ENERGY AUCTIONS AND MERCHANT PROJECTS WITH PPAS CREATING OPPORTUNITIES FOR INVESTORS - WATSON FARLEY & WILLIAMS

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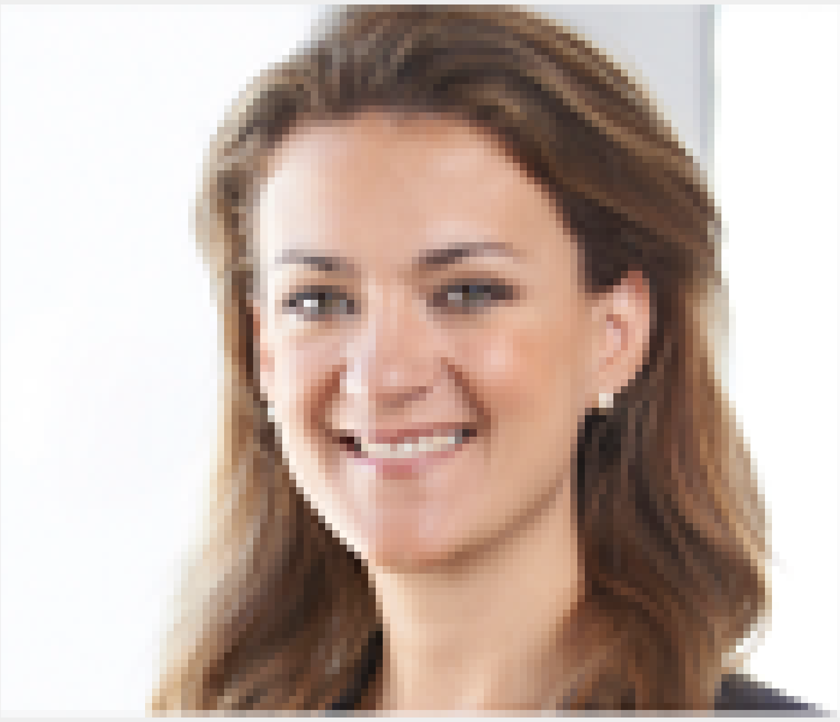

Category: Energy

The emergence of merchant projects without regulated incomes has marked the beginning of a new era in the Spanish renewable energy market

The Spanish renewables sector is currently offering investors a wide range of opportunities including projects arising from the government's energy auctions as well as merchant plants involving power purchase agreements, says María Pilar García Guijarro, managing partner of Watson Farley & Williams' Madrid office.
However, she adds that investors need to be cautious due to uncertainty regarding the reasonable rate of return, which is reviewed every six years. García Guijarro also argues that the approach the government takes when reviewing the rate of return is "not in line with applicable law".
Investors looking for high returns have the option of acquiring projects in the development or construction phase, says Garcia Guijarro. She adds that, in this group of potential investments, there are three alternatives: projects arising from the auctions conducted by the Spanish government; merchant projects; and projects involving power purchase agreements.

For new projects coming out of the government's recent renewable energy auctions, one of the key issues is deadlines, according to García Guijarro. She adds that recent winning bids have been those that "accepted very high discounts". García Guijarro continues: "This means that, essentially, they are not going to receive any regulated return, instead they have a floor price guaranteed by the government." She adds that deadlines are tight, but feasible. "Clients need to act diligently and rapidly in order to achieve the floor," García Guijarro says.

Another option for investors is merchant projects, which are plants that, in order to be built and exploited, go to the pool and sell electricity at market prices, says García Guijarro. These plants face both challenges and opportunities, she adds. They need to take into account future prices of electricity when structuring their financial models. Within this context, a very important sub-group of energy projects is emerging – these are merchant plants that have been able to negotiate and close power purchase agreement (PPA) contracts. These bilateral agreements between buyers and sellers set the price for the sale and acquisition of electricity, usually with variable components in accordance with formulas. In this way, they afford plants protection against fluctuating market prices and facilitate cash projections and the financing of the projects.

Structuring a power purchase agreement can be a complex process. "PPA contracts are new in the Spanish market," García Guijarro says. "They involve challenging documentation – now we are seeing huge PPAs that need to be structured with framework agreements, it's not a 'plain vanilla' PPA as in certain other jurisdictions." There is substantial interest in these kinds of merchant projects, García Guijarro says. "Lenders are analysing and studying how to structure the debt in an optimal manner to be able to finance merchant projects," she adds.

New era for Spanish renewables

The emergence of merchant projects without regulated incomes marks a new era in the Spanish renewable energy market, according to García Guijarro. Consequently, this new trend will generate significant opportunities for lawyers. Watson Farley & Williams recently advised Cox Energy on the biggest-ever solar PPA, with Audax – construction of the solar power plants and photovoltaic facilities are scheduled for completion in 2020. García Guijarro, who led the Watson Farley & Williams team advising on the transaction, says such a deal represents "a milestone in the energy sector".

Meanwhile, investors interested in assets already in operation in Spain are able to find a significant number of opportunities, according to García Guijarro. However, there is one key issue to take into account when analysing such assets, which is an element of uncertainty in relation to the reasonable rate of return for the next regulatory period which begins in 2020. "According to what the authorities have said, the possible reasonable rate of return [for the next regulatory period] may run from 4.5 to 7 per cent," García Guijarro says. The rate of return – which is currently 7.4 per cent or 7.5 per cent depending on the asset – can be reviewed every six years. García Guijarro adds that the method that the Spanish government seems to apply when conducting such a review is not in line with applicable law and regulations, since "they maintain that in order to modify the reasonable rate of return, it [the government] shall seek the approval of the parliament".