

## NEW REGULATORY FRAMEWORK FOR THE CALL FOR RENEWABLE-ENERGY TENDERS

On 4 November 2020, Royal Decree 960/2020, of 3 November, regulating the economic regime for renewable energy for electricity generation facilities (“RD 960/2020”) was published in the Official State Bulletin.

This Royal Decree implements the provision contained in Article 2 of Royal Decree-law 23/2020 of 23 June, approving measures relating to energy and other areas for economic recovery (“RDL 23/2020”), which introduced a new section 7. bis in Article 14 of Law 24/2013, of 26 December, on the Electricity Sector (“LSE”), which gives the Government the power to develop a new remuneration framework for the generation of electricity from renewable energy sources, based on the long-term recognition of a fixed price for energy.

In addition, on 10 November 2020, the public consultation phase of the draft Ministerial Order “*regulating the first auction mechanism for the awarding of the economic regime for renewable energy and establishing the indicative timetable for the period 2020-2025*” (“Draft MO on the first auction mechanism”) was initiated.

The purpose of this Legal Briefing is to analyse the main aspects of this new remuneration mechanism for renewable energy generation facilities, which is known as the “*economic regime for renewable energy*” (“REER”).

### 1. What is the REER and what is its objective?

The REER is a remuneration mechanism for facilities that generate electricity from renewable sources, which is in addition or an alternative to the existing mechanism, based on the long-term recognition of a fixed price for the energy generated.

Its objective, as stated in Article 14.7.bis of the LSE, is to “*encourage predictability and stability regarding the income and financing of new facilities that are built to generate electricity from renewable energy sources*”.

More specifically, the preamble of RD 960/2020 specifies that the REER aims to facilitate access to financing for the developers of renewable projects, providing greater certainty regarding their future revenue and avoiding strong economic and financial tensions. The aim is to resolve what the regulation calls “*market failure*”, which occurs as a result of the “*forecast of a significant inflow of renewable energy*”, which adds “*additional uncertainty regarding*

*wholesale market prices, which is transferred to the cash flows of the projects, making them more expensive and, in the extreme, unfeasible to finance under market conditions”.*

This “*market failure*”, in short, refers to the so-called “*price cannibalisation*” effect that would occur in the event of mass entry into the renewable energy market, “*depressing prices and preventing the installation of more renewable power in the medium term, given the uncertainty about revenue from projects without public support of any kind*”.

## 2. Which facilities are eligible to apply the REER?

All facilities that generate electricity from renewable energy sources are eligible<sup>1</sup>, provided that they are the result of a **new investment** undertaken after an auction which gives rise to the right to receive it, either because they are entirely new facilities or because they are an extension or modification of an existing facility, under the terms specified in the ministerial order (“**MO**”) governing the auction mechanism<sup>2</sup>.

If the new investment relates to an extension or modification of an existing facility, the REER may only be awarded in respect of the part corresponding to the new investment.

In any case, the facilities that are eligible for the REER can use more than one technology (hybrid facilities), and can have storage systems<sup>3</sup>.

## 3. How is the REER awarded?

The REER will be awarded by means of auctions in which (i) the product to be auctioned will be the installed power, the electrical energy or a combination of both and (ii) the bid variable will be the price per unit of electrical energy (€/MWh).

There is a possibility of auctions not being technology-neutral, in that a distinction can be made between generation technologies provided this is justified under Community law insofar

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<sup>1</sup> All the facilities defined in category b) of Article 2.1 of Royal Decree 413/2014 of 6 June, which regulates the activity of electricity generation from renewable energy sources, cogeneration and waste (“**RD 413/2014**”). The facilities defined in category a) of Article 2.1, i.e. producers that use cogeneration or other forms of generating electricity using waste energy, are therefore excluded.

<sup>2</sup> On 10 November 2020, the Ministry for the Ecological Transition and the Demographic Challenge started the public consultation phase concerning the Draft MO on the first auction mechanism, which lasts until 18 November 2020.

<sup>3</sup> It is worth noting that the Draft MO on the first auction mechanism requires that the storage system of the facilities that are eligible for REER be used for the exclusive storage of the energy produced by the facility and that the facility not act as an energy purchasing unit in the market.

as this would otherwise lead to sub-optimal results<sup>4</sup>.<sup>5</sup> The MO regulating the auction mechanism can also exempt small facilities with an installed capacity of less than 5 MW and demonstration projects from the competitive tendering procedure for receiving the REER<sup>6</sup>.

