

Remuneration of production in the Electricity Industry Bill: farewell to the special production scheme

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Pursuant to the Electricity Industry Bill, the government may only exceptionally approve, for facilities that use renewable technologies, cogeneration and waste, specific remuneration schemes that, predicated on the need of these facilities to be market participants, supplement their market revenues with specific regulated remuneration. Such remuneration should make it possible to (a) cover the shortfall between market revenue and costs, (b) earn a reasonable rate of return with reference to the relevant standard (efficient and well-managed) facility, and (c) compete on a level playing field with other technologies.

1. INTRODUCTION: ALL SCHEMES TO BE UNIFIED IN THE "SPECIFIC REMUNERATION" SCHEME

The Official Gazette of the Spanish Parliament published on 4 October the Electricity Industry Bill (121/000064, EIB), which repeals the Electricity Industry Act 54/1997, of 27 November, almost in its entirety.

The bill is included in the Council's Recommendation regarding Spain's 2013 National Reform Programme, approved by the Council of the European Union on 9 July 2013. It introduces several new features, aimed at preventing the overwhelming increase in the tariff deficit (currently 26,000 million euros), which has become the industry's main problem and threatens, in the words of the explanatory notes, the electricity system with bankruptcy. The cornerstone of the new regulation is financial sufficiency, such that, on the one hand, any additional cost must be off-set by the revenue and, on the other, the remuneration of regulated activities (transmission, distribution and, as the case may be, remuneration) will be based on the costs that would be incurred by an efficient and well-managed company.

This legislation also intends to put an end to the plethora of rules and legal uncertainty that to date have afflicted the industry and hindered investment.

This document merely describes the new regulation of the remuneration scheme for electricity production facilities based on renewable energy, cogeneration and waste, which until now fell under the special electric energy production scheme.

The first change is terminological and gives a sense of the philosophy behind the new scheme. The bill does not discuss a "special scheme", but rather talks about production facilities with specific remuneration. In light of the increased market share of production from renewable energy, cogeneration and waste, the regulator believes that it is pointless to have a separate regulation tied to capacity and its technology. Therefore, the bill sets aside the different concepts of ordinary and special schemes and instead proceeds with a unified regulation of electric energy production (title IV), notwithstanding certain special considerations.

All references to the specific remuneration scheme made in connection with the EIB

(art 14.7) will also be understood to be applicable to any of the special economic schemes existing before the entry into force of the new law. Pursuant to the first transitory provision of the EIB, any reference to ordinary and special schemes shall be taken to be within the meaning of said schemes prior to the entry into force of the new law.

2. NEW REMUNERATION SCHEME: MARKET PRICE AND EXCEPTIONAL SPECIFIC SUPPLEMENTARY REMUNERATION

In the new electricity industry scheme, all production units, including those belonging to the defunct special scheme, must offer electricity to the market. Article 14 sets out the general principles of the remuneration of activities aimed at supplying electrical power, incorporating a number of specificities for certain facilities according to their production technology (art. 14.6) and location within or outside the peninsula (art. 14.7). The particularities of the remuneration according to the type of technology are described below.

2.1. Exceptional nature of the specific remuneration

We must stress the exceptional nature of the additional remuneration. The law does not recognise the right of owners of certain facilities to receive remuneration, but rather leaves this remuneration to the government's discretion when certain objectives outside the government's energy policy are met. Thus, article 14.7 provides that "the government **may exceptionally establish** a specific remuneration scheme in order to encourage production based on renewable energy, high-efficiency cogeneration and waste, when **certain energy objectives derived from Directives or other European Union rules must be fulfilled** or when such a scheme would lead to a reduction in energy costs and dependence on imported energy."

All in all and in spite of this exceptional nature, the second final provision of Royal Decree Act 9/2013, of 12 July, adopting urgent measures to ensure financial stability in the electricity industry (RDA 9/2013), delegates to the government, by way of the Ministry of Industry,

Energy and Tourism, the adoption of an instrument regulating the legal and economic regime for facilities based on renewable technologies, cogeneration and waste, with special remuneration that will modify the remuneration model for already existing facilities (third final provision). This new model must meet the criteria provided under article 30 of the Electricity Sector Act 54/1997, as worded by the aforementioned royal decree act and applicable as of its entry into force (14 July 2013).

2.2. Components of the specific remuneration

When the government exercises the exceptional powers granted by article 14.7 of the EIB and regulates specific remuneration for certain production facilities, such remuneration will include the parameters common to all other production facilities (art 14.5) as well as the specific parameters for the remuneration of production from renewable energy, cogeneration or waste (art 14.7). In other words, this remuneration scheme, which is additional to the remuneration from the sale of energy at production market prices, will be made up of a value per unit of installed capacity, to cover, as appropriate, the investment costs of a model facility which cannot be recovered with the sale of electricity, and a value for the transaction, to cover, as the case may be, the difference between such model facility's operating costs and the revenues it obtains from its participation in the production market.

$$\text{additional Remuneration} = (\text{unrecovered Investment costs}^* \text{ installed Capacity}) + (\text{Income market sale} - \text{non-covered Operating costs})$$

The remuneration scheme will not exceed the minimum level necessary to cover the costs that permit these facilities to compete on a level playing field with other technologies and allow them to obtain a **reasonable rate of return** with reference to the relevant standard facility. This reasonable rate of return

will revolve around the average yield of ten-year Spanish government bonds increased by the appropriate differential.

On an exceptional basis, the remuneration scheme may also incorporate an incentive for investment and execution in a given period when the installation will suppose a significant reduction of costs in systems of the non-peninsular territories.

