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**Subject: State aid SA.42270 (2016/NN) — Spain
Electricity production in Spanish non-peninsular territories**

Excellency,

1. PROCEDURE

- (1) On 24 June 2015 the Spanish authorities notified to the Commission a draft Royal Decree regulating the production and dispatching of electricity in the electrical systems of non-peninsular territories ("NPT")¹ in Spain. That draft was adopted on 31 July 2015 as Royal Decree 738/2015 and entered into force on 1 September 2015. As Spain implemented the scheme before the Commission adopted a positive decision, the case was transferred to the register of unlawful aid.
- (2) The Spanish authorities provided additional information on the scheme on 16 October 2015, 1 March, 14 June and 7 October 2016.
- (3) Further information regarding the specific situation of some of the NPT was provided by the Spanish authorities on 4 April 2018, 20 April 2018 and 22 May 2018.

¹ Spanish non-peninsular territories include the Balearic Islands, the Canary Islands and the cities of Ceuta and Melilla.

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- (4) The Spanish authorities also provided information on some modifications introduced in the scheme and other related issues on 31 October 2018, 12 July 2019, 2 October 2019, 13 February 2020 and 23 April 2020.
- (5) On 14 January 2020, Spain waived its right under Article 342 TFEU in conjunction with Article 3 of Regulation (EEC) No 1/1958 to have the decision in this procedure adopted in Spanish and agreed that the decision be adopted and notified in English.

2. DETAILED DESCRIPTION OF THE MEASURE

2.1. Overview of the legal framework for the Spanish non-peninsular territories

- (6) Law 24/2013 ("**the Electricity Sector Law**") establishes that the supply of electricity in the Spanish NPT is subject to a specific regulation. It also sets out that this activity can receive an additional remuneration to cover the difference between the costs to generate electricity in the NPT and the revenues from the sales of electricity.²
- (7) Law 17/2013 sets out the general provisions for the guarantee of supply and increase of competition in the electricity systems in the NPT. It establishes that in order to receive the right to the additional remuneration scheme, new installations or renewals of existing ones should first obtain the "*favourable resolution of compatibility*" (i.e. prior condition to be included in the scheme³) resulting from a competitive procedure.
- (8) Royal Decree 738/2015 ("**the Royal Decree**") regulates in detail the activity of producing electricity and the power dispatching procedure in the electricity systems in the NPT as well as the remuneration scheme of this activity, particularly the remuneration scheme for generation installations from manageable sources (Category A, see recital (38)). It also develops the regulation of the competitive procedure for granting the "*favourable resolution of compatibility*" for Category A, new capacity and capacity to be refurbished.
- (9) Finally, Law 6/2018 ("**the 2018 Budget Law**"), introduced an amendment in Law 17/2013 by which, exceptionally and only during 2018, the Minister of Energy was able to apply, to the necessary extent and for a limited period of time, the additional remuneration scheme to existing power plants that have to make additional investments required to be able to continue operating in line with the EU and Spanish legislation. As described in section 2.10 below, the provision requires the system operator⁴ ("**SO**") to show that there is a security of supply risk in the NPT in a time horizon shorter than five years. The provision also exempts from the prior "*favourable resolution of compatibility*".

² Law 54/1997, the previous Electricity Sector Law, already provided that the supply of electricity to the electricity systems in non-peninsular territories would be excluded from the market and be remunerated by reference to the price in the mainland system, taking into account all costs that could not be covered by the revenue obtained in those territories.

³ See recital (44) for the details on the "*favourable resolution of compatibility*".

⁴ Red Eléctrica de España (REE).

2.2. The Royal Decree 738/2015

- (10) The Royal Decree 738/2015, notified by the Spanish authorities, concerns Spain's four non-peninsular electric systems. They consist of (i) the Autonomous Communities of the Canary Islands (seven islands, two of them interconnected), (ii) the Balearic Islands (four systems merged into one system, having a single dispatching procedure since December 2018 and partially connected to the Iberian peninsula) and the two Autonomous Cities of (iii) Ceuta and (iv) Melilla. This Royal Decree (738/215) amends the provisions already laid down by the framework law on the electricity sector in 1997 and repeals the previous rules that developed these elements⁵.
- (11) The Royal Decree regulates the system for the dispatch of electricity that replaces the market, and the payment system for producers in the NPT. The State can grant the so-called "*additional remuneration*" to electricity installations from manageable sources to cover their costs of electricity generation in the NPT. The Royal Decree defines the extra cost as the difference between all the costs of generation and the price paid in the electricity dispatch run by the SO. Additionally, the Royal Decree introduces a competitive procedure for the selection of new capacity and capacity to be refurbished. Before launching the procedure, the SO needs to show the capacity needs taking into account the technical and economic conditions of different alternatives.

2.3. Characteristics of the electricity systems in the NPT

- (12) The electricity systems in the NPT have technical characteristics which make them different from the electric system in the mainland.

2.3.1. *Small size and isolation*

- (13) All Spanish NPT are relatively small and electrically isolated from the mainland with the partial exception of the Balearic Islands that have one interconnection with the mainland. The six non-interconnected systems in the Canary Islands add up to 2.8 GW of installed capacity with an annual demand of 8 958 GWh in 2017. The city of Ceuta has 91 MW of capacity installed (203 GWh demand in 2017) and Melilla 78 MW (211 GWh demand in 2017).
- (14) As regards the Balearic Islands, since 2012 the electrical system of Mallorca-Menorca has been interconnected with the Spanish mainland, through a 400 MW interconnector that covers around 20% of the annual demand. Historically, the Balearic Islands comprised two electric systems ("Mallorca-Menorca" and "Ibiza-Formentera") with capacities of 1.9 GW and 0.3 GW respectively. In December 2018, a new connection between the systems of "Mallorca-Menorca" and "Ibiza-Formentera" became operational, creating a single electric system for the whole archipelago ("**the Balearic system**") of total installed capacity of 2.2 GW and an annual demand of 6 028 GWh in 2017. The Spanish authorities have confirmed the plans for the installation of a second cable between the Balearic Islands and the Spanish mainland that would increase the

⁵ The Royal decree under examination repeals and replaces Royal Decree 1747/2003, which regulated the electricity systems in the NTP, and a number of Ministerial orders concerning compensation parameters and the procedure for the electricity dispatch and settlement.

interconnection capacity to around 40%-50% of the demand. However, this second interconnection will probably not be ready before 2025.

- (15) Currently, the situation of Menorca is different to that of the rest of the Balearic Islands. In July 2017, the cable linking Menorca with Mallorca broke down and the manufacturer certified that it could not be repaired due to its age (42 years), the expiry of its useful life and the current state of degradation. The cable laying works for a new interconnection of 100 MW between Mallorca and Menorca were completed in November 2019, but it will not be in operation until the third quarter of 2020. Moreover, the Spanish authorities are accelerating the planning for an additional second interconnection for Menorca. As a result, Menorca remains isolated from the rest of the Balearic electric system until the third quarter of 2020.
- (16) The Directive 2019/944⁶ on common rules for the internal market for electricity defines the categories of “small isolated system” and “small connected system”. Any “small isolated system” had a consumption of less than 3 000 GWh in the year 1996, where less than 5% of annual consumption is obtained through interconnection with other systems”. The Canary Islands, Ceuta and Melilla fall under this category. In contrast, the new category of “small connected system” comprises any system that had a consumption of less than 3 000 GWh in the year 1996 but where more than 5% of annual consumption is obtained through interconnection with other systems. The Balearic Islands fall under this category. Article 66 of the Directive allows Member States to apply derogations from some of its provisions if they can demonstrate substantial problems for the operation of their small isolated and connected systems, including derogations from Article 8, which relates to the authorisation procedure for new capacity. The Spanish authorities have expressed their intention to request those derogations.

2.3.2. Low level of competition, lack of functioning market

- (17) Competition in the electricity market in the NPT is very low across the value chain. As regards generation, the plants owned by Endesa group⁷ have historically generated approximately 90% of the energy produced in the Balearic Islands and the Canary Islands, and almost 100% in Ceuta and Melilla. This is the case still today. Distribution and retail electricity supply are also mostly carried out by companies of the Endesa group⁸.
- (18) As regards market entry, the Spanish authorities have stated that the small size of the NPT and the environmental restrictions make difficult to find appropriate sites for the

⁶ Directive (EU) 2019/944 of the European Parliament and of the Council of 5 June 2019 on common rules for the internal market for electricity and amending Directive 2012/27/EU (OJ L 158, 14.6.2019, p. 125–199).

⁷ Endesa group is 70% owned by Enel Group.

⁸ As for retail activities, Endesa sells around 70% of the energy consumed in the NPT through its retail subsidiaries. There are other suppliers that also carry out their activity in these territories, in some cases, as a complement to their activity in the mainland. More information in: <https://sede.cnmc.gob.es/listado/censo/2>
The main retail companies are (data as of July 2019):

- Canary Islands (market share): Endesa energía y Endesa comercializadora UR: 67%; Gas Natural comercializadora, SUR y servicios: 4%; Iberdrola Generación: 14%
- Balearic Islands (market share): Endesa energía y Endesa comercializadora UR: 66%; Gas Natural comercializadora, SUR y servicios: 5%; Iberdrola Clientes: 13%.

location of new generation installations. Additionally, the Spanish authorities indicate that the small size of the market prevents economies of scale that would reduce generation costs. Moreover, as regards system security, the SO requires a reserve capacity margin of 40-70% as opposed to 10% margin in the mainland. They explain that a coverage ratio of 110% has traditionally been used to plan the development of the transport network. Nowadays however, probabilistic methods are used by the SO to take into account the availability of facilities, and in particular, the availability of intermittent generation sources. According to these probabilistic methods, in order to achieve the level of security of electricity supply aimed at by the Spanish authorities in the NPT, the capacity installed must provide an average monthly probability of failure of less than 1 day in 10 years. Hence, the utilisation factor of many of the generation units is relatively low during normal operational times. These special features of the electricity market in the NPT deter investors from building new capacity.

2.3.3. High costs of generation and homogeneous regulated tariffs across the Spanish territory

- (19) In the NPT, electricity is mainly generated from fuel-oil and diesel plants, with high variable and low fixed costs. The supply of fuel (the main variable cost of generation) is more difficult and expensive than in the mainland. Due to their isolation, generators in these systems also face higher costs of investments and operation and maintenance. Hence, electricity generation costs in these territories are considerably higher than in the mainland.
- (20) NPT electricity systems do not have indigenous manageable sources of primary energy for production of electricity nor do they have nuclear facilities. They have practically, no hydroelectric capacity⁹ and until a few years ago, renewable sources were limited, despite the fact that some systems such as the Canary Islands, have potentially large wind resources. There is potential for storage only in the future¹⁰. In contrast, the potential for demand response appears limited due to the inelastic demand mainly coming from the tourism sector.
- (21) Data provided by the Spanish authorities show that the cost of generating electricity in the NPT in 2017, due to generation from manageable sources, was more than double the average market price of the mainland.

Table 1: Volumes and costs of electricity generation in the NPT

Electric system	Electricity produced (GWh)	Total generation costs (mn EUR)	Average cost (EUR/MWh)
Balearic Islands	4,398	515.48	117.22
Ibiza-Formentera	915	104.23	113.88
Mallorca-Menorca	3,483	411.25	118.10
Canary Islands	8,277	1,134.68	137.09
El Hierro	44	20.06	459.38

⁹ There is only one small hydro pumped storage facility (11MW) in El Hierro.

¹⁰ The Project Chira-Soria, a pumped-storage hydroelectric power station in Gran Canaria, is under authorisation process.

Gran Canaria	3,178	415.43	130.68
La Gomera	74	15.44	209.55
La Palma	233	46.13	198.05
Lanzarote-Fuerteventura	1,499	205.13	136.89
Tenerife	3,249	432.49	133.10
Ceuta & Melilla	403	84.51	209.50
Ceuta	203	43.36	213.73
Melilla	200	41.15	205.23
Grand total	13,078	1,734.67	132.64

Source: Spanish authorities.