The following are essential elements of the auctions:

- (i) The auction mechanism for awarding the REER and its characteristics will be regulated by MO, which will specify, among other aspects: eligible technologies, conditions and guarantees, the product to be auctioned, as well as the parameters and other elements that make up and determine the REER<sup>7</sup>. In particular, the amount of the guarantee required to participate in the auction and the guarantee required to apply for the facility to be added to the electronic register of the REER with a pre-allocation status will be specified<sup>8</sup>.
- (ii) Invitations to tender will be made by means of a Resolution of the State Secretariat for Energy (“SEE”) which will specify the quota of product to be auctioned, the maximum price or reserve price (with bids that exceed that price being excluded) and, optionally, the minimum price or risk price (excluding bids that are below it)<sup>9</sup>, as well as the maximum period for delivery of the energy by the successful bidder and the starting date of such period.
- (iii) In order for the auction to be valid, one of the conditions is that the volume of product offered be at least 20%<sup>10</sup> higher than the volume of product to be auctioned. If this percentage is not reached, the volume of product to be auctioned will be reduced by the amount necessary to meet this threshold.

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<sup>4</sup> Taking into account (i) the long-term potential of a specific technology; (ii) the need for diversification; (iii) grid integration costs; (iv) grid constraints and stability; (v) in the case of biomass, the need to prevent distortions in commodity markets.

<sup>5</sup> However, the preamble of the Draft MO on the first auction mechanism indicates that the auctions will be technologically neutral and open to all renewable energy technologies included in the scope of application of RD 960/2020 and located within the peninsular electricity system, although within each quota, minimum reserves of product to be awarded to one or several technologies may be established.

<sup>6</sup> In these cases, the result of these procedures may be used as a reference for remuneration.

<sup>7</sup> The Draft MO on the first auction mechanism specifies that the product to be auctioned will be the installed power.

<sup>8</sup> In the Draft MO on the first auction mechanism, the amount of both guarantees is set at 60 euros/kW for the power to be offered or the power to be registered respectively.

<sup>9</sup> Both prices may be confidential and will be expressed in €/MWh to two decimal places, either as a fixed amount or as the result of a calculation formula.

<sup>10</sup> This percentage can be increased in the MO regulating the auction mechanism.

- (iv) Maximum percentage limits are established for product awarded to the same company or business group, which may not exceed 50%<sup>11</sup> of the total volume of the product auctioned.
- (v) The award will be made according to the sealed-bid method and the pay-as-bid mechanism<sup>12</sup>, and the result of the auction will be made public (circulation thereof is the responsibility of OMIE, as the entity administering the auction).
- (vi) As a result of the auction, the power or energy awarded to each participant will be obtained, according to the product auctioned, as well as the auction price that will correspond to their economic offer. The auction price will not be updated.

#### 4. What are the rights of the facilities who bid successfully?

The REER allows for the revenue to be collected through the sale of energy in the market, with the special provision that, for a given volume of energy and within a defined period of time, the sale price of energy will be calculated on the basis of the result of each auction.

Therefore, the main right acquired by the facilities to whom the REER is awarded is that of receiving the auction price for the energy produced, with the limit of the maximum volume awarded (maximum auction energy) and within the maximum delivery period.

As indicated, the maximum delivery period will be set in the Resolution of the SEE with the invitations to tender and will be between 10 and 15 years, with the possibility of an exceptional extension of up to 20 years if this is justified because technologies with a high initial investment or technological risk are being used<sup>13</sup>.

The following price adjustment mechanisms should be taken into account when determining the price that the facilities to whom the REER is awarded are entitled to receive:

- (i) **Symmetrical market incentive:** this is a mechanism for correcting the auction price using a market adjustment percentage, to be set in the MO regulating the auction mechanism, which can amount to up to 50% of the difference between the daily market

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<sup>11</sup> This percentage can be decreased in the MO regulating the auction mechanism.

<sup>12</sup> Unlike the marginal pricing system used in the auctions held so far under Article 14.7 of the LSE.

<sup>13</sup> As stated in Article 16 of RD 960/2020, the maximum delivery period “*will be limited to the period of time necessary to transmit a sign of certainty regarding the revenue of the facilities, so as to facilitate the financing of new projects*”.

price and the auction price<sup>14</sup>. If no value for the percentage is specified in the MO, the percentage is considered to be zero by default<sup>15</sup>.

- (ii) **Price of exemption from collection:** this is set at zero €/MWh and means that, in those trading periods in which the daily or intraday market price is lower than this, the facilities awarded the REER receive the market price in these periods and the energy traded in these trading periods is not counted as auction energy.

The MO regulating the auction mechanism may set a price for exemption from collection which is higher than zero €/MWh for specific auctions and if this is relevant in accordance with common criteria in the internal electricity market. In any case, the price of exemption from collection may not be modified during the period in which the facilities have been awarded the REER.

