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Complejo de la Moncloa

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28071 Madrid

D. José Luis Rodríguez Zapatero, President of the Spanish Government

Copy to: D. José Enrique Serrano, Chief of Staff of the Presidency

Madrid, May 27, 2010

**Subject: Proposed Spanish retroactive reduction of solar PV feed-in tariffs**

Dear President,

We are a group of international investors and investment managers who invest long-term capital on behalf of global pension funds and insurance companies whose beneficiaries are millions of workers – both governmental and private – around the world. Collectively we hold investments in Spanish solar photovoltaic projects with a value of about €3 billion. These projects have been financed with nearly €400 million of our clients' and shareholders funds and with approximately €2.6 billion of loans from Spanish and European banks. Our investors seek low-risk, regulated assets, thus we made these investments relying on the regulatory assurances of the Spanish Government that the Solar PV tariff under Royal Decree 661/2007 would not be changed or reduced during the life of these projects.

In recent weeks, it has been reported that the Spanish Government might be considering to a reduction in the Royal Decree 661/2007 tariff for legally built and operating projects, including those owned by us. Having followed previous tariff negotiations for new renewable energy projects, we are inclined to believe that such an outcome is not likely. However, as the Spanish Government has not publicly ruled out retroactivity, we have heightened concerns that Spain may in fact be considering such an unprecedented and potentially damaging step. We want to register our strongest possible objection to the consideration of any such retroactive reduction. It would result in the loss of all or nearly all of our shareholders' funds and clients' pension and insurance funds invested in the equity of these projects. A substantial portion of the debt funds lent by international and Spanish banks (including some of the more constrained Cajas) would also be lost and it could have very serious long-term ramifications for Spain's ability to attract foreign investment.

We understand that that an unprecedented retroactive change is potentially warranted because based on mistaken beliefs of "excessive profitability," a contribution to the "tariff



deficit,” and “swindles and poor practices in the sector.” These assertions are neither accurate nor warranted and certainly do not apply to our investments. Rather, we call your attention to the following facts surrounding investment under the Royal Decree 661/2007 tariff:

- Solar and wind projects have higher capital costs, but lower operating costs than conventional power generation. Feed-in tariffs such as those defined in Royal Decree 661/2007 are provided to attract the lowest cost of capital, and to compensate investors for the substantial risk of large amounts of capital exposed to long-term repayment from equipment performance and the resource meeting the predicted level. Without the confidence that capital will be repaid with reasonable profit offered by the tariff, investors will not invest.
- Our investments were based on market conditions and equipment prices at the time when the investments were made, not today’s market. That solar PV costs have fallen since we made our investments is neither a relevant nor logical argument. Capital expenditures of solar projects are front-loaded and once the project is constructed installation costs and potential returns are locked in at that time. In fact, our early investment to support Spain’s renewable energy policy was the foundation for the technological improvements and efficiencies of scale that allow new projects to enjoy lower costs today. This initial investment has created the possibility of tariff reductions for future projects, effectively reducing costs to consumers. Critical to us in making these pioneering investments was Spain’s promise of long term, stable regulation and profitability assumptions based on equipment costs and technology risks at the time.
- Spain has a “tariff deficit” in large part because it is currently choosing not to pass on to consumers the full cost of either conventional or renewable energy. Of the accumulated deficit of €17 billion as of December 2009, ca. €3.5 billion is attributable to special regime generation, primarily wind. The balance is attributable to system balancing costs and a decision not to pass on high oil and gas costs in 2007 and 2008. Solar PV is not the underlying problem and is being unfairly targeted when the real issue lies elsewhere.
- We have heard that certain promoters may have secured the Royal Decree 661/2007 tariff illegally. This is not the case with us. We operate to the highest financial, legal and operating standards. Investors and promoters who acted lawfully should not be penalized for the actions of those who did not.