Table 2: Cost of electricity generation in the mainland market

Mainland market	Weighted average price paid by electricity retailers and direct consumers (EUR/MWh)
2017	59.33
2018	63.44

Source: <https://www.esios.ree.es/es>

- (22) Approximately 75% of the total generation costs in the NPT are variable costs, mainly covering fuel, which depends directly on world market prices and on foreign exchange rates. The lower costs in the Balearic Islands compared with the other NPT are explained by the fact that coal, which is used in some installations in Mallorca, is not as expensive as fuels used in other NPT.
- (23) Spain applies a principle of homogeneous regulated retail tariffs between territories; therefore, electricity retail consumers in the NPT are entitled to regulated prices equivalent to those paid by retail consumers in the mainland¹¹.

2.3.4. A Service of General Economic Interest

- (24) The Spanish Electricity Sector Law establishes that the supply of electricity is a Service of General Economic Interest ("SGEI")¹².
- (25) According to the Spanish authorities, it is not possible to deploy a functioning wholesale market in the NPT and without public intervention. There would be no undertakings willing to supply electricity under the required conditions of quality, safety, affordability, equal treatment and universal access.
- (26) Spain has therefore established a regulated production dispatch in each of the electric systems in the NPT, similar to the one that existed in the mainland during the pre-liberalisation period. Article 5.3 of the Royal Decree requires all production facilities, retail suppliers and direct consumers operating in the NPT to participate in the dispatch.

¹¹ See Article 17 of the Electricity Sector Law.

¹² See Article 2.2 of the Electricity Sector Law.

Moreover, the system of homogenous regulated tariffs is applied in the NPT as mentioned in recital (23).

2.3.5. Production dispatch

- (27) In each electric system, the SO dispatches generators to cover the expected demand in order of merit, based on their variable generation costs. For Category A installations, these costs include fuel, start-up, regulation band, operation and maintenance and emission allowances. Category B installations typically have a low variable cost in order to maximise their production. Additionally, under equal economic conditions, electricity from installations using renewable energy sources, followed by high-efficiency cogeneration plants¹³, have priority dispatch.
- (28) The dispatch involves weekly, daily, intraday forecasting as well as deviations in real time. In the Balearic system, the dispatch also takes into account the maximum exchange of electricity available through the interconnection with the mainland¹⁴.
- (29) The hourly energy sales price in the dispatch is obtained¹⁵ from the average price on the mainland daily and intraday market for the corresponding day, and affected by a coefficient that takes into account the hourly changes in daily demand. This ensures that the energy in the production dispatch is sold at a higher price during the hours when demand is higher giving a price signal, as required in the Electricity Sector Law.

2.4. Objective of the scheme

- (30) According to the Spanish authorities, the objectives of the scheme are to guarantee supply of electricity in the NPT at the lowest overall cost, while respecting the Spanish legal requirement of keeping electricity prices for consumers equivalent to those on the mainland. The Royal Decree aims at:
 - (a) encouraging power plant maintenance and the replacement of inefficient power plants. Establishing a uniform remuneration of regulated activities that only takes into account the additional costs associated with the remoteness of these systems;
 - (b) promoting renewable energies in Spain when they are technically feasible and result in a reduction of system costs;
 - (c) reducing the extra costs of generating in the NPT through the efficiency incentives.

2.5. Budget and financing mechanism

- (31) The *additional remuneration scheme* establishes that the extra cost of electricity generation in NPT is financed by 50% from the general State budget and by 50% from electricity charges paid by electricity consumers in the electricity bill based on their

¹³ Category A or Category B CHP plants (see recital (38)).

¹⁴ Note that the interconnector is normally operated at around 35% of nominal capacity due to security reasons (N-2).

¹⁵ As regulated in TEC/1172/2018, 5 November.

connection capacity and consumption. These charges also serve to finance other system regulated costs, such as the *specific remuneration scheme*¹⁶ in the NPT and in the mainland.

- (32) Every month the SO calculates the compensation that each installation (apart from those in the *specific remuneration scheme* – Category B installations) is entitled to receive according to the data from the production dispatch. The energy regulator, the National Commission for Markets and Competition (“CNMC”) is the authority responsible for establishing the cost of the *specific remuneration scheme* in the NPT, managing the settlement system and administering the payments. The annual final settlement has to be approved by the Directorate General for Energy Policy and Mines.
- (33) The extra cost financed by the scheme in 2015-2016, the preliminary figures for 2017-2018 and the Government’s forecast for the period 2019-2020 are shown in **Table 3**.

Table 3: Extra cost of the NPT

Extra costs NPT (million EUR)	2015	2016	2017P	2018P	2019E	2020E
Charged to the electricity system	572	648	770	780	741	821
Charged to the general State budget	572	648	770	780	741	821
TOTAL	1,144	1,296	1,540	1,560	1,482	1,642

Source: Spanish authorities (best information available in September 2019).

2.6. Duration of the scheme

- (34) The Royal Decree entered into force on 1 September 2015 and does not have a time limit for its application. There are however, some limitations in its application. In particular, an electricity system will be no longer considered isolated once it is effectively integrated with the mainland, i.e. where the capacity of the interconnection with the mainland allows its participation in the mainland electricity wholesale market and there are mechanisms to allow its energy flow into the energy market¹⁷. Once a system is effectively integrated with the mainland, the additional remuneration will stop being granted, and plants will be subject to the mainland’s market regulation.
- (35) The technical and financial compensation parameters of the additional remuneration scheme are set for regulatory periods of six years (“**regulatory periods**”). They will be

¹⁶ The *specific remuneration scheme* supports electricity generation from renewable energy sources, high efficiency cogeneration and waste. It applies in the NPT only to non-manageable renewable technologies (wind, solar) and small CHP. Under the Royal Decree under examination, these plants are classified as “Category B installations” (see recital (38)).

¹⁷ The concept of “effective integration” is not defined in the Royal Decree. The fact that a system is effectively integrated in the mainland must be established by order of the Ministry of Energy, following a report of the system operator and the market operator (Article 3.4 of the Royal Decree).

regularly reviewed as described in section 2.9.4. The first regulatory period had a shorter lifespan and run from 1 September 2015 until 31 December 2019¹⁸.

- (36) Each power plant receives the additional remuneration during its so-called "regulatory useful life". This period is 25 years for thermal installations and 65 years for hydroelectric installations. These periods can be extended if a plant succeeds in a competitive bidding procedure. As explained in more detail in section 2.9.5.1, two situations can occur: (i) when new investments extend the useful life of the plant and (ii) when a plant is about to reach the end of its regulatory useful life but can continue to operate without new investments.
- (37) The "8th additional disposition" of the Royal Decree defines one exception. Until a competitive bidding procedure for granting the "*favourable resolution of compatibility*" for new capacity and capacity to be refurbished is organised, plants reaching the end of their regulatory useful life will continue receiving part of the additional remuneration, except for investment costs.¹⁹

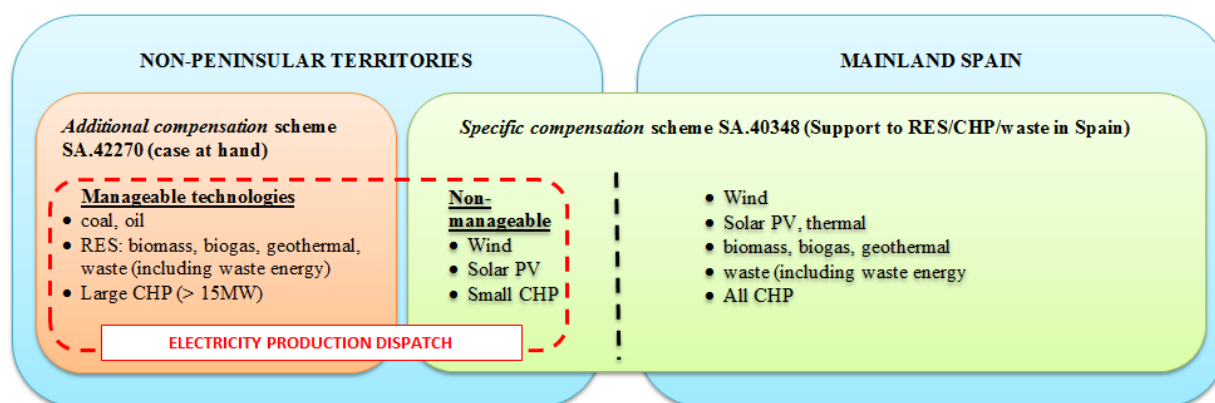
2.7. Beneficiaries of the scheme

- (38) Article 2 of the Royal Decree differentiates between two types of facilities, based on their manageability:
- (a) **Category A** installations (manageable technologies) include:
- hydroelectric installations that are not run-river installations;
 - thermal generation installations using energy sources such as hydrocarbons, coal, biomass, biogas, geothermal, waste and waste energy from any installation, machine or industrial process not intended to produce electrical energy;
 - cogeneration installations with net capacity above 15 MW.
- (b) **Category B** installations (non-manageable technologies) include:
- all installations that use renewable energy sources and are not included in the previous category;
 - cogeneration installations with net capacity of 15 MW or less manageable (they are not by their small size).
- (39) The Royal Decree establishes that Category A installations are eligible to benefit from the additional remuneration scheme. Category B installations benefit from the *specific remuneration scheme* for the support of electricity generation from renewable energy sources, cogeneration and waste regulated in Royal Decree 413/2014 of 6 June, which

¹⁸ The Royal Decree also laid down a transitional arrangement from 1 January 2012 until 1 September 2015. During this period, several criteria were applied as in the first regulatory period, except the efficiency requirements, to the extent that producers can no longer adjust their behaviour to meet them.

¹⁹ See recital (70).

applies throughout the Spanish territory and is not assessed in this Decision²⁰. Nevertheless, as mentioned in recital (26), all installations have to participate in the production dispatch.



(40) Therefore, the beneficiaries of the *additional remuneration scheme* can be Category A existing installations within their regulatory useful life, existing installations for which the regulatory useful life is extended (with or without additional investments) and new installations that receive the "*favourable resolution of compatibility*" following a competitive procedure.

(41) **Table 4** below shows the installed capacity and energy generated in 2017 in each of the systems, for installations Category A and B.

Table 4: Installed capacity and energy production in the NPT

Installed capacity (MW)	Mallorca Menorca	Ibiza Formentera	Gran Canaria	Tenerife	Lanzarote Fuerteventura	La Palma	La Gomera	El Hierro	Ceuta	Melilla
Type A	1.772	340	881	970	364	96	18	11	91	76
RO-hidroeléctrico								11		
Type B	169	3	154	170	48	11	0	0	0	2
Total	1.941	342	1.034	1.140	412	108	19	23	91	77
Energy generated (MWh)	Mallorca Menorca	Ibiza Formentera	Gran Canaria	Tenerife	Lanzarote Fuerteventura	La Palma	La Gomera	El Hierro	Ceuta	Melilla
Type A	3.482.322	930.016	3.178.891	3.249.399	1.498.553	232.916	73.660	23.381	202.858	200.518
RO-hidroeléctrico								20.296		
Type B	448.066	3.843	298.137	285.553	69.781	28.409	521	47		10.029
Total	3.930.388	933.858	3.477.028	3.534.951	1.568.334	261.325	74.181	43.724	202.858	210.547
Interconnection with peninsula	1.177.802									
Consumption by demand	5.085.787	930.641	3.465.948	3.521.325	1.565.876	259.836	74.181	43.602	202.858	210.417

Source: Spanish authorities. RO-hidroeléctrico = hydro pumped storage facility in El Hierro.

