URÍA MENÉNDEZ

The Spanish government confirms support for renewable energy projects

27 November 2019

Uría Menéndez

The Spanish government confirms support for renewable energy projects

In line with the market's expectations since Autumn 2018, the Spanish caretaker government has issued Royal Decree-Law 17/2019 (the "**RDL 17/2019**"), setting the renewable energy facilities' regulated rate of return ("**RRR**") for the 2020-2025 regulatory period at 7.09%.

However, renewable energy plants entitled to feed-in tariffs in operation before mid-July 2013 are entitled to freeze their RRR at the current rate of 7.398% for the next two regulatory periods —i.e., until the end of 2031— provided that any legal proceedings brought by such plants (or their shareholders) against the Kingdom of Spain regarding the regulatory changes introduced since 2007, are dropped.

The passing of RDL 17/2019 represents a strong confirmation of stability in an industry that has suffered several adjustments and changes over the past years, as notwithstanding the different government in office the regulated remuneration structure approved in 2013/2014 has been maintained and its rules applied.

On 27 November 2019, RDL 17/2019 was unanimously endorsed by all political parties represented at the Permanent Committee of the Congress of Deputies (which is Spain's stand-in legislative body while the new Congress of Deputies is being formed). Following this endorsement, the new regulations will come into force on 1 January 2020.

A regulated remuneration based on a reasonable rate of return

- **For the 2014-2019 regulatory period** and for renewable energy plants commissioned by mid-July 2013, **the RRR was set at 7.398%**, after adding a 300bps spread to the 24-month average of the Spanish 10-year bond yield.
- The remuneration scheme envisages a **revision of the RRR applicable to the 2020-2025 regulatory period** before 1 January 2020.

The Spanish legal framework of renewable energy facilities pivots on Law 24/2013, of 26 December, on the Electricity Sector, which among other provisions abrogated the former feed-in tariff system. The overarching principle is that the regulated incentives should consist of a reasonable rate of return on the investments made by sponsors of renewable energy facilities, estimating the revenues and operating costs for a given regulatory useful life of a standard renewable energy facility managed by a well-run and efficient undertaking. This translates into an RRR obtained by adding a spread to the average yield of the Spanish 10-year bond —the average yield uses a 24-month May-to-May term ending on the last month of May of the preceding regulatory period.

While certain parameters (such as the estimated revenues and operating costs) may be adjusted every three years, the RRR may only be revised before the start of the next six-year regulatory period. For the first regulatory period (2014-2019), the Spanish government approved a 300-basis point spread, which resulted in an RRR of: (i) 7.398% for plants in operation prior to the 2013 regulations ("**Pre-2013 Plants**"); and (ii) 7.503% for plants achieving COD after the 2013 regulations —if and to the extent they were entitled to receive the regulated remuneration.

The path to RDL 17/2019

- The Spanish regulator suggested **using the WACC** of renewable energy facilities as the basis for the RRR.
- As the end of current period approached without a revised RRR, **different interpretations were generating uncertainty** in an already shaken industry.
- Spain continues to face **legal proceedings on account of the changes to the remuneration scheme** of renewable energy facilities since 2007.

On 30 October 2018 the Spanish regulator (*Comisión Nacional de los Mercados y la Competencia*) issued a report on the suggested RRR applicable to the next regulatory period (2020-2025). In line with the principles applied to the regulated remuneration of transmission and distribution activities, the regulator suggested using the weighted average cost of capital (WACC) for renewable energy companies as the basis for the remuneration of renewable energy facilities, plus a reasonable spread. The result would thus be implemented as a spread on top of the yield average of the Spanish 10-year bond between May 2017 and May 2019, such that the end figure should be the same for both calculations.

In early 2019, the government at the time issued a draft bill that was very much in line with the regulations ultimately included in RDL 17/2019. That draft bill received the support of most market players, but the ensuing political deadlock and back-to-back general elections forestalled the approval of the new regulations. The 2013/2014 legal framework provided that the RRR had to be determined by law. But a legal dispute arose as to what would happen if such law was not issued and came into force by 1 January 2020. Some practitioners claimed that the current spread of 300bps would simply have to be added to the yield average of the Spanish 10-year bond achieved between May 2017 and May 2019 (resulting in an RRR in the range of 4.5-5%). Others, in turn, argued that the current 7.398% RRR would be automatically extended unless a new law came into force. This second option seemed more consistent with the existing framework but confusion in the market was unavoidable.

In the meantime, Spain has been facing several legal proceedings, both before ordinary courts (claiming compensation for damages suffered as a result of the Spanish legislator's decisions) and arbitration tribunals (foreign investors claiming compensation under bilateral or multilateral investment protection treaties such as the ECT), for the regulatory changes introduced since 2007 (the "**Compensation Proceedings**"). Some international investors have been successful and have obtained arbitration tribunal awards for damages payable by the Kingdom of Spain, although the enforcement of such awards is still underway.

