

## ***Spain Approves a New Remuneration Regime for Renewable Energy (REER)***

***The new regulation aims to provide a stable and predictable framework to attract investment in the renewable energy sector.***

### **Key Points:**

- Spain aims to achieve a 100% renewable electrical system by 2050.
- The new remuneration regime intends to promote decarbonisation by incentivizing the development of renewable energy facilities with guaranteed stable cash-flows during a limited time period.

Spain announced ambitious targets for the development of renewable energy under its proposed Integrated National Energy and Climate Plan (PNIEC) 2021-2030, which involves the installation of around 5,000 MW per year of new capacity over the next decade. To achieve these objectives, the PNIEC proposes, among other measures, the development of a competitive process for granting a new remuneration regime. The Ministry of Ecological Transition's objective is to cover 80 gigawatts (GW) until 2025, which represents nearly 80% of the PNIEC target, through the new competitive process.

In accordance with this plan, the Spanish government passed Royal Decree-Law 23/2020 on 23 June. The Royal Decree-Law requires the Spanish government to develop a new remuneration framework for renewable energy sources and electricity generation based on long-term energy prices (the remuneration of renewable energy, known as REER), different from the specific remuneration scheme set forth in previous regulations. On 4 November 2020, the Spanish Official Gazette published Royal Decree 960/2020, which develops the new remuneration regime applicable to renewable energy facilities (the "New Regulations"), which entered into force on 5 November.

### **General features**

#### **Purpose**

The New Regulations' purpose is to establish the REER, based on the long-term recognition of a price expressed in euros per megawatt hour (MWh) (the "Award Price") for the electricity to be supplied during a specific time period. The REER must be awarded through competitive auctions called by order of the Ministry for Ecological Transition (the "Ministerial Order"), which will regulate the main characteristics of the auctions. To guarantee legal certainty, the New Regulations expressly state that the Award Price

cannot be modified. On 6 November, the Ministry for Ecological Transition published a proposed Ministerial Order (the “Draft Ministerial Order”) for public consultation.

### Renewable energy facilities entitled to REER

REER will only be available for:

- Renewable non-fossil energy sources classified as group b) under Royal Decree 413/2014, of 6 June, which regulates renewable energy generation (the “Royal Decree 413/2014”, i.e. solar, wind, small hydro or biomass, among others) even if such facilities are hybridized or have storage systems (the “Renewable Facilities”)
- Provided that new Renewable Facility investments take place after the auction. Such new investments can include new facilities as well as modifications or enlargements to existing Renewable Facilities. The Ministerial Order will define the terms and conditions that would qualify a modified or enlarged Renewable Facility as a new investment for the purposes of REER. Pursuant to the Draft Ministerial Order (which is subject to further changes), a modification or enlargement of a Renewable Facility will only be entitled to REER provided that: (i) at least 17 years have elapsed since its registration as an energy production facility; and (ii) the modification is substantial, meaning that either the facility’s main equipment has been replaced, “the investment level has been exceeded” (this term has not been defined), or a combination of both as determined by resolution of the Secretary of State for Energy. In this case, however, REER would only be available for the electricity produced by the new investment, which would require specific metering equipment.

REER will not be compatible with the former specific remuneration scheme provided under Royal Decree 413/2014 or with other public aid, except for justified circumstances to be determined by the Ministerial Order.

### Further regulatory developments

The New Regulations defer to the Ministerial Order the most of the auction’s details (e.g., auction procedure, technologies, the product to be awarded, eventual exemption of small-scale facilities or demonstration projects from the auction system, particularities for the participation of renewable energy communities (*comunidades de energía*), features of the bid selection system, tiebreaker rules, and criteria to assign the quota that has not been covered, if applicable, milestones and requirements in the commissioning and operation of the facilities to guarantee the seriousness of a project entitled to REER, penalties for failure to comply with them or the particular definition of the auction parameters).

In order to guarantee predictability and stability, the Ministry will publish the expected timeline of economic support instruments for renewable energy technologies for the next five years. This timeline will include indicative time periods, auction frequency, expected capacity and technologies, and will be updated annually.

The Draft Ministerial Order regulates: (i) the first auction mechanism to award REER; and, (ii) a timeline for future auctions. Pursuant to this timeline, auctions will be called for a minimum volume of 19,440 MW through 2025. The majority of this volume will be covered through wind and solar PV technologies (i.e., 18,500 MW of the total volume), following by concentrated solar (500 MW), biomass (380 MW), and other technologies such as small hydro or biogas (60 MW).

Once the Ministerial Order is published, the Secretary of State for Energy will issue a resolution calling for the auction and establishing the quota of the product to be auctioned (the “Resolution”).

## The Auction System

### Main features

REER will be awarded through competitive sealed-bid auctions in which the auctioned products will be the electricity, the installed capacity, or a combination of both. The product will be defined by the Ministerial Order. The Draft Ministerial Order provides that the auctioned product for the next call will be the installed power capacity.

