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The Spanish Government prepares to finalize the renewable energy reform with the approval of Royal Decree 413/2014, dated 6 June 2014

On 6 June 2014, the Spanish Government approved Royal Decree 413/2014, regulating electricity generation activity using renewable energy sources, cogeneration and waste, which was **enacted on 11 June 2014** ("**RD 413/2014**").

This Royal Decree establishes, as foreseen in Royal Decree-Law 9/2013, the new legal and financial regime applicable to the existing installations which generate electricity using renewable energy sources, cogeneration and waste (referred to in this briefing as the "**Renewable Installations**").

RD 413/2014 has yet to be finalised by means of the Order to be issued by the Ministry of Industry, Energy and Tourism, which will establish the remuneration parameters of standard installations, whose approval is expected to take place in short time (the "**Order on Parameters**").

Key highlights

- **Purpose and scope of application of RD 413/2014**
- **Remuneration regime**
- **Priority of dispatch and access and connection to the grid and concept of group of installations**
- **Financial standing of the companies affected by the Royal Decree**

The main reason for the reform of the regulatory regime applicable to the generation of electricity using renewable energy sources is the tariff deficit encumbering the electricity system, which, for the year 2013, has reached 3,188 million euros (while the total tariff deficit amounted, in May 2013, to more than 26,000 million euros). Accordingly, the Government has adopted a series of financial measures aimed at reducing this deficit, including the reduction of premiums imposed on the generation of electricity using renewable energy.

Another of the declared reasons for the reform is the development of technologies in the sector, and the need to adapt the legal regime accordingly.

RD 413/2014 does not include substantial changes compared to the last versión of its Project made public.

I. Purpose and scope of application of RD 413/2014

The purpose of RD 413/2014 is to regulate a specific regime for Renewable Installations.

The specific regulation of this type of installations focuses on allowing them to compete on equal footing with other technologies, so that they are able to obtain reasonable profitability throughout their useful life.

RD 413/2014 eliminates the concept of 'special regime', in the understanding that the widespread penetration of renewable technologies means that its specific regulation based on its power –previously set at a maximum of 50 MW- and on the corresponding technology is no longer relevant. For this reason, a system is adopted in which the Renewable Installations are considered in the same way as the rest of the technologies present in the market, and are assessed on the basis of their technology and implications on the system, instead of their capacity, whereby the distinct concepts of ordinary and special regimes cease to exist.

The Renewable Installations belonging to the categories, groups and subgroups included in the Schedule are included within the scope of application of RD 413/2014.

II. Remuneration regime

a) General characteristics

In line with the above, the remuneration regime of the Renewable Installations is based, according to RD 413/2014, on the necessary participation of these installations in the market, supplementing market income with specific regulated remuneration, which would permit these technologies to compete on equal footing with the rest of the technologies in the market. In this way, installations will be able to receive, throughout their regulatory useful life, in addition to remuneration from the sale of the energy valued at market price, specific remuneration consisting of:

(i) A return on investment per unit of installed capacity, which covers, when appropriate, the investment costs for each standard installation which cannot be recovered through the sale of the energy on the market in question, and

(ii) A return on operation, which covers, when appropriate, the difference between the operating costs and the earnings through the participation in the generation market of said standard installations. This supplementary specific remuneration must be sufficient to reach the minimum level necessary to cover the costs which, unlike conventional technologies, they cannot recover in the market and allows them to

obtain a reasonable profit (not real, but in reference to the standard installation applicable in each case).

In order to calculate the return on investment and the return on operation, for standard installations, the standard earnings from the sale of energy valued at market price, the standard operating costs needed to carry out the activity and the standard value of the initial investment, all for an efficient and well-managed company, will be taken into consideration. The Order on parameters is what establishes the series of remuneration parameters for each of the different standard installations, with the most relevant parameters being as follows:

(i) Return on investment (Rinv);

(ii) Return on operation (Ro);

(iii) Incentive for investment due to the decrease of the generation cost (Iinv);

(iv) Regulatory useful life;

(v) Minimum number of operating hours;

(vi) Operation threshold;

(vii) Maximum number of operating hours for the purposes of receiving the return on operation, as the case may be;

(viii) Upper and lower annual limits of the market price;

(ix) Annual average of the daily and intraday market price.