RDL 17/2019 backs the current remuneration scheme

- RDL 17/2019 sets the RRR at **7.09%** for the **2020-2025 statutory period**.
- **Renewable energy plants in operation by mid-July 2013** are entitled to continue receiving a **7.398% RRR until 2031 provided that** their Compensation Proceedings are dropped.

RDL 17/2019 sets the RRR applicable to renewable energy facilities for the new regulatory period 2020-2025 at 7.09% (pre-tax). This comes as no surprise to the market: it is the same RRR included both in the CNMC 2018 report and in the draft bill released in early 2019. However, Pre-2013 Plants are subject to different options depending on their involvement in any Compensation Proceedings. Namely:

- **Pre-2013 Plants not involved in any Compensation Proceedings**:
  - Their regulated remuneration will be the current 7.398% for the next two regulator periods —i.e., 2020-2025 and 2026-2031. No action is required for these plants to continue benefiting from the 7.398% from 1 January 2020; ***unless***
  - The sponsors of such plants expressly opt out and accept the new 7.09% rate for the 2020-2025 regulatory period and any revision of that for the 2026-2031 period. This option needs to be exercised prior to 1 April 2020. Presumably, this option would be exercised by sponsors now willing to start new Compensation Proceedings.
- **Pre-2013 Plants involved in any Compensation Proceedings**:
  - Their regulated remuneration will be the new 7.09% for the 2020-2025 regulatory period; ***unless***
  - No later than 30 September 2020, the sponsors of such plants expressly provide evidence to the Department of Energy Policy and Mines that their Compensation Proceedings involving their relevant plant have been withdrawn and discontinued. If any amounts are

> however subsequently paid as a result of a judgment or award in the context of any such Compensation Proceedings, the 7.398% rate will be automatically revoked effective from —oddly enough— 1 October 2020, and the regulated remuneration paid to any such plant in excess of the new 7.09% RRR shall be deducted from future payments of the regulated remuneration. The details of such an adjustment are yet to be issued by the Ministry.

Compared to the early 2019 draft bill, RDL 17/2019 has provided clarifications on the types of Compensation Proceedings that need to be discontinued to continue benefitting from the 7,398% RRR:

- all claims based on international treaties signed by the Kingdom of Spain regarding investment protection;
- all claims initiated by any direct or indirect owners of renewable energy facilities, irrespective of any subsequent transfers of stakes in such facilities;
- all claims continued by third parties under any assignment, subrogation, procedural undertaking or any other equivalent legal title (*i.e.*, including claims sold to third parties); and
- all claims submitted with respect to the same installation (*i.e.*, if there are several petitioners within the same proceedings, all of them must withdraw the claim).

General remarks

With the approval of the RDL 17/2019, the Spanish government confirms the regulated remuneration scheme in place since 2013/2014, notwithstanding the fact that the current remuneration structure was designed by a different political party.

In an industry that has endured several regulatory changes since 2007, it is expected that investors will positively welcome the new RRR as a sign of stability and predictability. Although respectful of the equation provided by the 2013 regulations (yield average of the Spanish 10-year bond plus a spread), RDL 17/2019 uses the CNMC's suggested methodology to ensure an attractive return to investors, with the ultimate goal of supporting the development of renewable energy in the overall national strategy. Consistent with this goal, RDL 17/2019 includes a provision anticipating the prospective allocation of the access capacity, which will be liberated as a consequence of the closure of thermal and coal-fired power stations, to new renewable energy plants. The criteria for such allocation are to be further developed by the Ministry.

The government has taken advantage of the revision by attempting to reduce and discourage litigation against the Kingdom of Spain on account of the past changes to the remuneration scheme. RDL 17/2019 offers more visibility than the 2019 draft bill on the proceedings that need to be dropped to benefit from a constant RRR over two consecutive regulatory periods.

Whilst the quantum of the existing claims is significant, the complexity, duration and costs of such legal proceedings, together with the fact that to date no single claimant appears to have collected any amounts, by way of compensation or otherwise, from the Kingdom of Spain, may lead several investors to take up the offer of the 7.398% RRR and abandon —insofar as they are still the holders of the plant or the claim— or force the abandonment of —insofar as they have transferred their stake to third parties— any ongoing Compensation Proceedings.

Yet the different vicissitudes applicable to each facility (divestments, transfers of stakes, sale of claims, etc.) will need to be analysed with care in order to assess the situation and decide on the preferred course of action.

This report provides preliminary comments on the most significant implications of RDL 17/2019 but is not a comprehensive description or summary of all its provisions, nor is it legal advice for any specific company, project or transaction.

Our Energy and Project Finance Practice Area will be pleased to provide further information or specific legal advice upon request. Please contact:

Juan I. González
Partner
+34 91 586 03 81
juan.gonzalezruiz@uria.com

María José Descalzo
Counsel
+34 91 587 08 90
mariajose.descalzo@uria.com

Ignacio Álvarez
Senior Associate
+34 91 586 05 48
ignacio.alvarez@uria.com

José-Félix Zaldívar
Senior Associate
+34 91 586 06 12
josefelix.zaldivar@uria.com