We believe that there are serious implications to Spain of a retroactive tariff change. We are sure that these have been considered, but in the event that they have not, they could very well include:

#### 1. **Loss of Investor Confidence in Spain.**

Our investors include many of the largest pension funds, insurance companies and sovereign wealth funds in the world. In addition to investments in renewable energy through us, they make other investments in Spain and Spanish companies – Spanish government bonds, Spanish corporate bonds and listed and private Spanish equities. They are aware of the threatened changes and the impact on their investments. They



have made it clear that we should not seek further investments in Spain until the matter is settled, and make no further investments if retroactive changes are made because it would lead them to conclude that Spain does not offer a stable regulatory environment or is respectful of foreign investment. Thus, investment decisions are being delayed whilst this uncertainty persists and in the absence of decisive action by the Spanish Government to clarify that such a step will not be taken.

## **2. Higher Borrowing Costs and Reduced Share Prices.**

If a change is made, investors may either stop investing in Spain, or demand higher returns for the increased risk of investing in Spain. This would be a market-wide reaction, beyond the investors that we represent. It is likely to manifest itself in two ways. First, the interest charges for Spanish sovereign and corporate debt will increase. This will exacerbate Spain's deficit funding costs and the borrowing costs, and therefore profitability, of Spanish companies. Second, it may lead to sales in listed Spanish shares, especially in the utility and infrastructure sectors where long-term stability is essential. This could significantly reduce the value of shareholdings by Spanish investors, including Spanish individuals and pension and insurance investors.

## **3. Loss of investor confidence in renewable energy in all EU countries.**

Across the EU, countries are trying to raise capital for renewable energy and low carbon projects. Raising that capital depends on stable regulation, including stable feed-in tariffs. Many consider long-term, stable feed-in tariffs the best mechanism to attract the lowest cost capital to meet the EU's renewable energy targets. If Spain were to retroactively change the Royal Decree 661/2007 tariff, investors are likely to assume that other countries may follow Spain's example. There is a possibility therefore that action by Spain will result in reducing investment across Europe, threatening delivery of the European Commission's and member states' renewable energy and climate change targets.

In short, although it may appear a small action, any retroactive tariff change could have significant negative ramifications for Spain. The mere discussion of such a change at high government levels is already undermining confidence in Spain as a place for foreign direct investment. We are already advising our investors and their Governments of the risk, and enlisting their strongest diplomatic protests. We are not the source of Spain's tariff deficit or other issues, and should not be made to pay for them.

We accept that due to recent cost reductions in technology arising from PV investments in recent years (which we were part of funding), there should be a managed and reasonable reduction to the tariff for new solar projects. We support such changes. However this is not relevant to our existing investments which were made in a different time, and at a different cost base. We also are willing to cooperate with different improvement initiatives, such as improved monitoring of the PV fleet and grid management with Red Electrica, R&D initiatives and closer coordination with the local industry and relevant administrations.

We urge you to promptly and publicly repudiate any retroactive change of the 661 Tariff. Speedy action is needed to maintain general investor confidence in Spain. Without such a



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statement investor confidence will continue to fall and we will clearly have no choice but to suspend new investment activity and continue to advise our investors of the possible change under consideration. We will continue to pursue other avenues at our disposal to dissuade Spain from such a change and should the change occur we will certainly pursue all legal avenues to seek full compensation for any losses that arise. We do not consider this a matter of scale or negotiation. We understand that some officials have been reported to be discussing how much the Royal Decree 661/2007 tariff could be cut. Our unambiguous position is that no retroactive reduction is acceptable. Any change would undermine our confidence in Spanish regulatory frameworks going forward with all the attendant consequences discussed earlier in the letter.

A Spanish translation of this letter is attached. A similar letter will also be sent to other agents within the Spanish Administration.

We would be pleased to meet with you to discuss our concerns. If you wish to do so please contact Iñigo Gortazar, Managing Director, Plenium Partners, Velázquez 47, 28001 Madrid, 914449986

Respectfully yours

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