In addition, all parameters needed for the purpose of calculating the foregoing, by way of example and not exclusively, will be remuneration parameters, the most relevant of which are as follows:

(i) Standard value of the initial investment of the standard installation;

(ii) Estimate of the daily and intraday market price;

(ii) Number of hours of operation of the standard installation;

(iv) Estimate of future income from participation in the generation market;

(v) Other operating income defined in Article 24;

(vi) Estimate of future operating cost;

(vii) Readjustment rate which takes as its value that of reasonable profitability;

(viii) Adjustment index of the standard installations;

(ix) Net value of the asset.

RD 413/2014 further specifies the regulation on the concept of 'reasonable profitability', establishing it as a before-tax profitability centred on the average performance of ten-year government bonds on the secondary market, for the 24 months prior to May of the year before the start of the regulatory period, increased by applying a differential.

RD 413/2014 establishes regulatory periods of six years, with the first regulatory period falling between 14 July 2013 (date of entry into force of Royal Decree-Law 9/2013) and 31 December 2019. Each regulatory period is divided into two regulatory half-periods of three years. Remuneration parameters can be reviewed at the end of each regulatory half-period or regulatory period, and all remuneration parameters can be modified, including the reasonable profitability for the rest of the regulatory useful life. On the contrary, neither the parameters of the regulatory useful life nor the standard value of the initial investment can be modified.

Three years after the start of the regulatory period, the following will be reviewed, for the rest of the regulatory period: (i) estimated earnings from the sale of the energy generated, valued at production market price, according to the performance of market prices, (ii) forecast operating hours, and (iii) estimated generation market prices for the first three years of the regulatory period, adjusting them to actual market prices.

In relation to the price of energy in the market, in order to reduce uncertainty in this regard, RD 413/2014 sets upper and lower limits for this estimate. When the annual average of the daily and intraday market price exceeds such limits, this creates, in the annual calculation, either a positive or a negative balance. This will be called the 'adjustment value due to deviations in the market price' and will be offset during the useful life of the installation.

Renewable Installations only receive the specific remuneration until they reach the regulatory useful life, at which time they cease to receive the return on investment and the return on operation. Such installations can continue to sell the energy generated in the market.

b) New renewable installations

In general terms, RD 413/2014 establishes that the new Renewable Installations may access this remuneration regime bidding in competitive procedures. In addition, it is envisaged that in

off-peninsula systems (the Canary Islands, Balearic Islands, Ceuta and Melilla) incentives to investment may be introduced, in accordance with the efficiency of the Installations planned for said territories.

c) Existing installations

RD 413/2014 envisages that the remuneration regime established by it also applies to existing installations. In order to be considered an existing installation, a Renewable Installation must, prior to 14 July 2013, have been deemed eligible for the incentivised financial regime envisaged in Royal Decree 661/2007, of 25 May, governing the activity of special-regime electricity generation or in Royal Decree 1578/2008, of 26 September, on remuneration of electricity generation activity using photovoltaic solar technology for installations dating from after the deadline for the maintenance of remuneration under Royal Decree 661/2007, of 25 May, for said technology.

The reasonable profitability of these installations will depend, before tax, on the average performance of ten-year government bonds on the secondary market over the ten years prior to the entry into force of Royal Decree-Law 9/2013, plus 300 basis points, all notwithstanding the review of this reasonable profitability envisaged at the conclusion of each regulatory period and half-period.

The existing installations will be subject to the new regime as of 14 July 2013. For the purposes of standardising the remuneration received between said date and the date of entry into force of the new remuneration regime, one-ninth of the total amount to be standardised will be included in each of the 9 payments following the seventh payment of the 2014 financial year. The amount to be included in each payment for this item will not exceed half of the amount to which each installation is entitled under the new remuneration regime. If, as a result of this latter limit, it is not possible to recover the entire amount owed by an Installation in 9 payments, the remaining amount will be included in the following payments.