The main features of the auction system will be the following:

- A reserve price (*precio de reserva*) above which the bids will be rejected (to incentivize bids that take into account its costs and avoiding larger market (Pool) prices). A minimum price (*precio de riesgo*) below which the bids will also be rejected may be established. Admitted bids between the reserve price and the minimum price will be ordered from lowest to highest price, awarding them on a “pay-as-bid basis” until the auction volume limit is reached.
- The auction volume limit cannot be exceeded unless the Resolution approves a mechanism to award quota not covered by the selected bids and considering that only a non-substantial increase (*incremento moderado*) of the quota will be allowed. The meaning of a “non-substantial increase” remains unclear in the New Regulations and the Draft Ministerial Order.
- The New Regulations provide for specific rules to guarantee the auctions’ competitiveness. In particular, the volume of the product to be offered must be at least 20% greater than the volume of product to be auctioned. The Ministerial Order may increase this percentage. Besides, the total volume to be awarded to the same company or group of companies cannot exceed 50% of the total volume of product auctioned. The Ministerial Order may reduce this percentage. The Draft Ministerial Order does not modify such percentages.
- The selected bids will be considered as award bids. As a result of the auction, an energy generator whose bid has been selected, will obtain the capacity or volume of electricity awarded as well as the Award Price that will be equal to the bidder’s selected bid (except if adjusted as described below). Guarantees of origin associated with the volume of electricity auctioned (GoO) will be assigned to the electricity system on the terms and conditions to be established by a ministerial order. This provision was not included in the different drafts of the New Regulations submitted for public consultation and differs to the current regime in which generators from renewable sources are the holders of GoO.

### Entities organizing the auction process

The Spanish market operator, OMI-Polo Español, S.A., (OMIE) will manage the auctions and the Spanish National Commission on the Markets and Competition (CNMC), will be the supervising entity that validates that the auction process has been objective, transparent, and non-discriminatory. The results of each auction will be made public by resolution of the General Directorate of Energy Policies and Mining.

## The new remuneration regime

### Volumes and Maximum Term

- Renewable Facilities must sell through the *Pool* a volume of electricity output during the maximum term of delivery (the “Maximum Term”) which will be considered the “Electricity Auction Volume”. The Electricity Auction Volume should be between the minimum volume of electricity that needs to be reached by each Renewable Facility to be established by the Ministerial Order (the “Minimum Electricity Auction Volume”) and the maximum auction volume entitled to REER (the “Maximum Electricity Auction Volume”).
  - If the product to be auctioned is electricity, the Minimum Electricity Auction Volume will be equal to the Maximum Electricity Auction Volume. If the product to be auctioned is installed capacity, the Minimum Electricity Auction Volume will be calculated on the basis of the annual minimum operating equivalent hours for technology and the Maximum Term. The Ministerial Order may include partial milestones for control. In each milestone, the Auction Electricity Volume needs to be higher than the electricity volume established for the relevant milestone.
  - The Maximum Electricity Auction Volume will be calculated on the basis of the annual maximum operating equivalent hours for technology (to be determined by the Ministerial Order) and the Maximum Term.
- For the purposes of the above, the Maximum Term is defined as the total non-extendable period of time during which the Renewable Facilities are entitled to receive REER. As a general rule, the Maximum Term will be between 10 and 15 years. In exceptional situations justified by high initial investment or technological risks, the term may be extended up to 20 years. The *dies a quo* for REER entitlement will be the date defined by the Resolution and will not be modified in any case by the date of registration. However, in order to calculate the Electricity Auction Volume, the *dies a quo* will be the later of (i) the date defined by the Resolution; and (ii) the date following the day in which the Renewable Facility has been registered with the Registry with an “operation” status.

### Selling electricity through the Pool: bilateral contracts

Bidders need to sell the Electricity Auction Volume through the Spanish Pool during the Maximum Term. This obligation entails that the generator becomes a market agent and that the Renewable Facility needs to be registered as an individual energy generating unit participating in the balance system. Becoming a market agent and complying with the ongoing obligations imposed by the *Pool* rules may be burdensome for small generators. Aggregating bids will not be allowed for Renewable Facilities entitled to REER. Therefore, it seems unlikely that Renewable Facilities would benefit from the “unbalances management” (*gestión de desvíos*) carried out currently by market agent representatives.

Energy generators cannot declare physical bilateral contracts for Renewable Facilities entitled to REER. The CNMC considered in its report on the draft New Regulations published for consultation that this provision does not incentivize liquidity in the forward markets and proposed to include more flexible rules. No modification has been included in the final published wording. Pursuant to the preamble of the New Regulations, this provision intends to avoid arbitration between bilateral contracts and the participation in the *Pool* and, thus, intends to maximize the reduction of energy generation costs that are passed on to final customers.

## Prices

The price to be received in each negotiation period for the participation in the daily and intraday markets will be one of the following:

- The Award Price without modification
- The Award Price as adjusted by the difference between the daily or intraday *Pool* price and the Award Price, affected by a market adjustment coefficient between 0 and 0.5 to be determined by the Ministerial Order (zero, if the Ministerial Order is silent in this respect) (the “Market Adjustment”).

