CLIFFORD CHANCE

Briefing note

March 2012

The Spanish Energy Commission's report on the Spanish Energy Sector

On 9 March 2012 the Spanish Energy Commission (Comisión Nacional de Energía) ("CNE") published a report dated 7 March 2012 regarding the Spanish energy sector ("Energy Sector Report"). Said report presents a series of regulatory adjustment measures which could be adopted in the energy sectors particularly aimed at containing the evolution of the tariff deficit.

Said report has been drafted upon request from the Energy Secretary of State. During the process, the CNE received several observations and proposals from different groups of interest. In any case, it must be taken into account that the proposed measures are not are not binding for the Spanish Government. In fact, the Ministry of Industry, Energy and Tourism has recently declared that it does not share all measures proposed in the Energy Sector Report, and has emphasized that these will not be adopted, given the non-binding nature of the same.

Content

Among the measures proposed in the report, we highlight below those which, if finally adopted, would have a direct impact on the remuneration currently acknowledged to the generation facilities subject to the special regime.

1. Measures which, in principle, would affect all technologies

1.1 Increase of the "x" in the index for the update of tariffs and premiums (CPI – x)

Pursuant to Article 44.1 and the First Additional Provision of Royal Decree 661/2007, the tariff or premium received by facilities which use renewable energy sources is updated according to the CPI and corrected by an efficiency factor of "x", which until 31 December 2012 amounts to 25 base points and as from that date it will amount to 50.

Given that the majority of the annual earnings received by such facilities is used to cover investment costs (85% of the premium in the case of wind and solar energy) the CNE considers, that only a part of the premium should be updated (15%, bearing in mind the previous estimate).

The proposed measure would entail an increase of the "x" correction factor, and in this regard it considers that for a CPI value of 2%, the efficiency factor affecting the CPI in updated financial incentives of renewable energy and co-generation should be around 175 base points, so that only 15% of the value of the tariffs and premiums is updated.

1.2 Elimination of the tariffs and special regime premiums after the end of the economic life of the installations

Electricity generation facilities subject to a special regime are currently entitled to a remuneration system that is not close-ended, but rather is divided into two tranches, decreasing after the first period of time without being eliminated.

The CNE proposes to limit the application of the remuneration system to which these types of installations are entitled to the economic life of the facilities, which would be in line with the first tariff tranche currently considered in Royal Decree 661/2007 (similar to the modification previously approved for photovoltaic technology, the economic life of which was established as 30 years) except in the case of co-generation and biomass which would be established at 20 years.

Upon completion of the facility's economic life, they could continue to receive the market price for the energy subsequently discharged to the network.

1.3 Consideration of the cap and floor of the premium

Under the current system contained in Royal Decree 661/2007, renewable energy technology (except photovoltaic technology which is remunerated exclusively under the tariff option) may opt for the "market plus premium" remuneration option. Under this option the final remuneration to be obtained by the generator is subject to a cap and a floor such that, if the market price supplemented by the reference premium is less than the floor, then the reference premium is increased so that the amount obtained for both concepts is equated to the established floor. However, if the market price is greater than the cap, the value of the premium will be equal to zero, but the producer may keep the market price received above the cap.

The measure proposed by the Energy Sector Report would consist of applying a full reimbursement to the system, as taxable income, of all the amounts that exceed the cap. Additionally, the CNE understands that the application of this measure should be accompanied by a provision that prevents facilities affected by the measure from withdrawing from the special regime in order to apply the ordinary regime or at least until the end of their economic or remunerative life.

2. Measures affecting solely solar thermoelectric technology

2.1 Harmonising the premium of solar thermoelectric technology in respect of its regulated tariff

Pursuant to the Energy Sector Report, the current regulation is not consistent with regard to the values related to the premium and the tariff for solar thermoelectric technology. Therefore, in its opinion, a reduction of 12% must be applied to the premium corresponding to pre-registered solar thermoelectric plants, in order to put the remuneration obtained by the generator under the plus plus premium option on a level with the remuneration that would be obtained under the tariff option.

The CNE understands that this correction would maintain the principle of obtaining a reasonable rate of return since, as indicated, the regulated tariff was borne in mind for the economic viability studies on the new facilities.

2.2 Lamination of the temporary path of the premiums on solar thermoelectric facilities recorded at the pre-assignment registry but without a final start-up certificate

This measure presents the possibility of reducing the premiums on solar thermoelectric facilities below those currently planned, then increasing them in the future so that, in terms of present value (value discounting the cash flow of the project), the total remuneration received for the facilities whilst the measure is in force remains the same as in the current system.

The CNE furthermore raises as an alternative measure to the one indicated above, the possibility for energy producers using solar thermoelectric technology recorded at the pre-assignment registry who have not obtained their final start-up certificate to voluntarily waive the earnings of their production which are subject to a premium in exchange for financial compensation that would acknowledge their estimated investment costs in advance (including a reasonable rate of return). Said compensation would be included in the access tariff, and could be deferred for a maximum of 15 years.

3. Measures that would solely affect certain technologies

3.1 Limiting the use of supporting fossil fuels bearing a premium to 5% of primary energy (which would affect biomass, solar thermoelectricity and waste)

Article 2 of Royal Decree 661/2007 allows the use of conventional fossil fuels at biomass, solar thermoelectric and waste-to-energy assessment facilities (in general 10%, 12% or 15 and 30%, respectively) at specific times such as start-up, variation in the charge or dissatisfaction with the fuel or main renewable energy resource in order to minimise effects on the operation and efficiency of the plant.

Until the minimum techniques necessary for each type of technology are developed the CNE provisionally proposes establishing a generic limitation of 5% on primary energy being produced by conventional fuels. Surplus energy produced in excess of 5% of supporting fuels could be sold at market price.

3.2 Establishment of competitive mechanisms for the assignment of the new capacity (which would affect photovoltaic, wind, solar thermoelectric and mini-hydroelectric technologies)

This measure proposed by the CNE contemplates the possibility of establishing more competitive mechanisms for assigning the new capacity, such as auctions, going from an administrative scheme for determining the remuneration to a scheme based on market mechanisms.

In this regard the Energy Sector Report presents the possibility of holding auctions according to the types of technologies or auctions in which the different technologies would compete among one another.

3.3 Premiums based on regulatory cost information (which would affect at least photovoltaic solar technology on roofs, cogeneration, waste and biomass)

According to the CNE, this involves very specific technologies for which, due to their location, available resource and small size, the auction mechanism mentioned in the section above would not be advisable.

This measure would link any updates to the tariffs and premiums to the obtaining, maintenance and review of a system of regulatory cost information of an auditable nature and which would make it possible to systematically monitor and regulate those costs faced by companies in the sector.

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