2.8. Granting of the right to the additional remuneration

(42) Whenever the SO, that guarantees security of supply, detects an adequacy issue for one of the electricity systems (taking into account the estimated peak demand, the available

²⁰ The Commission approved the specific remuneration scheme by Decision of 10 November 2017 "SA.40348: Spain – Support for electricity generation from renewable energy sources, cogeneration and waste" (OJ C/442/2017).

capacity, planned interconnections as well as the planned new renewable –non-manageable– capacity), the Secretary of State for Energy will organise a competitive procedure for new generation capacity and for facilities requiring an extension of their regulatory useful life.

- (43) The calls for this procedure will be published in the Spanish official journal (BOE) and interested parties will have two months to apply. The installations will be selected based on the criteria of minimisation of long-term costs (through the investment costs and fuel costs of the specific projects) for the particular system (as shown by the report from the CNMC) and improvement of the technical efficiency of the system (as shown in the report from the SO).²¹
- (44) The procedure will result in the award to the winning proposals of the "***favourable resolution of compatibility***"²² by the Directorate General for Energy Policy and Mines. This administrative decision gives the beneficiaries the right to receive the additional remuneration and sets certain aspects which are relevant for the remuneration, such as: year of entry in the administrative register of electricity production facilities, authorised capacity, technology, connection node, location of installation and undertaking concerned.
- (45) Once the power plant is built and all requirements are complied with, the Directorate General for Energy Policy and Mines will take the "***decision on the recognition of the additional remuneration***". This decision has a dual purpose. On the one hand, it is an administrative act that verifies compliance with the requirements and then gives the green light to receive the additional remuneration. On the other hand, it sets the standard installation type on which the technical and economic remuneration parameters will be calculated, the authorised investment value, the capacity and the regulatory useful life during which the facility will have the right to receive the additional remuneration, all according to the methodology set out in the Royal Decree.

2.9. Elements of the additional remuneration: eligible costs

- (46) The additional remuneration covers the extra cost of electricity generation in the NPT. The extra cost is defined as the difference between the cost of generation and the price paid by the SO in the electricity dispatch (a similar price to the average daily price in the mainland). Therefore, the additional remuneration of new and existing Category A installations considers production costs, that include two components: (i) a compensation for fixed costs, which includes the depreciation of the investment, a reasonable rate of return and fixed operation and maintenance costs, regardless of the energy generated; and (ii) and a compensation to cover variable costs.
- (47) The components are based on the technical and economic parameters of a “standard installation” managed by an efficient and well-run undertaking. The Royal Decree defines 37 types of installations (and their compensation parameters), according to their technology and fuel type, their location and their capacity. To set these parameters, the

²¹ Articles 46 to 54 and Annex VIII of the Royal Decree.

²² The "*favourable resolution of compatibility*" is a step beyond the administrative authorisation and it is essential to be entitled to the additional remuneration. Without this resolution, an installation will only be able to receive the dispatching energy price, without any additional support.

Ministry of Energy took into account the views of the CNMC, two independent technical studies, the results of performance tests carried out in existing plants as well as the audited costs of those installations. When competitive tenders are organised, only installations that correspond to a standard installation type whose compensation parameters have been defined by the Ministry of Energy can participate in the tender.

- (48) The Spanish authorities argue that the use of standard installation types encourages continuous technological improvement in plants since less efficient plants will be paid below their costs if they do not improve their performance and their cost management. Standard installation curves are constructed from individual curves and an “ideal” curve proposed by the CNMC.²³ The Royal Decree provides that plants undergo performance tests, the results of which will be taken into account for the following 6-year regulatory period. Therefore, any efficiency gains will be taken into account in the following periodic review.

2.9.1. Compensation for fixed costs:

- (49) The **compensation for fixed costs** covers depreciation, the financial return on the investment and compensation for fixed annual operation and maintenance:
- (a) when the installation starts its activity, it is assigned an investment value;
 - (b) the **financial rate of return** on the investment fixed in 6.5% for the first regulatory period which coincides with the remuneration of electricity transport and distribution, which bear a similarly low risk. On 22 November 2019, the Spanish government approved a rate of 5.58% for the second regulatory period (2020-2025)²⁴;
 - (c) the **value of the investment** assigned to each generation facility is an audited value of the specific investment, plus 50% of the difference between the standard value of the investment and its actual audited value, with a lower and upper limit. Any other public support received by the installation is deducted from the value of the investment;
 - (d) a compensation for **fixed operation and maintenance costs**, covering the fixed costs that are independent of energy generated (staff, maintenance, insurance, rent, costs of a recurring nature, investments for non-substantial changes in the facility and other operating expenses).
- (50) To avoid overcompensation and provide incentives to improve efficiency, the scheme foresees several **control mechanisms** that apply to the remuneration for fixed costs:

²³ The ideal curve is a sort of "best-practice" curve which is proposed by the CNMC and has a weight of 5% in the calculation.

²⁴ Following the proposal from the CNMC, this financial rate, approved by Royal Decree 17/2019, is now calculated based on a WACC methodology similar to the one used by most of the European regulators for the remuneration of regulated activities in the energy sector. See report from the CNMC: https://www.cnmc.es/sites/default/files/editor_contenidos/Energia/Consulta%20Publica/Propuesta_Metodolog%C3%ADa_Tasa_Retribuici%C3%B3n_Financiera_redes%20INF_DE_044_18.pdf.

- (a) a **correction factor** is applied to units located in the same production facility. This factor takes into account economies of scale, so that the remuneration of the installations belonging to the same facility shall be lower;
- (b) plants that are **unavailable** during more than 30% of the hours in a year will not be entitled to receive the fixed operation and maintenance compensation in that particular year;
- (c) a control mechanism whereby if a plant is more often available than during the annual hours provided for in the Royal Decree, the remuneration for fixed costs shall in no case exceed that required to cover depreciation and the financial investment compensation and the compensation for fixed annual operation and maintenance costs;
- (d) every year, installations with a low performance shall follow the SO's instructions to start-stop. If they fail to fulfil these instructions, the compensation for fixed costs will be suspended for a minimum period of one year. A second breach shall entail the definitive loss of entitlement to the remuneration for fixed costs.

2.9.2. Compensation for variable costs

- (51) The **compensation for variable costs** depends on the amount of power generated and includes the following components:
 - (a) the **compensation for fuel**, which can be broken down into several cost items associated with the operation of the plant (normal operation, start-up, operation by modulating power, etc.). This compensation depends also on the technical parameters of each standard plant, the price of the fuels used including, costs of logistics, and the number of start-ups;
 - (b) the compensation for variable costs not associated with fuel which includes **variable operation and maintenance and other operating costs** (such as taxes, grid connection charges, toll ancillary services and financing of the SO and market operator);
 - (c) the compensation for the costs of CO₂ allowances.
- (52) There are also **mechanisms to improve efficiencies** and control of the expenditure:
 - (a) a performance curve is used for each standard type of plant. This curve is constructed from actual individual curves of each plant²⁵, and an "ideal" curve;
 - (b) for the calculation of the compensation for fuel and CO₂ emission rights, price indexes from international markets are used – where it is understood that an efficient operator would have purchased fuel and rights at the lowest possible

²⁵ Each plant has its own technical performance curve (fuel consumption varies depending on the power being generated). These curves are built from technical and economic data generated by the performance tests carried out in each plant.

cost. For the calculation of fuel prices, the isolated electricity system where the installation is located is taken into account. Those price indexes are updated twice yearly;

- (c) the administration verifies fuel purchase invoices to check actual fuel costs. The audited purchase costs have to include separately invoices from other subsidiaries in order to control the expenditure. Moreover, an additional **correction factor** compares purchase invoice value to fuel cost compensation, and decreases the final settlement remuneration by half if the compensation is higher than the purchase invoice value. The methodology to develop this comparison was proposed by the CNMC and set out by the Directorate General for Energy Policy and Mines.

2.9.3. Verification of actual costs

- (53) The Royal Decree provides that the administration carries out checks and inspections for the calculation of the final compensation.
- (54) Each month the CNMC performs settlements and interim payments, on the basis of the monthly production dispatch settlements made by the SO.
- (55) Every year the CNMC proposes a final settlement, to check whether the provisional monthly settlements have resulted in the facility receiving more than it is entitled to. Before the Directorate General for Energy Policy and Mines approves the final settlement, it has to be audited by the National Audit Office of the General State Comptroller²⁶. At the end of the process, any excess compensation has to be credited to the system. Once approved, the annual final settlements are published in the Spanish official journal (BOE).
- (56) The system foresees penalties for inaccurate or false data or documents presented, and for failure to meet the requirements set in the regulation. For example, if it is found that an installation does not longer comply with the conditions under which it was entitled to the additional remuneration, it loses its right to receive it.
- (57) When the additional remuneration scheme is granted to new investments carried out in existing installations, the CNMC inspects the premises beforehand to verify that the investments are not due to the lack of maintenance of the power plant.

2.9.4. Revision of the remuneration parameters

- (58) The remuneration parameters will be revised in accordance with the timetable detailed in **Table 5**. The revision takes into account the cyclical situation of the economy, the evolution of electricity demand and the adequate return for these activities.

²⁶ Intervención General de la Administración del Estado.

Table 5: Revision of remuneration parameters

Frequency of review	Parameters to be reviewed:
Every six years (at the end of the regulatory period)	All the values of the remuneration parameters
At least once a year	Compensation for operational costs

- (59) For every 6-year review, the installation owners must submit duly audited cost values associated with each parameter. The review will also take into account the results of compulsory performance tests to be carried out by all plants, as well as economic and technical standards proposed by the CNMC. All this information is used to define standard installation types parameters, encouraging continuous technological improvement in plants given that less efficient plants will be paid below their costs. Therefore, the updated parameters in the following period take into account any technological developments and efficiency gains.

2.9.5. *The additional remuneration scheme for new installations, new investments in existing installations and installations extending the regulatory useful life*

- (60) The Royal Decree foresees two types of competitive mechanisms to grant the additional remuneration scheme to Category A installations:
1. calls to cover a capacity adequacy issue in the long-term (5 years);
 2. calls for new generation capacity to reduce costs in the electricity system of the NPT.
- (61) Category B facilities may not participate in the competitive tendering for the granting of the additional remuneration scheme, but they can participate in any competitive bidding processes organised for the whole of Spain for the assignment of the specific remuneration regime. The Spanish authorities declare that the deployment of Category B production facilities is taken into account in the SO's annual report on demand coverage²⁷, as well as the best information available referring to demand, storage capacity and connections between electrical systems, that will be used as the basis for the calls for tenders for Category A installations. In all cases, a cost-benefit analysis for the options will be carried out. The costs and technical aspects of each of the offers presented will also be analysed to select the one(s) that best minimise generation costs.

2.9.5.1. *Calls to cover a capacity deficit in the long term (5 years):*

- (62) If the SO signals a potential capacity deficit within the next 5 years, the Secretary of State for Energy will organise a competitive bidding procedure to grant the "*favourable resolution of compatibility*"²⁸.
- (63) Eligible installations for this procedure are new installations, existing installations where new investments will be made, or installations that are close to ending their

²⁷ According to the Spanish authorities, since 2015 all the new generation capacity installed in the NPT has been renewables.

²⁸ See footnote 22.

regulatory useful life and whose owners want to remain under the additional remuneration scheme because the plant can still produce electricity without further investments. Note that the Spanish authorities have committed to include a CO₂ emissions limit of 550gr CO₂/kWh for new installations to be eligible in the future calls for capacity in order to advance in the decarbonisation of the electricity sector in the NPT.

- (64) The Royal Decree refers to the limitation established in Law 17/2013 by which new installations belonging to groups holding more than 40% of electricity generating capacity in the electricity system concerned (i.e. in practice the incumbent Endesa group) will not be able to participate in these calls. The additional remuneration scheme may be granted to new installations from the incumbent only in exceptional cases where the necessary capacity to cover demand is not exceeded and where no other companies are interested in presenting bids. The Spanish authorities explained that this restriction on the incumbent aims at encouraging the entry of new market participants and increasing competition, to change the current quasi-monopolistic situation. With more producers present in the NTP, it will also be possible to better benchmark the costs incurred by the local plants.
- (65) The proposals will be selected according to the following criteria²⁹:
- (a) the additional planned thermal power needs approved in the notice of the competition;
 - (b) the most economically advantageous option to reduce the costs of the system (through the investment costs and fuel costs of the specific projects) as a whole (based on an assessment from the CNMC);
 - (c) the most appropriate technical characteristics to promote efficiency in the operation of the system (based on an assessment from the SO).