The existing installations will be automatically recorded in the registry of the specific remuneration regime. Recording in said registry will be either with pre-assignment status or operating status, as appropriate, according to the following:

(i) Those installations which, at the time of recording, are not registered in the payment system and have been deemed eligible for incentivised remuneration will be recorded with pre-assignment status.

(ii) Those installations which, at the time of recording, are registered in the payment system will be recorded with operating status; however, in the event that these installation have not been definitively recorded in the corresponding administrative

registry of electricity generation installations or have not begun to sell energy, in the maximum period applicable to them as of the date of notification of the decision recording them in the registry for the pre-assignment of remuneration, they will not be entitled to a specific remuneration regime.

d) Provision for a specific remuneration regime for certain installations included in the moratorium of Royal Decree-Law 1/2012

RD 413/2014 establishes a specific remuneration regime for a maximum of 120 MW, applicable to those installations or modifications of installations with technologies other than wind, solar thermoelectric and remuneration, in one of the following situations:

(i) They have submitted the application for recording in the registry for the pre-assignment of remuneration, in accordance with Article 4 of Royal-Decree Law 6/2009, of 30 April, on the adoption of certain measures in the energy sector and approval of the 'bono social' discount rate, said application has been received by the administrative registry of the Ministry of Industry, and they meet the requirements of Article 4.3 of Royal Decree-Law 6/2009, of 30 April, all before 28 January 2012 (date of entry into force of Royal Decree-Law 1/2012).

(ii) They have obtained a definitive start-up licence, for their entire capacity, within the thirty calendar days prior to the entry into force of Law 24/2013, of 26 December. For modifications to installations, the start-up licence will refer to the entire capacity of the modification to be recorded in the registry for the pre-assignment status remuneration regime.

Renewable Installations wishing to opt for this regime will have one month as of the 15 days next to the entry into force of the Order on Parameters to send an application for recording in the registry for the specific remuneration regime to the Directorate General for Energy Policy and Mines for a specific project, including documentation demonstrating fulfilment of the requirements mentioned.

The priority of the applications will be determined by the following criteria (and until it reaches the limit of 120 MW): (i) fulfilment of the requirement mentioned in letter a), (ii) fulfilment of the requirement mentioned in letter a), without fulfilment of the requirements of Article 4.3 and, (iii) in case the limit power has not yet been reached, fulfilment of the requirements mentioned in letter b). In the event of a tie between several applications as a result of the application of these criteria leading to the limit established being exceeded, a ranking will be established in each of said criteria according to the date of the administrative authorisation and the date of the start-up licences for the second and third cases.

III. Priority of dispatch and access and connection to the grid and concept of group of installations

a) Priority of dispatch and access and connection to the grid

RD 413/2014 maintains the essential rights and obligations of producers using renewable energy sources, cogeneration and waste.

The most important rights of the Renewable Installations are priority in terms of dispatch and access and connection to the grid.

Meanwhile, said Installations are still required to have reading equipment, be registered with a generation control centre (provided they exceed the 5 MW capacity limit), send remote readings to the system operator (also when they exceed the 1 MW capacity limit) and meet the requirements for responding to voltage dips.

b) Concept of group of installations

(i) Concept of group of installations for the purposes of the mentioned obligations

For the purposes of the mentioned obligations, RD 413/2014 defines 'grouping' as the collection of installations which connect to the same point of the distribution or transport grid or have a shared discharge line or transformer, with a single point of the distribution or transport grid being understood to be a substation or transformation centre. In the same way, those installations with the same cadastral reference, determined by the first 14 digits, will also be considered to form part of the same grouping. The installed capacity of a grouping will be the sum of the installed capacities of the individual installations comprising it.

(ii) Concept of group of installations for the purposes of retribution

For the purposes of the remuneration applicable to each standard installation, installations will be understood to belong to a group if the following criteria are met:

a) Category a) installations:

(i) Installations sharing at least one useful thermal energy consumer or using residual energy coming from the same industrial process, and

(ii) Installations with definitive registration dates not further than 60 months from each other.

b) Categories b) and c) installations:

(i) Categories b.1), b.2) and b.3) installations which (i) connect to the transport or distribution network at the same point (this being a substation or transformer) or evacuating the energy through the same line or common transformer or located in the same land register (i.e. matching the first 14 digits), and (ii) have definitive registration dates not further than 36 months from each other.

