating to 2012, and the holding of calls for pre-allocation relating to 2012 and the following years has been cancelled.

⁶ In this connection, Article 3.3 of RD-L 1/2012 implicitly amends Article 30.4 LSE, insofar as it incorporates other factors that may be borne in mind when determining the special economic regime, such as the installed capacity or the type of primary energy used. In addition, RD-L 1/2012 establishes that such factors “may” be taken into account, in other words it amends the binding nature of Article 30.4 LSE which provides, without question, that factors such as investment and operating costs would be taken into account when determining the remuneration regime for special-regime electricity generation facilities.

by 2020 renewable energy should represent 20.8% of the gross final consumption of energy in Spain (according to data from the CNE, this corresponds to approximately 38.1% in the electricity industry), thus exceeding the minimum mandatory targets established for Spain in the renewable energy Directive. In this regard, it should be noted that according to data included in this planning document, the use of renewables in the consumption of primary energy has almost doubled since 2004, reaching 11.3% at the end of 2010.

2. PROPOSED REGULATORY AUSTERITY MEASURES SUBMITTED BY THE CNE TO THE MINISTRY OF INDUSTRY, ENERGY AND TOURISM

Consistent with other austerity measures that are being implemented in the Spanish economy, it seems that the Government is considering the possibility of approving a package of regulatory austerity measures aimed at containing the tariff deficit in the electricity industry. The Secretary of State for Energy of the Ministry of Industry, Energy and Tourism therefore commissioned the CNE to prepare a report that proposed the adoption of solutions in this area.

Thus, as part of the process of drafting this document, at the beginning of February 2012 the CNE launched a public consultation which led different interest groups to submit numerous observations and reform proposals⁷, all of which were sent to the Ministry of Industry, Energy and Tourism.

2.1 Main measures proposed in the Report on the Spanish energy industry

The CNE's Report proposes two broad packages of measures: Measures with an economic impact on the tariff deficit in the short- and medium-term.

2.1.1 Regulatory measures with a short-term impact.

With respect to the measures with an economic impact in the short-term, insofar as they affect the special regime, mention should be made of the following: i.1) Measures on costs and regulated activities; i.2) Measures to externalize part of the costs of special-regime premiums funded by access fees; and, i.3) Additional measures to reduce the impact of temporary gaps in the electricity system.

- Measures on costs and regulated activities:

Of the measures on costs and regulated activities, the following should be noted insofar as they relate to the costs of the special-regime premium:⁸

⁷ Specifically, 477 replies to the questionnaire on the electricity industry were received, 200 of which came from individuals.

⁸ As indicated in the Report, the CNE proposes that these measures apply from 2012.

- Harmonization of the thermal solar premium with respect to the regulated tariff. This measure is justified by the need to correct an incoherence in the determination of the premiums for the abovementioned technology. Thus, it is stated that the value of the tariff in force for this technology (€298.96/MWh) is inconsistent with the value of the premium collected by facilities that have chosen the sale option in the market, receiving, as the case may be, in respect of that sale, the market price plus a premium. The value of the premium referred to is currently €281.89/MWh, which entails a very low theoretical market price (€17.1/MWh instead of €50/MWh, which would be the average market price that would have to be considered). In this connection, it is thought that the premium for pre-registered thermal solar facilities would have to be reduced by 12%;
 - Reduction of the use of premium support fossil fuels. It is well known that thermal solar technology can use, in the generation of electricity, a support fossil fuel subject to an admissible maximum percentage which must be, calculated on an annual basis, less than 12% of the total energy generated if the facility sells its energy at the regulated feed-in tariff, or 15 % if the facility sells its energy to the market. The proposed measure involves reducing the percentage use of these fuels to just 5%; and
 - Increase of efficiency factors in the tariff and premium update index for all technologies. The tariff or premium used as an incentive for facilities that use renewable energy sources is updated in line with the CPI, corrected by an efficiency factor of X. Under the legislation applicable to these facilities, this factor of X is equal to 25 basic points until December 31, 2012, rising to 50 basic points thereafter. The proposed measure considers that the efficiency factor affecting the CPI in the updates for the financial incentives should be high. Thus, it is thought that this factor should be around 175 basic points with the result that only 15% of the value of the tariffs and premiums is updated and, therefore, it is argued that this is the only variable cost of such technologies.
- Measures to externalize part of the costs of special-regime premiums funded by access fees:

Furthermore, as indicated above, the Report on the Spanish energy industry contains measures to externalize part of the costs of special-regime premiums funded by access fees. Thus, for instance, the Report suggests that part of the income from CO₂ auctions could be used to finance, in part, the costs of special-regime premiums, bearing in mind the important contribution made by renewable energy in meeting the targets for the reduction of CO₂ emissions. The Report also suggests that special-regime premiums could be financed, in part, by the industries responsible for fossil

fuel consumption⁹ (cost redistribution system, which would entail the establishment of a tax on the sale of oil products) or, alternatively, by the state budget.