2.9.5.2. Calls for the installation of new additional power generation to reduce generation costs

- (66) The Royal Decree provides that the Ministry of Energy can also organise a separate competitive procedure to install new Category A production capacity that has the potential to reduce system costs as a whole, even if this raised capacity above the initial foreseen levels needed to cover demand. The invitation to tender may include economic signals to install facilities in a certain area where they could solve existing technical/grid constraints. The call will restrict the participation of dominant undertakings as explained in recital (64).
- (67) Before granting a "*favourable resolution of compatibility*" for the selected plant, the Autonomous Communities or Autonomous Cities shall issue reports. The call could also include additional requirements about assessing the technical and economic benefits of the introduction of the proposed new generation facility into the system at the chosen location.

²⁹ See Annex VIII of Royal Decree.

2.9.5.3. *Additional remuneration regime for new investments in existing installations*

- (68) The eligible new investments in existing installations are:
- (a) those for the refurbishment, modification or improvement of performance which require and administrative authorisation, and which exceed 5% of the total investment value of the installation. Investments required due to lack of maintenance of the installation are not eligible³⁰;
 - (b) investments in automatic generation control systems necessary to offer the frequency control service.
- (69) The remuneration of these installations shall be calculated as follows:
- (a) if the regulatory useful life of the new investment is shorter than that of the existing installation, it shall continue to be compensated for their variable generation costs during the regulatory useful life which had been previously recognised, and receive the annual remuneration of the new investment during the regulatory useful life of the new investment;
 - (b) if the regulatory useful life of the new investment is higher than the remaining useful life of the existing installation, the remuneration for variable generation costs and for fixed costs will be paid during the regulatory useful life of the new investment.

2.9.5.4. *Additional remuneration regime for facilities whose regulatory useful life is coming to an end and do not make new investments*

- (70) In general, the facilities exceeding their regulatory useful life are no longer entitled to receive the additional remuneration and are expected to close. However, if a power plant can continue its production, it can compete in the tenders for capacity to continue receiving some remuneration at the end of its useful life if it contributes to reducing the overall system generation costs. If the additional remuneration regime is granted, it will be so for only five additional years. In this case, the compensation for variable generation costs will not change, but the compensation for fixed costs will cover only fixed operation and maintenance costs.
- (71) As explained in recital (37), plants reaching the end of their regulatory useful life can exceptionally be able to continue receiving the additional remuneration until a competitive procedure for new and renewed capacity is organised.

2.9.6. *Remuneration of temporary facilities for security of supply*

- (72) The Royal Decree also provides for a ‘*special remuneration*’ for temporary capacity installed in response to the need to adopt temporary and extraordinary measures, or if the SO flags an adequacy issue in the short term. These plants do not have to comply

³⁰ Prior to granting a "*favourable resolution of compatibility*", the installations are inspected to determine their degree of maintenance.

with the same requirements as other permanent installations and they will only be dispatched at times when there is a true security of supply risk³¹.

- (73) The costs that will be eligible for compensation will depend on the technical solutions provided to cover for this generation adequacy risk. Only the costs and investments that relate exclusively to electric power generation would be taken into account. To obtain compensation, plant owners must submit an audit of the costs incurred. For example, if the solution is to hire an emergency diesel generator (which has been customary in certain islands) the duly audited rental and fuel costs will be compensated for, for the power and period allowed. The energy generated from those facilities and the costs will be considered as a power adjustment service for security of supply and system safety.

2.10. The amendment introduced in the scheme by the 2018 Budget Law

- (74) As explained in recital (9), the 2018 Budget Law, has introduced an amendment in Law 17/2013³² by which, exceptionally and only during 2018, when the SO shows that there is a security of supply risk in an time horizon of five years, the Ministry of Energy will be able to grant to the necessary extent, without the prior "*favourable resolution of compatibility*"³³, the additional remuneration scheme for a limited period of time to existing power plants that have to make additional investments required to be able to continue operating in line with the EU and Spanish legislation, in particular related to emissions limits.³⁴
- (75) Orden TEC/1158/2018 of 29 October, implemented the provision from the 2018 Budget Law by grating the additional remuneration scheme without the prior "*favourable resolution of compatibility*" to seven existing groups in three plants making additional investments in the islands of Menorca, Gran Canaria and Tenerife.
- (76) According to the Spanish authorities, the reason for this amendment is the urgent need for additional power capacity in the next few years for some of the electric systems in the NPT that could result in serious security of supply issues. Note than according to the Spanish authorities, the length of the competitive bidding procedure³⁵ and administrative steps added to the time needed to build new capacity would not otherwise allow for a timely solution of the situation.

2.10.1. The situation of capacity shortage

- (77) The Spanish authorities have submitted a report from the SO that reflects the need for additional power capacity in the period 2019-2023 for nearly all the electric systems in the NPT. The SO has used a probabilistic methodology under which the needed capacity in a particular year would be calculated in order to provide an average monthly probability of failure of less than 1 day in 10 years³⁶. The need for additional

³¹ These installations shall not be registered in the administrative register of production facilities, or be included in the calculations of coverage of demand.

³² See recital (7).

³³ See footnote 22.

³⁴ See "*Disposición final vigésima octava*" in Law 6/2018.

³⁵ See section 2.9.5.1

³⁶ See recital (18).

capacity is particularly urgent for Menorca (Balearic Islands) and three of the Canary Islands (Gran Canaria, Tenerife and La Gomera) which Spain expects to face a serious security of supply issue in particular in 2020 unless urgent investment is made.

- (78) This capacity shortage would mainly occur due to: i) several power plants coming to the end of their regulatory useful life, although they could still receive part of the additional remuneration³⁷, and ii) some other plants that will not be able to continue operating without making the investments required to comply with the Industrial Emissions Directive 2010/75/EU ("IED").
- (79) Table 6 below summarises for all the NPT the maximum demand values projected in 2020 together with the thermal power generation values available and the power values unavailable for the reasons indicated in recital (78). The table also shows, in the last two columns, the power which availability may be recovered.

Table 6: Demand vs. available generation capacity in the NPT in 2020

Sub-system	Maximum demand 2020 (MW)	Available power 2020 (MW)	Installed Renewable Power forecast 2020 (MW)	Power that may be available from those which expires each useful life (MW)	Power that may be available from those which needs adaptation to IED ⁽¹⁾ (MW)
MALLORCA	1.046	1.044	159	65	468
MENORCA	133	73 ⁽¹⁾	57	41	131
IBIZA-FORMENTERA	264	142	3	200	-
GRAN CANARIA	584	433	359	188	260
TENERIFE	597	515	411	181	223
LANZAROTE	152	102	37	103	-
FUERTEVENTURA	129	81	74	78	-
LA PALMA	46	67	11	29	-
LA GOMERA	12	12	3	6	-
EL HIERRO	9	6	12	6	-
CEUTA	43	69	0	22	-
MELILLA	41	53	0	22	-

⁽¹⁾ Gas turbines from Mahón TG1 and TG3 (73 MW) have a time of running limits to 1500 hours/year each one.

Source: Red Eléctrica de España.

- (80) As described in recital (13), all NPT except the Balearic Islands are completely electrically-isolated systems. In the particular case of Menorca (in the Balearic system), as the existing cable linking Menorca with Mallorca broke down, as explained in recital (15), it will also remain isolated at least until the end of 2020.
- (81) The Spanish authorities claim that if no action is urgently taken, the coverage failure situation in 2020 (LOLE) would be almost all year (8 341 hours) in Menorca, 2 300 hours in Gran Canaria, 1 030 hours in Tenerife and 1 280 hours in La Gomera. This implies that the amount of energy not supplied would reach 77% of the annual demand in Menorca, 5% in Gran Canaria, 3% in Tenerife and 2.5% in La Gomera.

³⁷ As explained in recital (37).

- (82) The Spanish authorities argue that the installation of new generation capacity with competitive calls to cover the power deficit (as explained in section 2.9.5.1) would be preferable. However, the new capacity would not be ready on time for 2020-2021.
- (83) Consequently, in order to address this short-term capacity shortage, the SO analysed several options:
- (a) **Extension of the regulatory useful life** of those power plants currently in service that have reached or will reach the end of their regulatory useful life between now and the year in which the capacity would be needed, and are suitable to prolong it. According to the SO, this is the fastest solution to prevent the short-term capacity shortage by keeping under the existing scheme those plants. However, with this measure only, the capacity remaining operational would not be sufficient to cover the estimated shortages in 2020 in all the NPT. According to the SO, this solution would only cover 38% of the additional necessary generation for Menorca, 55% for Gran Canaria, 56% for Tenerife and 75% for La Gomera and an elevated risk of power supply failure would remain. Therefore, an additional solution would be needed.
 - (b) **Authorisation of adaptation projects for the units that can be adapted to comply with IED limits.** This means that power plants that would have to stop in 2020 due to non-compliance with emission limits would be authorised to invest in the equipment required to comply with those limits. These power plants would therefore remain operational and under the additional remuneration scheme that would include the remuneration of those new investments made, during their regulatory useful life. According to the SO, with this solution added to the previous one, the estimated capacity shortages could be almost fully covered³⁸.
 - (c) In addition, in the particular case of Menorca, the new cable with Mallorca (expected for the third quarter of 2020), another one planned for later (without specific details) plus the installation of new renewable capacity do not allow the SO to have a clear picture of how much new capacity would be needed in the medium term.
- (84) Other alternatives such as renting temporary mobile units, new projects of renewable capacity, the use of battery storage or the contribution of demand side services have been also analysed by the Spanish authorities. However, they have been discarded due to the much higher cost and/or the technical or timing unfeasibility of those options as analysed and explained in a document submitted by the Spanish authorities.
- (85) The SO therefore concludes that both measures described in recital (83)(a) and (b) are urgently required to guarantee the security of supply in the NPT. However, the SO also warns that due to the time needed to implement these measures, this capacity may still not be fully available in 2020 and therefore, additional temporary units (see section 2.9.6) may still be needed.

³⁸ Any remaining potential shortage of capacity could be addressed, if necessary, with temporary facilities for security of supply, as explained in recital (72).

- (86) In summary, the Spanish authorities argue that, although a competitive bidding procedure for new generation to cover the power deficit would be preferable, the only viable option is to extend the regulatory lifetime of those power plants that have reached or will reach its end, and to authorise the investments that are needed in existing facilities, under the principles of adequate timing and the lowest possible cost.

2.10.2. *The amendment of the 2018 Budget Law and the implementation by Orden TEC/1158/2018*

- (87) In order to facilitate the implementation of the solution described in recital (83) (b), the 2018 Budget Law has introduced an amendment in the scheme by which, exceptionally and only during 2018, when the SO shows that there is a security of supply risk in a time horizon of five years, the Ministry of Energy will be able to grant, under certain circumstances and for a limited period of time, the additional remuneration scheme without organising a competitive procedure.
- (88) The power plants eligible for this exceptional granting of the additional remuneration introduced by the scheme are those existing power plants that would have to make additional investments required to be able to continue operating in the market in compliance with the requirements of the IED. Order TEC/1158/2018 has effectively reduced the scope of this provision by applying it to a limited number of specific power plants that are essential to secure electricity supply in the islands of Menorca, Gran Canaria and Tenerife. The objective of this very limited scope is to use this measure only to the minimum necessary to cover the forecasted capacity shortage on time, at the lowest cost and with the lowest medium term impact in the generation market.
- (89) The preamble of Order TEC/1158/2018 also acknowledges that, as no competitive procedure for new and renewed capacity is organised, those power plants currently in service that have reached or will reach the end of their regulatory useful life between now and the year in which the capacity would be needed will be able to remain under the additional remuneration scheme by extending their useful life³⁹. Note that in the case of extension of the useful life without any additional investments, the compensation for variable generation costs will not change, but the compensation for fixed costs will cover only fixed operation and maintenance costs⁴⁰.
- (90) Order TEC/1158/2018 sets out that these new investments will be remunerated as established in the Royal Decree⁴¹. In order to spread the cost for the system of these new investments over several years, their regulatory useful life will be 10 years, with the exception of the investments in Menorca, which will be only 5 years, in order to reduce the impact of this refurbished capacity on future investment decisions in the Balearic system.
- (91) The Spanish authorities argue that this amendment will help to solve the short-term security of supply risk explained in section 2.10.1 in particular in for Menorca, Gran Canaria and Tenerife. They also argue that the reduced scope of its implementation is

³⁹ See recital (37).