Revenues and costs of a "standard facility"

In this context, it is fundamental to define "standard facility" - an efficient and well-managed facility that will determine the additional remuneration, for which the following must be defined throughout its useful regulatory life: a) standard revenues from the sale of generated electricity valued at production market prices; b) standard operating costs; c) the standard value of the initial investment. Only those costs or investments determined by regulations or administrative acts applicable to the entire Spanish territory and those that have to do exclusively with the production of electrical power, taking into account best practices in this area, will be considered for these purposes. However, due to the singular characteristics of the non-peninsular territories' electricity systems, specific standard facilities may be determined for each one of them.

2.3. Six-year forecasts

The parameters for remuneration of production from renewable energies, cogeneration or waste will be valid six years. The review of such parameters, which will take place before the beginning of the regulatory period, shall take into account the cyclical status of the economy, the demand for electricity and the reasonable rate of return for these activities.

Although the first regulatory period will in general terms end on 31 December 2019, regardless of the beginning date for each of the activities, and the successive regulatory periods will follow

consecutively starting on January 1, 2020, the first regulatory period for production renewable energy, cogeneration and waste-based production activities with specific remuneration schemes began on 14 July 2013, the effective date of Royal Decree Act 9/2013 of 12 July.

2.4. Specificities of certain facilities

a) Hybrid facilities

Electrical power generated by a facility that uses non-consumable renewable energy will not be subject to specific remuneration, except in the case of hybrid facilities that use consumable and non-consumable renewable energy sources, in which case the power generated by a consumable renewable energy source may be subject to specific remuneration. For this purpose, the Ministry of Industry, Energy and Tourism will order the publication of the methodology to calculate the electricity generated by each type of fuel.

b) Innovative solar thermal technology facilities

The specific remuneration scheme established for solar thermal technology facilities included in the scheme provided for in the third additional provision of Royal Decree 1565/2012 of 19 November, regulating and modifying certain aspects in connection with the special scheme for the production of electrical power, will be made up of a value resulting from the economic offer for the awardee.

Article 4 of Royal Decree Act 2/2013, of 1 February, adopting urgent measures in the electricity system and the financial sector, which established certain benchmark values for the calculation of the premium for these facilities, has been repealed.

2.5. Transitional scheme for operating facilities, referral to regulation

Those facilities that at the time of entry into force of the new law are entitled to

remuneration under the special scheme will continue to receive the same as payments on account, in the terms provided for in the third transitory provision of RDA 9/2013.

A rule will establish the procedure for registration with the specific remuneration scheme registry of those facilities entitled to remuneration under the special scheme at the time of coming into force of the new law, facilities which will be subject to settlement under the appropriate specific remuneration scheme. This procedure will in all cases guarantee the interested party's right to be heard., with a maximum period to decide and notify such decision being one year

Pursuant to RDA 9/2013, in order to establish the new remuneration, the concept of reasonable rate of return throughout the regulatory life of the facility shall revolve, before taxes, around the average yield in the secondary market of ten-year Spanish government bonds increased by 300 basis points, without prejudice to subsequent reviews of the same in the terms provided by the law. In no event will the new remuneration model lead to a claim for remuneration for power generated before 14 July 2013, even with evidence that such reasonable rate of return could have been surpassed at that date.

3. NON-COMPLIANCE

The specific remuneration scheme will not apply if it is confirmed (by way of an inspection, for example) that the facility has not complied with one of the following requirements prior to the deadline established by the regulations:

- a) Completion. For these purposes, a facility is considered to be completed if it has *all the elements*, equipment and infrastructure *necessary to generate* electricity and *deliver it* to the grid, including, as may be applicable, storage systems;
- b) Correspondence between the technical characteristics and the technical characteristics projected for the facility at the time it was granted the right to receive the specific remuneration. When the technical characteristic that has been modified is the facility's capacity and provided such modification is evidenced in the registry of electrical

power production facilities before the deadline established in the regulations, compliance with this requirement will only be obligatory for the part of the facility corresponding to the registered capacity. In such cases, the facility will only be entitled to the specific remuneration for such registered capacity and to the fraction of the electricity generated by the same. *The provisions establishing the mechanisms for assignment of specific remuneration schemes may dispense new facilities that meet certain requirements from complying with point b).*

Apart from the specificities described above, the capacity or electricity generated by any part of a facility entitled to receive specific remuneration, which part was not installed and in operation before the deadline set by regulations, will not be entitled to receive the specific remuneration, without prejudice to the remuneration scheme established by the government for modifications of facilities.

The circumstances described above and the resulting inapplicability or modification, as the case may be, of the specific remuneration scheme applicable to the different facilities will be decided by the Directorate General of Energy and Mining Policy after a procedure that will in all cases guarantee the interested party's right to be heard. The maximum period to decide and notify such decision will be one year.

4. OTHER MATTERS REGARDING FACILITIES WITH SPECIFIC REMUNERATION

- *Creation of a specific remuneration scheme registry.* This registry will be kept by the Ministry of Industry, Energy and Tourism and will include the remunerative parameters applicable to registered facilities. Newly constructed or modified facilities that are not registered in such registry will only receive the market price.
- *Priority of access to the grid.* Without prejudice to the safety of the supply and the efficient development of the system and in the same way as the prior regulation, this regulation recognizes the right of priority access and connection to the grid to producers of electrical power from renewable energy and high-efficiency cogeneration, in the terms determined by the rules and based on objective, transparent and non-discriminatory criteria, (art. 26.2.II).

- *Ministerial authorisation.* The start-up of singular projects and actions will be subject to the approval of the Ministry of Industry, Energy and Tourism, which for such purposes will take into account the impact on electricity transmission structures and energy planning as a whole.
- *Abolishment of the cap on equivalent operating hours of photovoltaic facilities* provided for in the 24th additional provision of Royal Decree Act 14/2010, of December 23, establishing urgent measures to correct the tariff deficit in the electricity industry.

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