Additionally, facilities awarded the REER are entitled to participate in adjustment and balancing services under the terms established in the applicable regulations. The net value of the energy traded in the balancing and adjustment services will be valued at the difference between the price to be received by the facilities awarded the REER and the daily market price.

Likewise, the right of the facilities to waive the REER is expressly provided for, and would entail a financial penalty if waived before the minimum auction energy has been delivered.

Lastly, it is worth noting that the guarantees of origin associated with auctioned energy are assigned to the electricity system, with the appropriate operating mechanism being regulated by a MO.

## 5. What are the obligations of the facilities who bid successfully?

The main obligations of the facilities awarded the REER are the following:

- (i) Register the facility in the electronic register of the REER with a pre-allocation status and in an operational state within the established deadlines. To register with pre-allocation status, a financial guarantee must be deposited for the amount specified in the MO regulating the auction mechanism.
- (ii) Comply with the milestones prior to the completion of construction of the projects that have been established, where appropriate, in the MO regulating the auction mechanism.

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<sup>14</sup> The Draft MO for 2020-2025 provides for a market adjustment rate of 25% for technologies with the capacity to manage their production level, and a rate of 5% for those without such capacity.

<sup>15</sup> Provision is made for the possibility of the MO regulating the auction mechanism adapting the remuneration mechanism for facilities with storage capacity who are awarded the REER.

- (iii) Build the facility, obtain definitive registration in the Administrative Register of Electricity Generation Facilities<sup>16</sup> and start selling energy on the market before the deadline for availability and, in any case, before the date of expulsion of the REER set in the Resolution of the SEE with the invitations to tender.
- (iv) Deliver the minimum auction energy within the maximum delivery time and, where appropriate, the intermediate control milestones set in the MO regulating the auction mechanism.
- (v) Offer energy on the daily and intraday market, with its best production forecast and in accordance with the rules of operation of the daily and intraday markets.
- (vi) Not enter into physical bilateral contracts with facilities that have been awarded the REER.
- (vii) Be subject to the system of penalties established in order to provide an incentive to comply with the obligations relating to minimum auction energy<sup>17</sup>.

## 6. How is the REER financed?

Financing for the REER will be provided by the wholesale electricity market according to the following settlement mechanism:

- (i) In the event that the market matching price is higher than the auction price, the facility that was awarded the REER will only receive the auction price (corrected, where appropriate, with the symmetrical market incentive). The difference or economic surplus is considered as revenue for the market, to be distributed among the national purchasing units (trading companies and direct market consumers), in proportion to the daily energy programmed in their final hourly schedule after the continuous market.
- (ii) In the event that the market matching price is lower than the auction price, the facility that was awarded the REER will receive the difference up to the auction price (corrected, where appropriate, with the symmetrical market incentive). This difference or economic deficit is a payment obligation for the market, which will be distributed by the market operator among the national purchasing units (trading companies and direct market

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<sup>16</sup> The Administrative Register of Electricity Generation Facilities is regulated by RD 413/2014.

<sup>17</sup> In accordance with the provisions of Article 20 of RD 960/2020, (i) automatic penalties may be imposed for not reaching the equivalent minimum auction energy at intermediate control milestones; (ii) penalties may be imposed in the event that the auction energy of a facility does not exceed the value of the minimum auction energy at the end of the maximum delivery period; and (iii) penalties may be imposed in the event of cancellation of the registration of the facility in the operating register if the auction energy of the facility at the time of cancellation does not exceed the minimum auction energy. The penalties will be considered as revenue of the electricity system.

consumers), in proportion to the daily energy programmed in their final hourly schedule after the continuous market.

## 7. When will there be new invitations to tender?

RD 960/2020 provides that through a MO, subject to the agreement of the Government's Delegate Commission for Economic Affairs, a planned timetable for access to economic support instruments will be established, covering a minimum period of five years and including indicative deadlines, the frequency of calls for support instruments, the expected capacity and the technologies envisaged, where appropriate. This timetable will be updated at least annually and will be geared towards achieving the renewable energy generation targets set in the National Integrated Energy and Climate Plan (*Plan Nacional Integrado de Energía y Clima*, PNIEC) for 2021-2030.

Without prejudice to the above, in order to hold an auction, prior approval of the MO regulating the auction mechanism is required, as well as the subsequent Resolution of the SEE with the invitations to tender.

Regarding this point, it should be noted that when this Legal Briefing was published, the Draft MO on the first auction mechanism was in the public consultation phase. According to information published by the Ministry for the Ecological Transition and the Demographic Challenge, auctions are expected to be held in 2020 for the allocation of REER for a minimum of 3,100 MW, of which at least 1,000 MW will be for wind energy; 1,000 MW for photovoltaic energy and 80 MW for biomass energy, with the remaining power to be auctioned without technological restriction.

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