⁴⁰ See section 2.9.5.4.

⁴¹ See section 2.9.5.3.

based on finding a solution with the adequate timing, at the lowest cost and with the lowest medium term impact in the future generation markets of the different NPT.

3. ASSESSMENT OF THE MEASURE

3.1. Qualification of the measures as State aid

(92) According to 107(1) TFEU, “*save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or constitutes to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market*”.

(93) A measure can be qualified as State aid within the meaning of Article 107(1) TFEU, when it meets the following four cumulative conditions: i) it is imputable to the Member State and granted out of State resources, ii) it confers an economic advantage on undertakings, iii) the advantage is selective, and iv) it distorts or threatens to distort competition and affect trade between Member States.

3.1.1. Existence of State resources

(94) In order to be qualified as State aid, a financial measure must be imputable to the State and granted directly or indirectly by means of State resources. Compensatory payments for the operation of a SGEI, which are financed through parafiscal charges or compulsory contributions imposed by the State and apportioned in accordance with the provisions of the legislation, are compensatory payments made through State resources.⁴²

(95) In this case, the scheme under assessment involves State resources as it is financed by 50% from the general State budget, and by 50% from a charge levied on electricity consumers managed by the CNMC⁴³, which the Court of Justice of the European Union (“**the Court**”) has declared as a State resource within the meaning of Article 107 (1) TFEU⁴⁴.

3.1.2. Financial advantage

(96) In order to constitute State aid, a measure must confer on recipients a financial advantage. An advantage within the meaning of Article 107(1) TFEU, is any economic benefit which an undertaking could not have obtained under normal market conditions, that is to say in the absence of State intervention.⁴⁵

⁴² Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ C 8, 11.1.2012, paragraph 36. (“**the 2012 SGEI Framework**”).

⁴³ See section 2.5.

⁴⁴ Case C-275/13, Elcogás, ECLI:EU:C:2014:2314; Association Vent De Colère and Others, EU: C: 2013: 851.

⁴⁵ Judgment of the Court of Justice of 11 July 1996, SFEI and Others, C-39/94, ECLI:EU:C:1996:285, paragraph 60; Judgment of the Court of Justice of 29 April 1999, Spain v Commission, C-342/96, ECLI:EU:C:1999:210, paragraph 41.

(97) As regards compensation for costs incurred to provide a SGEI, the Court made clear in the Altmark judgment that the granting of an advantage can be excluded if the four cumulative conditions described in the following sections are met.⁴⁶

3.1.2.1. First, *"the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined"*.

(98) On the existence of a SGEI, point 47 of the SGEI Communication⁴⁷ says: 47. [...] *It transpires from Article 106(2) of the Treaty that undertakings entrusted with the operation of SGEIs are undertakings entrusted with 'a particular task'. Generally speaking, the entrustment of a 'particular public service task' implies the supply of services which, if it were considering its own commercial interest, an undertaking would not assume or would not assume to the same extent or under the same conditions [...]*.

(99) The Royal Decree requires generators located in the Spanish NPT to produce electricity under certain conditions, defines all their rights and obligations, and the compensation they will receive for their availability and the electricity generated. The Royal Decree also provides for an alternative to the electricity market, which should include all production facilities, retail suppliers and direct consumers in these systems.

(100) Additionally, if the SO points out that a certain installation is essential to ensure supply in an isolated electric system, this installation cannot cease production on a voluntary basis.

(101) In general, the provision or the increase of normal capacity generation should not be considered an SGEI. In fact, under normal circumstances, the market should spontaneously provide to cover expected demand (or expected increases of demand) under normal market and regulatory conditions.

(102) However, in small and isolated systems with certain characteristics the intervention by the national authorities by way of ensuring local generation in order to ensure equalisation of prices for retail customers and security of supply may be needed and justified.⁴⁸

(103) The Commission considers that the Spanish authorities have carried out an adequate probabilistic assessment of the capacity needs, as explained in recitals (18) and (77), which takes into account the particular situation of the NPT and justifies the need for a SGEI in these systems.

⁴⁶ Judgment of the Court of Justice of 24 July 2003, Altmark Trans, C-280/00, ECLI:EU:C:2003:415, paragraphs 87 to 95.

⁴⁷ Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ C8, 11.01.2012 (**"the SGEI communication"**).

⁴⁸ See Decision of 11 January 2017 "SA.45779: Malta – Delimara Gas and Power Energy Project" (OJ C/51/2017) and Decision of 16 September 2014 "SA.32060: Greece – Alleged illegal aid for discharging Public Service Obligations in the Non-Interconnected Islands" (OJ C/203/2015).

(104) Consequently, the Commission does not observe a manifest error in the definition of the supply of electricity in the Spanish NPT at equivalent prices to those on the mainland as a SGEI, because it cannot be provided under normal market conditions, given the small size and isolation of the systems⁴⁹. The Commission therefore considers that the public service obligation represents a genuine and correctly defined SGEI, as referred to in Article 106(2) of the Treaty, which is based on the grounds of social cohesion as regards support for the equalisation of prices of electricity and on the grounds of security of supply as regards the support to new and existing capacity.

3.1.2.2. Second, "the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner, to avoid it conferring an economic advantage which may favour the recipient undertaking over competing undertakings".

(105) The Royal Decree sets out in detail the technical and economic parameters needed for the electricity dispatch and the methodology for determining the purchase price and the selling price in the production dispatch. It also sets out all the parameters needed to calculating compensation generally (for installation types) and individually (for existing installations).

(106) The Spanish authorities explain that they used two independent technical studies and consulted the CNMC to determine the technical and economic remuneration parameters.

(107) The parameters that are not set in the Royal Decree, such as those which will determine the competitive bidding procedures for new plants, shall be approved by ministerial order.

(108) As explained in section 2.9.4, the parameters are regularly reviewed and are approved by the Ministry of Energy.

(109) Therefore, the Commission considers that the parameters on the basis of which compensation is calculated are established in advance in an objective and transparent manner by the Spanish authorities.

3.1.2.3. Third, "the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations".

(110) As indicated in section 2.9, the additional remuneration compensates producers for their additional fixed and variable costs of generating in these territories, including a reasonable profit.

(111) To avoid overcompensation, the Royal Decree has put in place the mechanisms that apply to fixed and variable costs, as described in recitals (50) and (52) of this decision.

⁴⁹ See section 2.3.

- (112) The financial rate of return on the investment (6.5% for the first regulatory period) is the same rate used for the remuneration of transmission and distribution activities, which are activities with a comparable low risk. For the second regulatory period (2020-2025), the Spanish government has approved a financial rate of return of 5.58%, following the proposal from the CNMC which is based on a WACC methodology similar to the one used by most of the European regulators for the remuneration of regulated activities in the energy sector.⁵⁰
- (113) Consequently, the Commission considers that Spain has provided enough evidence to confirm that the compensation of the SGEI does not exceed what is necessary to cover all or part of the costs incurred in the discharge of its obligations.

3.1.2.4. Fourth, "where the undertaking which is to discharge public service obligations in a specific case, is not chosen pursuant a public procurement procedure, which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking in the same sector, well run and adequately provided with the necessary means would incur, taking into account the receipts and a reasonable profit from discharging the obligations".

- (114) For both new and existing installations, the remuneration is calculated on the basis of a "standard installation" operated by an efficient and well-run undertaking as explained in recital (47). However, the Commission acknowledges that the electricity markets of the NPT present specific geographic and economic features, which make them less representative when calculating standard patterns. More specifically, these standard patterns are influenced by the small size of the markets, the lack of interconnection and the existence of incumbent operators.
- (115) The additional remuneration regime will be granted to new installations by means of a competitive procedure, as explained in section 2.9.5.
- (116) Existing installations were selected in the past through a simple administrative authorisation procedure. The Royal Decree determines their compensation on the basis of a standard type of installation. Given the lack of real competition and the lack of cost data from other producers than Endesa, the Spanish authorities have built the standard installation curves from individual plant curves and a theoretical curve provided by the CNMC.
- (117) Therefore, the Commission considers that the Spanish authorities have not provided sufficient evidence substantiating that existing capacity is compensated according to the costs of a typical, well-run undertaking within the sector because the NPT present features of small markets, which are less representative, and the benchmark for the "standard installation" relies mainly on the incumbent's data and figures.

⁵⁰ See recital (49)(b).

- (118) Regarding new installations, the calls for new capacity as defined in the Royal Decree do not allow the simultaneous participation of non-manageable renewable technologies (such as wind or photovoltaic, classified as Category B installations) or the participation of demand response providers or storage. According to the Spanish authorities, the lack of interconnection and need for back-up electricity generation in NPT justify the need of carrying out two types of auctions according to the different manageability of the technologies. The Commission understands the reasons provided by Spain in this regard and acknowledges that security of supply justifies the existence of two different schemes depending on the different types of capacity. However, the additional remuneration granted to the selected installations under this call for new capacity is not based solely on the criteria that are used in the selection of the proposals (see recital (65), e.g. investments costs, fuel costs), but also on the costs of a “standard installation”, defined *ex-ante* (see recital (47), e.g. the fixed and variable operation and maintenance costs), which are used as a benchmark and are not part of the competitive mechanism. Therefore, this situation may lead to the result that the tenders may not always select the type of capacity more capable of supplying electricity at the least cost to the community.
- (119) Finally, as described in section 2.10, the amendment introduced by the 2018 Budget Law exceptionally allowed existing installations ending their regulatory useful life or requiring investments to continue operating, to remain under the additional remuneration scheme without calling the competitive procedure in which new installations could participate.
- (120) On the basis of the above considerations, the Commission considers that the fourth Altmark condition is not met because the information provided by the Spanish authorities does not fully confirm that the provision of electricity will be remunerated at the least cost for the community.

3.1.3. Selectivity

- (121) In order to be qualified as State aid, a financial measure must be selective.
- (122) The Spanish authorities argue that the scheme is not selective because it is granted in transparent and equal conditions for all economic operators. In addition, the scheme is open to any operator wishing to invest in these systems.
- (123) It is the Commission's view, however, that the compensation for the additional costs of electricity generation in the NTP is by its nature selective. The scheme in practice benefits essentially existing generation assets due to the limited scope for market entry as explained in section 2.3.2. In addition, the scheme is not open to other types of capacity such as renewables, battery storage or to demand response providers and it is therefore selective.

3.1.4. Affection of trade and distortion of competition

- (124) In order to be qualified as State aid, the measure must affect trade between Member States and distort or threaten to distort competition.
- (125) In the assessment of these two conditions, the Commission is not required to establish that the aid has a real effect on trade between Member States and that competition is

actually being distorted, but only to examine whether that aid is liable to affect such trade and distort competition⁵¹. When aid granted by a Member State strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid.