In this scenario, the price to be received will be equal to the Award Price plus the result of multiplying the Market Adjustment percentage by the difference between the *Pool* price and the Award Price. The Market Adjustment represents the percentage of electricity to be remunerated at *Pool* prices while the remaining electricity volume will be remunerated at the Award Price. Therefore, the total remuneration to be received by the Renewable Facility will be higher if the *Pool* price is above the Award Price and will be lower when the *Pool* price is below the Award Price.

However, if the *Pool* price is equal or higher than a price to be defined by the Ministerial Order known as “*precio de exención de cobro*” (zero, if the Ministerial Order is silent in this respect), the price to be received by Renewable Facilities will be the *Pool* price and the volume of electricity sold at such price will not be considered as “Auction Volume”. This provision intends to avoid negative prices in the Pool.

Renewable Facilities entitled to REER will receive market prices for their participation in other markets (e.g. adjustment services market).

## Penalties

The New Regulations provide for a specific regime of penalties in the following scenarios: (i) if the Minimum Auction Volume is not reached in each partial milestone to be defined by the Ministerial Order; (ii) if the Minimum Electricity Auction Volume is not reached by the Maximum Term; or (iii) if the generator withdraws from REER before the Maximum Term without having reached the Minimum Electricity Auction Volume. Besides, it is important to highlight that if a power facility is not available and registered with the Registry under the operation status by the Maximum Term established in each case, but it is registered before the date established for its expulsion from REER (date to be determined by the Ministerial Order), registration will be allowed and the facility will be entitled to receive REER. However, the guarantees posted will be enforced as a penalty for the delay. The Draft Ministerial Order details the method for the calculation of the penalties.

## Settlement in the *Pool*: particularities

OMIE will carry out the Electricity Auction Volumes settlement negotiated in the *Pool* and will calculate the difference between the *Pool* Price and the Award Price. The difference will be a deficit or *superavit*. If a deficit arises, a payment obligation (cost) will be assumed by the national acquisition units (wholesale suppliers and direct consumers) in proportion to their daily energy nominated in their final scheduled program. In this deficit scenario, the income will also be assigned to the national acquisition units in proportion to their daily energy nominated in their final scheduled program. This mechanism will result in uncertainty regarding the costs to be assumed by the Spanish wholesale suppliers and the price that needs to be passed on to end consumers. Storage power facilities are exempted from this settlement mechanism.

## Registrations

In order to be entitled to the REER, Renewable Facilities must be registered with the Electronic Registry of REER (the “REER Registry”).

Projects must first go through the pre-assignment status, after the required guarantees have been posted up to its commissioning. Once the Renewable Facility has been commissioned in compliance with the auction rules and applicable administrative proceedings and the Renewable Facility is selling its electricity output to the *Pool*, Renewable Facilities need to be recorded with the REER Registry in the commercial operation status (*estado de explotación*).

Pursuant to the Draft Ministerial Order, the amount of the guarantee for registration in the pre-assignment status will be €60 per kW. Of this amount: (i) €12 per kW will guarantee the particular identification by the generator of the specific Renewable Facilities to be built linked to the installed capacity registered within six months of the publication in the *Spanish Official Gazette* of the registration with the REER Registry in pre-assignment status; (ii) €18 per kW of the total amount will guarantee obtaining the prior administrative authorization for such particular Renewable Facility identified within 12 months of its registration in the REER Registry; and, (iii) €30 per kW will be linked to the final registration with the REER Registry in the commercial operation status. The guarantee may be foreclosed if such milestones are not achieved.

Such interim milestones are likely intended to avoid situations encountered in past auctions whereby the capacity was awarded to projects that were not mature and could not be completed.

The Resolution must establish the maximum permitted timeline in which the Renewable Facility needs to have been fully authorized (including its evacuation facilities) and to have started selling its electricity to the *Pool*. Such maximum permitted timeline must be, at least, four months to the start date of delivery.

The REER Registry will identify the characteristic of the facility, its owners, the applicable REER and its term, the installed capacity (which cannot be higher than the award capacity) and the Minimum and Maximum Electricity Volume. Any subsequent modification of these elements must also be notified to the Registry.

Renewable Facilities registered with the REER Registry will be subject to periodic inspections to verify compliance with the requirements for the application of REER.

## What's next?

Undoubtedly, the implementation of New Regulations together with the publication at the beginning of the year of the new value for the reasonable return (IRR) for existing facilities entitled to the former specific remuneration regime, demonstrates the Spanish government's support for Renewable Facilities. The New Regulations will provide certainty for the development of new Renewable Facilities by establishing a predictable economic framework that will facilitate their financing. However, whether or not the auctions will achieve its objective, as well as any potential impact in current *Pool* prices, in other energy sector agents, or in existing projects under development through bilateral contracts, cannot be determined until (i) all the secondary legislation is in place, and (ii) we learn from the experience following the auctions to be called over the next years.

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