However, installation which meet the above-mentioned criteria, but can prove that there is no continuity between them, will not be considered as a group of installations.

(ii) Categories b.4) and b.5) installations which (i) have the water taking and draining point at the same height, (ii) have definitive registration dates not further than 60 months from each other.

(iii) Categories b.6), b.7) and b.8) and c) installations which (i) connect to the transport or distribution network at the same point (this being a substation or transformer) or evacuating the energy through the same line or common transformer or located in the same land register (i.e. matching the first 14 digits), (ii) have definitive registration dates not further than 60 months from each other, and (iii) for co-generation installations, share at least one useful thermal energy consumer.

IV. Financial standing of the companies affected by RD 413/2014

In recent years many companies were incorporated for the construction and operation of Renewable Installations. In many occasions they are special purpose vehicles with that exclusive corporate object and they obtained the funds necessary for the project (whether directly or through holding companies), by means of habitual project finance structures.

Therefore, their financial standing depends directly from the remuneration regime of Renewable Installations now regulated by the Royal Decree and which will be completed by the Order on Parameters.

Once the Order on Parameters is approved, these companies will be able to anticipate accurately their financial standing in the next years, considering their ability to continue servicing debt with the income they receive for their activity.

In this context, the managers of these companies must pay special attention to their obligations under Spanish mercantile laws.

On the one hand, the Law on Capital Companies obliges companies to keep their own resources above half of their share capital (otherwise, they must request dissolution unless an insolvency procedure is applicable); this is a purely accounting criteria, based on balance sheet. The disequilibrium may be remedied sometimes by converting debt into participative loan or into equity, or by reducing the share capital.

On the other hand, Insolvency Law obliges managers to file for insolvency (or file the application under art. 5bis) when the company is unable to comply on a regular basis with its obligations; this is a criteria based on liquidity. Insolvency occurs when the company has no liquidity to service due payments.

The approval of this new remuneration regime may impact the financial standing of these companies (their balance sheet) due to the account adjustments that are deemed necessary following its approval.

Also, the liquidity of these companies may be affected when they are not able to continue servicing their financial debt (which is frequently their main debt). In this sense, a difference must be made between actual insolvency (when there is no liquidity to pay obligations already due) and imminent insolvency (when it is foreseen that this will occur in the future). Actual insolvency triggers the obligation to file for insolvency (or file the application under art. 5bis). Imminent insolvency allows managers to adopt some of these measures. Applicable Law does not define what qualifies as "imminent insolvency", whether expected in on month or one year, but we tend to consider that Courts would grant insolvency protection to companies that have certainty of their insolvency, even if in the medium term. All the above without prejudice to the refinancing and restructuring that, as the case maybe, could be agreed to avoid those situations.

SCHEDULE

Categories, groups and subgroups of Renewable Installations included in the scope of application of RD 413/2014

a) Category a): producers which cogeneration or other forms of electricity generation using residual energy:

b) Category b): installations which use one of the non-fossil renewable energies as their primary energy source:

This category b) is in turn divided into eight groups:

Group b.1 installations which use solar energy as their primary energy source. This group is divided into two subgroups:

Subgroup b.1.1 installations which only use solar radiation by means of photovoltaic technology as their primary energy source.

Subgroup b.1.2 installations which only use thermal processes for the transformation of solar energy into electricity, as their primary energy source.

Group b.2 installations which only use wind farm energy as their primary energy source. This group is divided into two subgroups:

Subgroup b.2.1 on shore wind farm installations.

Subgroup b.2.2 off shore wind farm installations which include both internal waters as well as the territorial sea.

Group b.3: installations which only use geothermal, hydrothermal, ocean thermal and aerothermal energy, as well as energy from waves, tides, hot dry rocks and marine currents as their primary energy source.