- (126) In the scheme under examination, the beneficiaries obtain an advantage because they are relieved of the expenses they would otherwise have had to bear, and by making profitable an activity that would not be profitable under normal market conditions.
- (127) The largest beneficiaries of the scheme are GESA (in the Balearic Islands) and UNELCO (in the Canary Islands), which generated around 85% of the electricity consumed in the NPT in 2017. They are 100% owned by Endesa, which has a market share of around 27% in conventional generation in mainland Spain, as well as a strong presence in distribution and retail of electricity and gas in the NPT and in mainland Spain and Portugal. Endesa is partly owned by the group Enel⁵², which is active in other European and international markets. Note that the electricity supply sector is characterised by trade between Member States and the public service compensation granted mainly to Endesa/Enel group could strengthen its position vis-à-vis other undertakings competing in the internal market.
- (128) The Commission therefore considers that the support granted to Category A plants and to existing installations may distort competition within the internal market and affect trade between Member States.

3.1.5. Conclusion

- (129) In the light of the above assessment, the Commission considers that the additional remuneration regime constitutes State aid within the meaning of Article 107(1) TFEU.

3.2. Legality of the aid

- (130) The Spanish authorities notified the measure shortly before its formal adoption. The eleventh additional provision of the Royal Decree provides that the provisions regarding the additional remuneration scheme and the procedures for the electricity dispatch shall be effective only in the absence of objections by the Commission as regards their compatibility with EU law.
- (131) Spain has however implemented the measure under assessment before obtaining Commission approval and has consequently breached its obligations under Article 108(3) TFEU. Therefore, the aid granted until the adoption of this decision is unlawful aid.

3.3. Assessment of the compatibility of the aid

- (132) Under certain conditions, Article 106(2) TFEU allows the Commission to declare State aid for the compensation of an SGEI compatible with the internal market. The 2012

⁵¹ See for instance judgment of the Court in Case C-372/97 Italy v Commission [2004] ECR I-3679, para. 44.

⁵² See footnote 7.

SGEI Framework⁵³ sets out guidelines for assessing the compatibility of SGEI compensation which does not affect the development of trade to such an extent as to be contrary to the interests of the Union and exceeds the amount of €15 million per year⁵⁴. Since the overall compensation in the Spanish NPT exceeds this threshold⁵⁵, those compatibility criteria apply. They are listed and assessed in the following sections.

3.3.1. Genuine service of general economic interest as referred to in Article 106 TFEU

- (133) According to the 2012 SGEI Framework⁵⁶, Member States have a wide margin of discretion regarding the nature of services that could be classified as being services of general economic interest. The Commission's task is to ensure that the margin of discretion is applied without manifest error as regards the definition of service of general economic interest.
- (134) As explained in section 3.1.2.1., the Spanish authorities have demonstrated the need for an SGEI through an adequacy assessment that takes into account the particular situation of the electricity market in the NPT. Therefore, as already stated in recital (104), the Commission has not observed a manifest error in the definition of SGEI in the case at hand.
- (135) The SGEI Framework⁵⁷ also requires Member States to show that they have given proper consideration to the public service needs supported by way of a public consultation or other appropriate instruments to take the interests of users and providers into account.
- (136) The Spanish authorities have consulted the CNMC, the Electricity Advisory Council⁵⁸, and the Council of State⁵⁹. The Electricity Advisory Board is a body of the CNMC that represents the government, the regulator, the 17 autonomous communities, business associations in the energy sector, the SO, consumer associations, etc. The Board presented its arguments to the CNMC, which included them in its report on the draft Royal Decree.
- (137) Based on this, the Commission can conclude that the obligation to carry out a public consultation on public needs to define the SGEI has been met.
- (138) The Commission therefore concludes that the public service obligation represents a genuine and correctly defined SGEI as referred to in Article 106(2) of the TFEU.

⁵³ Communication from the Commission – European Union framework for State aid in the form of public service compensation (2011) 2012/C 8/03 OJ C8, 11.1.2012, p.15 ("**the 2012 SGEI Framework**").

⁵⁴ Commission Decision of 20 December 2011 on the application of Article 106(2) of the Treaty of the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest C(2011) 9380, 2012/21/EU.

⁵⁵ See Table 3.

⁵⁶ Point 56.

⁵⁷ Point 14.

⁵⁸ Consejo Consultivo de Electricidad.

⁵⁹ Consejo de Estado.

3.3.2. Need for an entrustment act specifying the public service obligations and the methods of calculating compensation

- (139) The 2012 SGEI Framework⁶⁰ requires an act which entrusts the provision of an SGEI to the undertaking concerned and spells out the nature of the task as well as the scope and the general operational conditions of the SGEI.
- (140) In the Spanish NPT the public service obligation is specified in different instruments: the Electricity Sector Law⁶¹, Law 17/2013⁶², the Royal Decree⁶³, several developing Ministerial Orders, the decision granting entry in the administrative register of electricity production facilities and the favourable decision of compatibility, which grants the right to receive the additional remuneration, against meeting the requirements set in the Royal Decree.
- (141) In particular, the Royal Decree defines the details of the scheme, including the obligations of undertakings which produce energy in the NPT and their participation in the electricity production dispatch. It also includes the compensation parameters for Category A installations and the provisions for their revision.⁶⁴
- (142) In addition, the annual settlement system aims to avoid and correct any possible overcompensations. It takes into account the costs verified by the CNMC, a report by the SO and the costs audited by the General State Comptroller⁶⁵. Any overcompensation found through this mechanism will be credited to the electric system.⁶⁶
- (143) The Commission therefore concludes that, viewed together, these legislative provisions meet the criteria set out in the 2012 SGEI Framework.

3.3.3. Duration of the period of entrustment

- (144) According to the 2012 SGEI Framework⁶⁷, "*the duration of the period of entrustment should be justified by reference to objective criteria such as the need to amortise non-transferable fixed assets. In principle, the duration of the period of entrustment should not exceed the period required for the depreciation of the most significant assets required to provide the SGEI.*"
- (145) The duration of the obligation and the compensation are limited to the power plant's regulatory useful life (25 or 65 years⁶⁸). A plant that is about to end its regulatory useful lifetime and wins a tender for new capacity may continue to receive the remuneration for five more years if it contributes to reducing the system generation

⁶⁰ Points 15-16.

⁶¹ See recital (6).

⁶² See recital (7).

⁶³ See recital (8).

⁶⁴ See section 2.

⁶⁵ Intervención General de la Administración del Estado.

⁶⁶ See section 2.9.3.

⁶⁷ Point 17.

⁶⁸ 25 years for thermal installations and equipment for hydroelectric installations and 65 years for hydroelectric fixed assets.

costs. The regulatory useful life could also be extended in case of exceptional circumstances for reasons of security of supply as described in section 2.10.2.

- (146) The Royal Decree sets the rule that isolated electrical systems will no longer be considered isolated when they are effectively integrated with the peninsular system, that is to say, when the interconnection capacity is such that they can be incorporated into the peninsular wholesale market and there are market mechanisms that allow integrating their energy. The Royal Decree does not establish the specific interconnection capacity that will trigger this rule. It only states that it will be declared by ministerial order upon consultation with the SO and the Market Operator. In the meantime, work to increase interconnections is in progress⁶⁹.
- (147) The Royal Decree also establishes that when an electrical system loses its isolation status, the additional or specific remuneration that may have been granted after 1 September 2015⁷⁰ to installations located in that system, will become the same as the one applicable to plants located in the mainland. In practice, this means that Category A plants that started receiving this remuneration from that date will stop being entitled to it. Conversely, existing Category A plants already entitled to the additional remuneration prior to that date will still be entitled to the compensation until the end of their regulatory life. Category B installations will be entitled to the specific remuneration scheme as it applies in the mainland.
- (148) The Commission notes that there is no specific duration for the public service obligation. However, when any of the systems loses its isolation status because it is properly integrated into the mainland wholesale market the public service obligation will no longer be necessary. The Spanish authorities have confirmed the specific plans for the installation of the second cable between the Balearic Islands and the mainland (increasing the interconnection capacity to around 40%-50% of the demand on the islands), which will probably not be ready before 2025. On this basis, the Commission considers that a reassessment of the situation in the Balearic Islands will be needed in due time. Therefore, in the particular case of the Balearic system this decision will only cover the period until 31 December 2025.
- (149) On the basis of the above considerations, the Commission thus concludes that the duration of the public service obligation in its current set-up is limited.

3.3.4. Compliance with Directive 2006/111/EC

- (150) According to the 2012 SGEI Framework⁷¹, "*aid will be considered compatible with the internal market on the basis of Article 106(2) of the Treaty only where the undertaking*

⁶⁹ The official planning of the electricity network for the period up to 2020 includes several new interconnections: five new interconnections between islands (two in the Balearic Islands, three in the Canary Islands), and a first link between Ceuta and the mainland (planned to enter into service in 2020). Provisional interconnection plans beyond 2020 include two links: i) a new link between two Canary islands, and ii) a second link between the Balearic Islands and the mainland (see recital (14)). Currently there are no plans to connect the mainland with the Canary Islands (this would be unfeasible given the distance and the low sea bed), or Melilla. The official planning of the electricity network for the period 2021-2026 will be approved in 2020.

⁷⁰ Date of entry into force of the Royal Decree.

⁷¹ Point 18.

complies, where applicable, with Directive 2006/111/EC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings".

- (151) Article 1(1) of Directive 2006/111/EC requires Member States to ensure that financial relations between public authorities and public undertakings are transparent, so that the following emerges clearly:
- (a) public funds made available directly by public authorities to the public undertakings concerned;
 - (b) public funds made available by public authorities through the intermediary of public undertakings or financial institutions;
 - (c) the use to which these public funds are clearly defined.
- (152) Under Article 2(d), any undertaking that enjoys a special or exclusive right granted by a Member State pursuant to Article 106(1) TFEU or is entrusted with the operation of an SGEI pursuant to Article 106(2) TFEU, that receives public service compensation in any form whatsoever in relation to such service and which carries out other activities, is an undertaking required to maintain separate accounts. Its financial and organisational structure must be correctly reflected in the separate accounts, so that the following emerges clearly: (a) the costs and revenues associated with different activities; (b) full details of the methods by which costs and revenues are assigned or allocated to different activities.
- (153) The Spanish authorities have explained that the undertakings receiving the additional remuneration have to keep accounts of all the expenses incurred, because the compensation for those expenses is the only income from electricity production they are entitled to (no other income is allowed). Furthermore, beneficiaries must submit annually the audited costs incurred in the previous year to the Ministry of Energy and the CNMC. Companies engaged in other activities shall keep separate accounts of those activities.
- (154) The Spanish authorities have confirmed that information concerning the compensation given to beneficiaries will be at the Commission's disposal.
- (155) Consequently, the Commission considers that the beneficiaries of the additional remuneration scheme comply with the principles prescribed by Directive 2006/111/EC.

3.3.5. Compliance with Union public procurement requirements

- (156) According to the 2012 SGEI Framework⁷², "*Aid will be considered compatible with the internal market on the basis of Article 106(2) of the Treaty only where the responsible authority, when entrusting the provision of the service to the undertaking in question, has complied or commits to comply with the applicable Union rules in the area of public procurement. This includes any requirements of transparency, equal treatment and non-discrimination resulting directly from the Treaty and, where applicable,*

⁷² Point 19.

secondary Union law. Aid that does not comply with such rules and requirements is considered to affect the development of trade to an extent that would be contrary to the interests of the Union within the meaning of Article 106(2) of the Treaty."