- Additional measures to reduce the impact of temporary gaps in the electricity system:

According to the Report on the Spanish energy industry, the urgent application of the proposed package of short-term measures would lead to a significant reduction of the current and future system deficit. However, in the CNE's view, these measures are insufficient to eliminate the deficit. Accordingly, with a view to achieving a progressive and stable adjustment of fees, the CNE proposes the introduction of additional measures to finance temporary gaps by means other than access fees.

One possible measure to reduce the impact of temporary gaps in the electricity system would be to temporarily modify thermal solar premiums and tariffs received by thermal solar facilities that are registered in the pre-allocation register but which do not have a definitive start-up certificate, due to the fact that this type of technology has the highest degree of penetration in the medium term and the greatest impact on fees. The proposed measure involves modifying the trajectory of premiums for thermal solar technology, reducing the value of the premiums in the initial years and increasing them in subsequent years.

The CNE also raises the possibility of “early repayment of investments” which would involve offering, on a voluntary basis, to developers of facilities registered in the pre-allocation register but not yet in operation, economic compensation that would wholly or partly recognize, in advance, their estimated investment costs (including a reasonable return) in exchange for waiving the premium remuneration regime for their production.

2.1.2 Regulatory measures with a medium-term impact.

The following medium-term measures should be noted:

- Measures to meet the targets set forth in Directive 2009/28/EC and in energy planning (PER 2011-2020), as well as the application of competitive mechanisms, involving a review of the existing rules in order to reach the abovementioned targets, minimizing the associated costs. These measures would involve modulating the penetration rate of new

⁹ Those would be the heating and refrigeration industries (natural gas and others) and the industry for oil products used in transport.

facilities initially provided for in the PER 2011-2020, delaying the installation of new capacity until towards the end of the period under consideration. Another possible measure is the establishment of competitive mechanisms (auctions) to allocate new capacity and determine costs. This would entail modifying the remuneration structure for, among others, ground-based photovoltaic, thermal solar and wind power technology, moving from an administrative structure to one based on market mechanisms.

- Furthermore, there are regulatory proposals on the remuneration of existing special-regime facilities such as, for example, the establishment of a technology-specific time limit for the receipt of the premiums and tariffs currently in force or the assessment of the upper and lower limits of the premium so that if the market price exceeds the upper limit, the amounts beyond that limit return to the system as income for settlement.

2.2 Observations of the Ministry of Industry, Energy and Tourism on this Report

The Secretary of State for Energy of the Ministry of Industry, Energy and Tourism issued a communiqué concerning the publication of the Report on the CNE's website and its content, in which the following observations were made:

- The Report is not binding in any way;
- The Report contains certain proposals with which the Secretary of State for Energy does not agree and which will not be taken up; and
- The Report is only one of several elements to be considered in deciding upon which measures may be adopted in the future.

The Secretary of State for Energy regretted the consequences that the CNE's unilateral and exclusive decision to publish the Report may have had or may have in the future as regards the situation of companies and the interests of those directly or indirectly referred to therein.

As to the content of the Report and, generally speaking, the austerity measures that the Government may approve in the months ahead, mention must be made of the comments made by the Minister of Industry, Energy and Tourism, José Manuel Soria, during a breakfast information session held on March 13, 2012. The main statements made by the Minister during that session are as follows:

- With respect to the Report, the Minister indicated that the measures submitted by the different industries and the CNE were being assessed by the Secretary of State for Energy. As yet, however, there were no specific measures, which would be drawn up principally in light of the general interest. In this connection, the Minister made special reference to the principles of legal certainty and legality.

- In the Minister's words, the role of renewable energy in the energy mix will continue to increase, in light of energy dependence, the competitiveness of companies in this industry and its contribution to the environment. In this regard, the Minister stressed that this kind of energy can continue to be developed without premium economic regimes provided that there is connection to the grid and the necessary permits have been obtained.
- In response to the question as to whether any new regulatory legislation will apply equally to all technologies, the Minister replied that technology-specific exceptions could not be justified. Moreover, at least in the short-term, in view of the deficit, it is difficult to continue to think about new energy admissions that have, as renewables do, a premium economic regime, notwithstanding the temporary nature of RD-L 1/2012.
- In any event, the Minister stated that work was underway on a specific legislative instrument for the Islas Canarias, in view of the special features of the islands' electricity systems, where it is more expensive to generate electricity using traditional fuels than using renewable energy. The Minister indicated that this instrument would entail savings for the system as a whole.

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