Group b.4: hydroelectric plants with an installed capacity not exceeding 10 MW. This group is divided into two subgroups:

Subgroup b.4.1: hydroelectric plants where the hydraulic installations (reservoirs or dams, outlets, waterways and others) were built exclusively for hydroelectric purposes.

Subgroup b.4.2: hydroelectric plants built using pre-existing infrastructures

(reservoirs, channels or aqueducts) or infrastructures that were not being used for hydroelectric purposes.

Group b.5: hydroelectric plants whose installed capacity exceeds 10 MW. This group is divided into two subgroups:

Subgroup b.5.1: hydroelectric plants where the hydraulic installations (reservoirs or dams, outlets, waterways and others) were built exclusively for hydroelectric purposes.

Subgroup b.5.2 2: hydroelectric plants built using pre-existing infrastructures (reservoirs, channels or aqueducts) or infrastructures that were not being used for hydroelectric purposes.

Group b.6: cogeneration or electricity generation plants which use as their main fuel biomass derived from energy crops, agricultural, farming or plant-based activities, forest exploitation and other silviculture operations in woodland areas and green spaces, in the terms set forth in Annex I. The term 'main fuel' will be understood to mean any fuel which makes up at least 90 per cent of the primary energy used, measured according to the lower calorific value.

Group b.7: cogeneration or electricity generation plants which use as their main fuel bioliquids derived from biomass, understood as liquid fuel destined for energy use other than transport and including the generation of electricity and heat and cold, or which use biogas derived from the anaerobic digestion of energy crops, from agricultural residue, from farming by-products, from biodegradable waste from industrial installations, from domestic and similar waste or sludge obtained from the treatment of residual waters or others to which the anaerobic digestion process is applied (both individually or via co-digestion), as well as biogas recovered from controlled landfill sites, all of this in the terms set forth in Annex I. The term 'main fuel' will be understood to mean any fuel which makes up at least 90 per cent of the primary energy used, measured according to the lower calorific value.

This group is divided into two subgroups:

Subgroup b.7.1: installations which use biogas from controlled landfill sites as their main fuel. These installations may be supplied with up to 50 per cent of primary energy derived from biogas generated in digestors.

Subgroup b.7.2: installations which use as their main fuel bioliquids or biogas generated in digestors derived from: energy crops or agricultural residue,

farming by-products, biodegradable waste from industrial installations, domestic and similar waste or sludge obtained from the treatment of residual waters or other sludge to which the anaerobic digestion process is applied, both individually or via co-digestion. These installations may be supplied with up to 50 per cent of primary energy derived from biogas from controlled landfill sites.

Group b.8: cogeneration or electricity generation plants which use as their main fuel biomass derived from industrial installations in the agricultural or forestry sectors in the terms set forth in Annex I. The term 'main fuel' will be understood to mean any fuel which makes up at least 90 per cent of the primary energy used, measured according to the lower calorific value.

c) Category c): installations which use as their primary energy waste with energy values not considered in category b), installations which use fuels in groups b.6, b.7 and b.8, provided they do not meet the consumption limits established for the said subgroups and installations which use black liquors.

This category c) is in turn divided into three groups:

Group c.1: plants which use domestic and similar waste as their main fuel.

Group c.2: plants which use as their main fuel other waste not considered in group c.1, fuels in groups b.6, b.7 and b.8, provided they do not meet the consumption limits established for the said groups, black liquors and those plants which, upon the enactment of this Royal Decree, were registered under category c) of group c.3 established in Article 2.1 of Royal Decree 661/2007, of 25 May, which regulates electricity generation activities subject to a special regime.

Group c.3: plants which, upon the enactment of this Royal Decree, were included in category c) of group c.4 established in Article 2.1 of Royal Decree 661/2007, of 25 May, using as a fuel non-commercial quality products from mines to generate electricity due to their high content in sulphur or ash, where waste represents more than 25 per cent of the primary energy used.

In accordance with the above, the term main fuel will be understood to mean any fuel which makes up at least 70 per cent of the primary energy used, measured according to the lower calorific value.

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