- (157) Before the Royal Decree was adopted, the legal framework by which economic operators generated electricity in the Spanish NPT could be considered an authorisation under EU law, given that they had the obligations to comply with the relevant legal requirements and to participate in the electricity dispatch system run by the SO. Furthermore, there seemed to be no limitation (at least in principle) on the number of economic operators that could carry out that activity (absence of selectivity), although *de facto*, companies belonging to Endesa group are the main producer. Such an authorisation scheme could be considered not to constitute a public procurement within the meaning of the Public Procurement Directives.
- (158) Under the Royal Decree, the granting of the “*favourable resolution of compatibility*” continues to be considered an administrative authorisation. As explained above in section 3.1.2.2 of this decision, the competitive processes for the award of the compensation to new generation capacity is transparent, since the criteria and the compensation parameters are approved by ministerial order and published in the Spanish official journal (BOE). Additionally, the annual final settlement is approved by the Directorate General for Energy Policy and Mines and published in the Spanish official journal, reflecting a specific overview for each company and splitting the total amounts into fixed and variable costs.
- (159) Additionally, the Royal Decree does not set any limit on the number or origin of economic operators that can present offers for new capacity and carry out the activity, provided they meet the conditions set in the Royal Decree and the relevant subsequent tender, and provided that the capacity required in the tender is not exceeded. As the only exception, business groups that already own electricity generating facilities exceeding 40% of the existing capacity in a given electric system cannot participate in the competitive procedure for new capacity. The additional remuneration may be granted to these groups only in exceptional cases where no other companies are interested in presenting bids, and provided the necessary capacity to meet the reserve margin is not exceeded.
- (160) At present, there is one operator (Endesa group) that generates 90% of the energy produced in the Balearic Islands and the Canary Islands, and almost 100% in Ceuta and Melilla⁷³. In addition, distribution and most retail activities are also carried out by companies of the Endesa group⁷⁴. The Spanish authorities argue that this situation makes it difficult to define objective benchmarks for generation costs in the NPT and to introduce competition that could lead to improve the efficiency and management of the power plants.
- (161) Tenders for new capacity shall be organised when there is a need to increase the electricity capacity in the NPT, meaning that the current installed capacity (mainly owned by the Endesa group) is unable to provide sufficient electricity supply under the

⁷³ Through its subsidiaries UNELCO (Canary Islands), GESA (Balearic Islands) and Endesa Generation (Ceuta and Melilla).

⁷⁴ See footnote 8.

normal market conditions. The exclusion of this operator from the auction is thus necessary to ensure that there will be other suppliers and therefore to ensure the continuity of the supply⁷⁵. Furthermore, if this operator could participate in the auction, it would actually be encouraged to underperform under the normal market conditions in order to trigger the auction and potentially benefit from the ensuing State aid. In conclusion, the exclusion of operators with a market share above 40% is compatible with Articles 49 and 56 TFEU.

- (162) When tendering out a limited additional capacity for the provision of electricity against a compensation, it could be objectively justified to require that no operator should control more than a certain specified percentage of the market in question. The Commission considers that giving preferential entry to smaller competitors into the tenders for new capacity is necessary to attain the ultimate objective to increase competition in the NPT, and in doing so to overcome some of the market failures that prevent the effective supply of electricity in these territories. The 40% ceiling can be considered proportional because it does not violate the principle of equality: the incumbent and competitors are not in the same situation, since Endesa group has a competitive advantage related to its existing assets and its knowledge of the market.⁷⁶ Therefore, the objective of increasing competition in the NPT (to in turn reduce system costs in the long run) would likely be jeopardized in the absence of this exception.
- (163) For the reasons explained above, the Commission considers that the entrustment of undertakings with the production and dispatching of electricity in NPT complies with the Union transparency requirements. Additionally, the requirement to exclude in a first instance operators which already enjoy more than 40% of the market from the tenders to award the additional compensation to new capacity, complies with the principles of non-discrimination and equal treatment. The Commission considers that the additional remuneration scheme precludes any distortion of competition that may arise from the management of public funds by the contracting authorities when awarding an SGEI and therefore, it is in line with the interests of the Union within the meaning of Article 106(2) of the Treaty.

3.3.6. Absence of discrimination

- (164) The 2012 SGEI Framework⁷⁷ provides that where the authority assigns the provision of the same SGEI to several undertakings, the compensation should be calculated on the basis of the same method for each undertaking.
- (165) As the method of calculating the compensation for producing electricity in the NPT is provided by regulation, it is applicable to all entities providing such services in the same manner. Category A plants entitled to the additional remuneration are classified

⁷⁵ Judgment of 28 March 1995, *The Queen v Secretary of State for Home Department, ex parte Evans Medical Ltd and Macfarlan Smith Ltd*. C-324/93, ECLI:EU:C:1995:84.

⁷⁶ In the antitrust Greek Lignite case (Case COMP/38700 Greek lignite and electricity markets) the Commission accepted a commitment by the Greek State to grant the exploitation rights of 4 lignite deposits to 'entities other than PPC [the public electricity company operating all the other lignite deposits in Greece] unless no other reliable offer is made'. In the Greek Lignite case, the Commission therefore accepted to settle the case on the basis of a stringent commitment consisting in a clear 'obligation de résultat' (subject to offers being made by competitors).

⁷⁷ Point 20.

under a standard installation type according to the type of technology, the isolated system in which they are located, and capacity ranges. Likewise, Category B installations are entitled to the *specific remuneration scheme*, which covers the whole territory of Spain and has taken into account the specificities of renewable energy installations. Therefore, all installations classified under the same type will be subject to identical remuneration parameters and methodology, but taking into account the specific characteristics and costs of each plant.

(166) The Commission therefore considers that there is no discrimination in the sense of point 20 of the 2012 SGEI Framework.

3.3.7. Amount of compensation

3.3.7.1. Net cost necessary to discharge the public service obligation

(167) According to the 2012 SGEI Framework "(...) *the amount of the compensation must not exceed what is necessary to cover the cost of discharging the public service obligations, including a reasonable profit*"⁷⁸. "*The amount of compensation can be established on the basis of either the expected costs and revenues, or the costs and revenues actually incurred, or a combination of the two*"⁷⁹.

(168) Under the cost allocation methodology, the net cost necessary to discharge the public service obligations can be calculated as the difference between the costs and the revenues for a designated provider of fulfilling the public service obligations, as specified and estimated in the entrustment act.

(169) The Spanish authorities have explained that the net avoided cost method cannot be applied because it is not possible to compare the costs of an electricity generator with and without the public service obligation. Therefore, the additional remuneration is calculated on the basis of the cost allocation methodology. The costs to be taken into consideration include all the costs necessary to operate the SGEI. The eligible costs of the additional remuneration scheme are described in detail in section 2.9.

(170) Based on the above, it can be considered that the methodology implemented by the Spanish authorities is in line with the requirements of points 28-38 of the 2012 SGEI Framework.

3.3.7.2. Revenue

(171) The 2012 SGEI Framework⁸⁰ provides that the revenue to be taken into account must include at least the entire revenue earned from the SGEI and the excessive profits generated from special and exclusive rights even if linked to other activities.

(172) In the scheme under consideration, the beneficiaries do not have any special or exclusive rights that could create excessive profits. In establishing the PSO

⁷⁸ Point 21.

⁷⁹ Point 22.

⁸⁰ Point 32.

compensation, the Spanish authorities take into account the entire revenue earned from the sale of electricity in the electricity dispatch⁸¹.

3.3.7.3. *Reasonable profit*

- (173) The 2012 SGEI Framework⁸² allows for the entities fulfilling the public service obligations to achieve a reasonable profit. This is the rate of return on capital that would be required for a typical company considering whether or not to provide the SGEI for the whole duration of the entrustment act, taking into account the level of risk. Where duly justified, other profit level indicators can be used, such as the average return on equity over the entrustment period, the return on capital employed, the return on assets or the return on sales.
- (174) Whatever indicator is chosen, the Member State must provide the Commission with evidence that the projected profit does not exceed what would be required by a typical company considering whether or not to provide the service, for instance by providing references to returns achieved on similar types of contracts awarded under competitive conditions.
- (175) In the case at hand, for the first regulatory period (September 2015-2019), the Spanish authorities allowed a return on assets based on the average yield in the secondary market of 10-year Spanish government bond in the months of April, May and June 2013, plus a 2% spread. This rate was 6.503% for that regulatory period and was equivalent to the remuneration of electricity transport and distribution activities, which bear a similar low risk. For the second regulatory period (2020-2025), following the proposal from the CNMC, the Spanish government has approved a rate of 5.58% based on a WACC methodology similar to the one used by most of the European regulators for the remuneration of regulated activities in the energy sector.⁸³
- (176) In the Greek Non-Interconnected Islands case⁸⁴, the Commission accepted a rate of return on the value of the Regulated Asset Base of 8% as a reasonable return under the 2012 SGEI Framework. In addition, in the Spanish renewables scheme⁸⁵, the Commission accepted a rate of return of 7.503% before tax for new facilities and 7.398% for existing facilities.
- (177) Based on the above, the Commission considers that the financial rate of return and the profit earned by the beneficiaries is not excessive.

3.3.7.4. *Efficiency incentives*

- (178) According to the 2012 SGEI Framework⁸⁶, Member States have to include efficiency incentives in their compensation mechanisms.

⁸¹ See recital (46).

⁸² Point 33-38.

⁸³ See footnote 24.

⁸⁴ SA.32060 (2014/NN) – Greece. *Alleged illegal aid for discharging Public Service Obligations in the Non-Interconnected Islands*. Decision of 16.09.2014.

⁸⁵ Decision of 10 November 2017 "SA.40348: Spain – Support for electricity generation from renewable energy sources, cogeneration and waste" (OJ C/442/2017).

⁸⁶ Points 39-43.

- (179) The additional remuneration scheme provides incentives to encourage the reduction of costs. Generators have to participate in tenders for the purchase of fuel and need to declare their audited costs, which are later verified by the regulator. In addition, the compensation parameters are updated regularly. The application of standards per installation type and the regular revision of parameters encourage installations to continuously improve their performance.
- (180) In addition, the SO is encouraged to minimise the fuel consumption per unit of energy produced in the electricity dispatch.
- (181) Based on the above, the Commission considers that the Royal Decree contains sufficient efficiency incentives for the provision of the SGEI.

3.3.7.5. Overcompensation

- (182) The 2012 SGEI Framework⁸⁷ requires that the act of entrustment includes arrangements for avoiding and recovering overcompensation. The latter should be understood as compensation that the undertaking receives in excess of the amount of aid as defined in point 21 for the whole duration of the contract⁸⁸.
- (183) As described in recitals (50) and (52), in order to avoid overcompensation, the Royal Decree has put in place several mechanisms that apply to fixed and variable costs such as the correction factor for fixed costs applied to units located in the same production facility or those for variable costs related to fuel invoices verifications that check actual fuel costs.
- (184) The 2012 SGEI Framework⁸⁹ states that "*Member States must ensure that the compensation granted for operating the SGEI meets the requirements set out in this Communication and in particular that undertakings are not receiving compensation in excess of the amount determined in accordance with the requirements set out in this section. They must provide evidence upon request from the Commission. They must carry out regular checks, or ensure that such checks are carried out, at the end of the period of entrustment and, in any event, at intervals of not more than three years. For aid granted by means other than a public procurement procedure with publication, checks should normally be made at least every two years*".
- (185) In this regard, the Royal Decree established the economic and technical parameters for the *additional remuneration*, which correspond to a standard installation type (managed by an efficient and well-run undertaking). The Spanish authorities explain that they consider the data from auditory costs as well as the independent technical studies and standard values proposed by the CNMC. Additionally, these remuneration parameters are public, and are reviewed at the end of each regulatory period taking into account the audited cost values associated with each parameter, the technical and economic standards and the results of compulsory performance test carried out by all plants.

⁸⁷ Point 16(e).

⁸⁸ Point 47.

⁸⁹ Point 49.

- (186) In addition, as described in section 2.9.3, every year the CNMC carries out a final settlement, to check whether the provisional monthly settlements have resulted in a beneficiary receiving more than it is entitled to. These monthly and final settlements are published on the website of the CNMC⁹⁰. Before the Directorate General of Energy Policy and Mines approves the final settlement, it has to be audited by the National Audit Office of the General State Comptroller. At the end of the process, any excess compensation has to be credited to the system. Annual final settlements are published in the Spanish official journal and reflect each beneficiary's data separately, splitting the total amounts into fixed and variable costs.
- (187) The Commission therefore concludes that the requirements under points 47 to 50 in the 2012 SGEI Framework are met.

