Renewable Arbitration – Case Study

The following Case Study provides a summary of the work carried out by EKON experts in one of the largest Renewable investors vs. the Spanish Government arbitration cases as a result of certain key regulatory changes that have impacted on our Client renewable investments in Spain since 2007

In this project, EKON experts acted as regulatory and quantum experts for our Client. At the time, the Assets were regulated under Royal Decree ("RD") 661/2007 and were therefore renewable assets operating under the Spanish Special Regime programme and entitled to a long-term renewable incentive (i.e. guaranteed remunerated return).

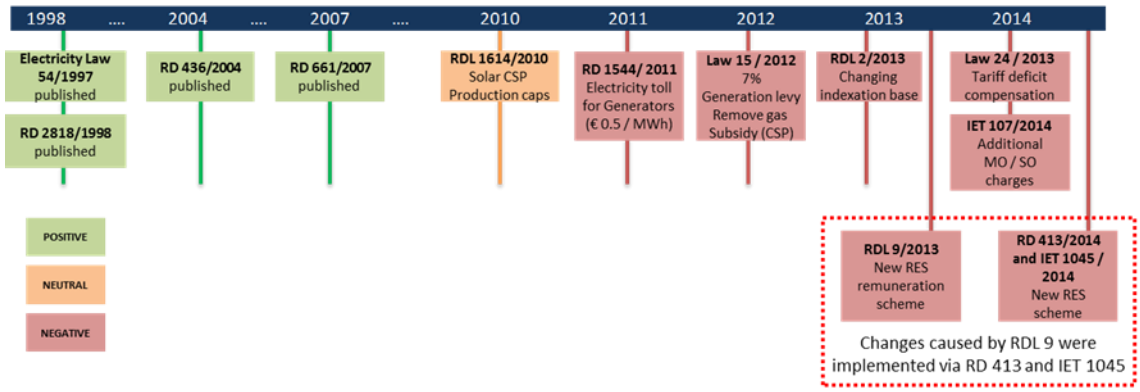
The Spanish Government (the "Government"), however, implemented a series of retroactive regulatory changes – initially in 2010, but mainly concentrated in 2012-2014, that impacted significantly and negatively on the economic performance of these projects.

Description of the original retributive scheme

Through RD 661/2007, the Government encouraged new investments in cogeneration and renewable energies by placing them under a Special Regime, and incentivised electricity purchases from renewable energy generators. Under RD 661/2007, these incentives were guaranteed during the operating lifetime of a plant.

The main advantages of the Special Regime were the right to deliver electricity to the local distribution network when this was technically feasible, and to receive a guaranteed remuneration. With regard to the latter, operators could choose between a Tariff Option and a Premium Option.

2010-2014 Regulatory Changes



In 2010, and with the aim of reducing the Tariff Deficit (mismatch between the electricity system income and costs), the Spanish Government issued two Royal Decrees that proved damaging to our client's investment. In November 2010 the Government published RD 1565/2010 which eliminated the premiums from the 25th year of operation onwards, in December 2010, the RD 14/2010 was published which reduced the premium to the photovoltaic installations during 2011, 2012 and 2013 (limitation of hours), and in exchange added three years to the end of the project's operating life (26th, 27th and 28th years).

Despite the above measures, the tariff deficit continued to grow in an uncontrollable manner and the Spanish Government decided that additional (retroactive) measures were needed. As a result, in 2012, the new Government published a series of reforms whose main points are summarized below:

- Royal Decree -Law 1 /2012, 27th of January: suspension of pre-allocation procedures and removal of economic incentives for new production of electricity from renewable sources, waste and cogeneration.
- Law 15/2012 of 27th of December, on fiscal sustainability for Energy: imposing a 7% tax on power generation.
- Royal Decree-Law 2/2013 of 1st of February, on urgent measures in the electricity and financial sector, for which the Consumer Price Index (CPI) that had been used in the formulas for updating the premium is replaced with a Consumer Prices Index at constant taxes excluding unprocessed food and energy products.
- Royal Decree-Law 9/2013 12th of July, on urgent measures to ensure the financial stability of the electricity system, which enables the Government to adopt a new legal and economic framework for production facilities from existing sources of renewable energy, CHP and waste electricity. The philosophy of the new economic system was based on "securing" a certain return on investments (theoretically the yield on the 10-year Spanish Bond state plus 300 basis points).

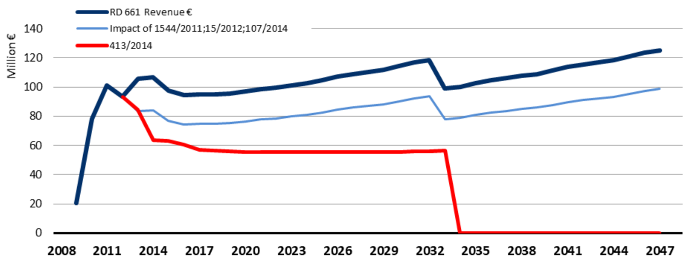
RENEWABLE ARBITRATION

Expert Report

EKON experts drafted a report that contained both the regulatory analysis and the damage assessment. In order to determine the exact impact that these measures were going to have on the value of the asset acquired, as well as the impact that it would have on our client's financial statements, our client asked EKON to carry out a full independent damage assessment and to prepare an expert report analysing not only the impact of the current regulatory change, but also providing an expert opinion on the likelihood of further retroactive measures that could impact on the Renewable Energy projects.

For that purpose, we performed a flexible and fully detailed bespoke financial model, incorporating a profit and loss account, balance sheet and cash flow account for the life of the asset. With the financial model we calculated different ratios such us IRR, NPV, DSCR and we performed different scenarios and viability analysis.

Using our in-house financial model to perform financial projections we have prepared the following table where we highlight the reduction in revenue corresponding to each of the years affected by some of the latest decrees.



Therefore, the revenue of those three years was reduced compared to the scenario originally planned. This reduction in revenue lead to the need for our client to restructure terms of the financing of the project and our expert report as well as our financial analysis was used in this respect.

Our model was also used to analyse the impact on the NPV (Net Present Value) and IRR of the assets as a result of the regulatory changes.

Expert report and Expert Witness

Once we had carried out the analysis of the reform, and the financial impact of these changes on the initial valuation of the transaction, we determined that indeed the viability of the plants had clearly and drastically been impacted.

We have used a financial model to establish the financial representation of the asset and have recreated the economic impact of the different events mentioned above.

Our report was used by our client as a central component of its case and our experts gave expert witness testimony in order to defend the findings as presented in our report.

EKON provides a full range of consulting services split into 4 general groups.

One of the keys to our success has been the full-time involvement of the experts from the very start of a project through to completion, to our clients' full satisfaction.

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STRATEGIC ADVICE
- Viability Analysis
- Entry / Exit Strategy
- Risk Analysis

M&A SERVICES
- Financial valuation,
- Financial model design including price projections,
- Assistance in commercial discussions.

Client

ARBITRATION SERVICES
- Strength of case
- Assistance in Commercial Discussions
- Expert witness role

POLICY ADVICE
- Regulatory Analysis
- Power Market design
- Tariff design

EKON strategy consulting

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