3.3.8. *Additional requirements to ensure that the development of trade is not affected to an extent contrary to the interests of the Union*

- (188) The requirements set out in the 2012 SGEI Framework⁹¹ are usually sufficient to ensure that the aid does not distort competition in a way that is contrary to the interests of the Union.
- (189) It is however conceivable, that in some exceptional circumstances, serious competition distortions in the internal market could remain unaddressed and the aid could affect trade to such an extent as would be contrary to the interest of the Union.
- (190) Such exceptional circumstances could be that the aid denies undertakings in important sectors of the economy the possibility to achieve the scale operations necessary to operate efficiently, that the entrustment has a duration which cannot be justified by objective criteria or bundles a series of tasks, that the SGEI has been entrusted without a competitive selection procedure in a non-reserved market, that the entrustment is connected with special and exclusive rights which seriously according competition, that the aid allows the beneficiary to finance the creation or use of an infrastructure that is not replicable and enables it to foreclose the market where the SGEI is provided or related relevant markets or if the entrustment hinders the effective implementation or enforcement of Union legislation aimed at safeguarding the proper function of the internal market.
- (191) As mentioned in recital (99), in principle, the public service obligation of supplying electricity in the NPT has been set up so that it applies to any company active in the respective market. *De facto*, Endesa group is the main supplier providing the public service due to the historical evolution of the electricity systems in the NPT. However, the exclusion of the incumbent operator from participating in the tenders for new capacity⁹² tries to ensure that there will be other producers that can enter the market and therefore to ensure the continuity of the supply.
- (192) Moreover, since 2015, the Spanish Government has launched three calls for support for renewables in the Canary and Balearic islands. The first call awarded 256 MW in the

⁹⁰ <https://www.cnmc.es/ambitos-de-actuacion/energia/liquidaciones-y-regimen-economico#liquidaciones>

⁹¹ Assessed in sections 3.3.1 to 3.3.7 of this decision.

⁹² See recital (64).

Canary Islands. In addition, since 2018, the ERDF has co-financed 25 projects amounting to 184 MW also in the Canary Islands and, a new call for ERDF funding for 326 MW of photovoltaic power in the Balearic Islands has been recently carried out. All this renewable capacity in the NPT allows the entrance of new producers in these systems.

- (193) As regards the future of these markets, the Spanish final "National Energy and Climate Plan 2021-2030"⁹³ includes specific plans to support new renewable energy technologies in the islands and to reduce fossil fuels and coal consumption in the NPT. Spain seeks to reduce by 50% the current contribution of fossil fuel generation in the Canary Islands before 2030 and to substantially reduce the share of fossil fuels also in the Balearic Islands already from 2020. This lower contribution of fossil fuel generation would also create more opportunities for less polluting new entrants in these markets. In fact, the Spanish authorities argue that the adoption of the scheme under assessment is key to continue the development of renewables in these territories.
- (194) Moreover, Spain's ambitious renewable energy targets are fully aligned with the European Commission's Green Deal Communication⁹⁴ and with the "Declaration on Clean Energy for EU islands"⁹⁵ which Spain signed in May 2017. The Spanish authorities are determined to promote and support a tailor-made clean energy transition for the islands, which should also help to reduce the extra costs of the NPT, while preserving security of supply.
- (195) Consequently, the Commission considers that as regards the present measure there are no exceptional circumstances leading to serious competition distortions in the internal market that would remain unaddressed or to an affectation of trade to such an extent as would be contrary to the interest of the Union.

3.3.9. Transparency

- (196) The 2012 SGEI Framework⁹⁶ provides that Member States must publish for each SGEI compensation: (i) the results of the public service consultation, (ii) the content and duration of the public service obligations, (iii) the undertakings and the territory concerned and (iv) the amounts of aid granted to the undertaking on a yearly basis.
- (197) As described in recital (136) the Spanish authorities have carried out a public consultation, the results of which are published in a CNMC report. The Royal Decree contains information on the content and duration of the public service obligations (as reflected in the regulatory lifetime of each facility), the plants and the territories concerned. The individual and aggregate cost of the scheme is also made public in the regulator's reports mentioned in recital (186).

⁹³ "Plan Nacional Integrado de Energía y Clima (PNIEC) 2021-2030":
https://www.miteco.gob.es/images/es/pnieccompleto_tcm30-508410.pdf

⁹⁴ "The European Green Deal":
https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf

⁹⁵ "Political declaration on Clean Energy for EU Islands":
https://ec.europa.eu/energy/sites/ener/files/documents/170505_political_declaration_on_clean_energy_for_eu_islands- final_version_16_05_20171.pdf

⁹⁶ Point 62.

- (198) Each year, the SO calculates the additional remuneration that each electricity production installation is entitled to receive according to the data from the production dispatch. As explained in recital (55), the annual final settlement is approved by the Directorate General for Energy Policy and Mines and it is then published in the Spanish official journal (BOE). These annual settlements include information both at aggregated and individual level.
- (199) Spain has also confirmed that it will report to the Commission on the compliance of all SGEI entrustments at two years intervals in accordance with point 62 of the 2012 SGEI Framework.
- (200) Consequently, the Commission considers that the condition of transparency specified in the 2012 SGEI Framework is met.

3.4. Compliance of the compensation with Articles 30/110 TFEU

- (201) In the field of energy, any levy that has the aim of financing a State aid measure needs to comply in particular with Articles 30 and 110 TFEU. According to the case-law, a charge which is imposed on domestic and imported products according to the same criteria may nevertheless be prohibited by the Treaty if the revenue from such a charge is intended to support activities which specifically benefit the taxed domestic products. If the advantages which those products enjoy wholly offset the burden imposed on them, the effects of that charge are apparent only with regard to imported products and that charge constitutes a charge having equivalent effect, contrary to Article 30 of the Treaty. If, on the other hand, those advantages only partly offset the burden borne by domestic products, the charge in question constitutes discriminatory taxation for the purposes of Article 110 of the Treaty and will be contrary to this provision as regards the proportion used to offset the burden borne by the domestic products.⁹⁷
- (202) If domestic electricity production is supported by aid that is financed through a charge on all electricity consumption (including consumption of imported electricity), then the method of financing, which imposes a burden on imported electricity not benefitting from this financing, risks having a discriminatory effect on imported electricity and thereby violate Articles 30 and/or 110 of the Treaty.⁹⁸
- (203) In accordance with established case law of the Court of Justice, the Commission is bound to assess the compliance with Articles 30/110 TFEU of the financing of aid measures where such financing mechanism is intrinsically linked to the competitive effects of the aid when assessing the compatibility of a State aid measure.⁹⁹

⁹⁷ Joined Cases C-128/03 and C-129/03 AEM, EU:C:2005:224, paragraphs 44 to 47; Case C-206/06 Essent, EU:C:2008:413, paragraph 42.

⁹⁸ Case 47/69 France v Commission, EU:C:1970:60, paragraph 20. See also Case SA.38632 Germany EEG 2014 – Reform of the Renewable Energy Law.

⁹⁹ E. Szyszczak, *Research Handbook on European State Aid Law*, Edward Elgar Publishing Limited, UK, 2011, page 287, Case C-225/91 Matra v Commission ECLI:EU:C: 1993: 239, paragraph 41; Case 73/79 Commission v Italy ("the sugar levy case ") ECLI:EU:C: 1980: 129, paragraph 11; Case 74/76 Iannetti ECLI:EU:C:1977:51, paragraphs 14 and 15.

- (204) In the case at hand, the additional remuneration scheme is 50% financed from charges levied on electricity consumers in Spain¹⁰⁰. These charges serve also to finance other regulated costs of the electric system and apply to both domestic and imported electricity.
- (205) The additional remuneration scheme supports installations only located in the NPT. Given the characteristics of these territories, in particular their small size and isolation, electricity in the NPT is a product with a differentiated attribute, namely that it cannot be imported and therefore needs to be generated locally. Imported electricity is simply not available in the Canary Islands, Ceuta and Melilla. It therefore does not compete with the electricity produced by the beneficiaries of the scheme.
- (206) In the Balearic Islands, by contrast, some imported electricity is available through the interconnector. The Spanish authorities have explained that the use of the interconnector is always maximised by the SO according to the maximum power that the Balearic system can absorb within the safety operation requirements established by law¹⁰¹. For example, in the period from December 2018 to November 2019 the use of the interconnectors amounted to 98% of the maximum programmable capacity¹⁰². The limited amount of imported electricity brought into the Balearic Islands from the mainland through the interconnector¹⁰³ is sold at the MIBEL¹⁰⁴ price. Given the high generation costs in the Balearic Islands (mostly variable costs), the fact that the scheme exists due to these high additional costs, and that the dispatch is done on the basis of variable costs, it can be argued that all the electricity coming from the mainland is bound to be cheaper, and therefore consumed first. As a result, under the current conditions in the Balearic Islands, electricity flowing through the interconnector (be it generated in the mainland or imported) has a distinct competitive advantage over electricity produced locally in the islands. Therefore, it can be argued that the charge on electricity consumption that partially finances the scheme does not impose a restriction to the free movement of imported electricity.
- (207) It can also be argued that the support scheme establishes a fiscal measure that does not discriminate against electricity from other Member States. The fact that producers of electricity from manageable sources located in the non-interconnected or small interconnected territories can offset the cost imposed on their products is not relevant for finding an infringement of Articles 30 and 110 TFEU, since their product is not in direct competition with electricity from foreign producers.
- (208) Finally, the Commission also considers that the allocation of these generation costs on all electricity consumption does not amount to internal taxation, i.e. does not represent a levy on electricity, but to tariff socialisation which finally benefits the consumers on the NPT rather than any electricity producers or suppliers. Socialising tariffs is a

¹⁰⁰ See section 2.5.

¹⁰¹ The N-1 security criterion, which is used in the operation of electricity transmission systems according to the guidelines of ENTSO-E:
<https://www.entsoe.eu/major-projects/network-code-development/system-operation/Pages/default.aspx>

¹⁰² This amounts to around 73% of the thermal capacity of the interconnector, with a maximum of 76.5% in the period from December 2018 to November 2019.

¹⁰³ Estimated by the Spanish authorities in 1,657 GWh in the period from December 2018 to November 2019.

¹⁰⁴ Iberian Electricity Market.

regulatory measure related to social cohesion and does not lead to a discriminatory treatment in the sense of Article 110 TFEU.

(209) Based on the above, the Commission concludes that the financing mechanism does not include discriminatory elements and therefore would not constitute a violation of Articles 30 and 110 TFEU.

4. CONCLUSION

(210) The Commission regrets that the Kingdom of Spain has put the compensation for the production of electricity in non-peninsular electric systems into effect, in breach of article 108(3) TFEU.

(211) On the basis of the elements examined above, the Commission concludes that the compensation for the extra costs of supplying electricity on the electric systems of NPT as regulated by Royal Decree 738/2015 fulfils the conditions of the 2012 SGEI Framework and is thus compatible with the internal market pursuant to 106(2) TFEU.

(212) The Commission has assessed the measure on the basis of its current design. However, it considers that the characteristics of the measure will change once more interconnections are built between the systems and between the systems and the mainland, in particular in the Balearic Islands. Therefore, this decision covers the period up to 31 December 2029 for the non-peninsular electricity systems of the Canary Islands and the cities of Ceuta and Melilla while only covers the period up to 31 December 2025 for the Balearic system.

(213) If Spain wishes to maintain the current measures in place, it shall notify the scheme again before these dates, with a view to implement it in compliance with Article 108(3) TFEU. In addition, if at an earlier date one of the electric systems in the NPT becomes connected to the mainland in a way as to allow participation of their electricity producers in the MIBEL, the scheme will become inapplicable in that electricity system.

(214) Spain shall report to the Commission on the compliance with the 2012 SGEI Framework every two years in accordance with point 62 thereof.

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Your request should be sent electronically to the following address:

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Yours faithfully,

For the Commission

Margrethe VESTAGER
Executive Vice-President