

Which way now?

While there is disappointment over the development of a pan-Iberian energy market and mixed opinions over Spain and Portugal's commitment to European energy harmonisation, Iberian Lawyer's annual survey of energy lawyers discovered an ever increasing enthusiasm for renewable energy sources.

With rising oil and gas prices, and geopolitical concerns over security of supply, energy matters have never been so high profile.

As the European Union (EU) puts pressure on countries to open their markets, and companies to open their networks, Spain is playing out one of energy's largest takeover battles, the struggle for control of Endesa.

While the pan-Iberian electricity market – MIBEL – has yet to live up to expectations, the key opportunity driving growth in the market, according to the top energy advisors, is undoubtedly renewables.



“The increase in competition has already obliged our clients to improve their performance.”

Alejandro Fernández de Araoz, Araoz & Rueda

The move to renewables

“The energy sector is in turmoil and Portugal is not immune to the fact,” says Manuel de Andrade Neves of Abreu Cardigos & Associados. “In a period of two years we have seen

approved by successive governments two different energy policy strategies and have been watching a market eager for full liberalisation.”

Though some say Portugal is behind Spain in the transition to a free-market energy environment, it is nonetheless pushing ahead with renewable energy – aiming to increase renewable output to 39% in less than a decade. “Kyoto has given the renewables market a real impetus,” says Manuel Protasio of Vieira de Almeida.

In May the Portuguese government announced plans to build the world's largest solar energy scheme, an 11MW site covering 60 acres, intended to be operational by January 2007. It has also announced plans to invest over \$1.3 billion in wind turbines – with a current public tender for 1700MW that has attracted four major bidders – with the opening of the world's largest wave turbine later this year.

In contrast, Spain's renewable target of 12%, in line with the EU's 2010 goals, are more conservative although Spain's energy majors are significantly increasing their renewable portfolios. Rafael Murillo of Freshfields Bruckhaus Deringer in Madrid singles out increasing interest in solar, wind and biomass schemes as the main opportunity.

In both Spain and Portugal, renewable projects are attracting new and different investors who, according to Silvestre Arana and José Guardo at Garrigues in Madrid, require innovative approaches to finance. “Complex financing structures are being put in place by developers and lenders,” they say, often with large asset portfolios such as a variety of



A pesar del desencanto generalizado respecto al mercado ibérico de la energía y a las opiniones divergentes sobre el compromiso de España y Portugal y su concepto respectivo de la armonización europea, el informe anual de Iberian Lawyer, que recoge la opinión de los abogados líderes de la península ibérica, descubre el entusiasmo creciente de un mercado de energías renovables emergente.

Iberian Lawyer cuestiona también el legado que va a resultar de la batalla por Endesa. Parece que la integración de estos gigantes de la energía tendrá inevitablemente una repercusión importante en el sector de la energía. La postura de la Comisión Europea respecto a la regulación del sector parece indicar también cierta fricción entre los Estados miembros, y la aparición de un debate sobre el equilibrio del mercado energético.

THE GOOD NEWS FOR LAWYERS

When it comes to assessing the impact of the current turmoil in Iberia's energy markets, most believe it has a positive impact for energy lawyers.

"The Gas market and the continued development of renewables are certainly areas of likely additional activity and sources of energy that will develop considerably in the next five years," says Manuel Santos Vitor of PLMJ.

A key factor in companies' diversification into renewables say many, has been the Kyoto Treaty. While Spain and Portugal are still a long way behind meeting their obligations, the established energy players are already beginning to exploit wind, wave, solar and biomass alternatives.

"Renewables projects and their

regulatory aspects have been the basis of the energy work for all firms. We expect renewable energy projects to continue for the foreseeable future, although solar projects will presumably become the darlings of the market," says Carlos de Cárdenas de Uría Menéndez in Madrid.

He also points to the drive for progressive liberalisation in the markets as a key driver behind the upturn in domestic consolidation and cross border transactions.

But while Portugal's energy giants watch the Gas Natural, debate with concern, lawyers there remain optimistic about levels of corporate activity, highlighting the government's privatisation plans for Rede Eléctrica Nacional (REN), Galp Energia Group (GALP), and an

additional stake of Electricidade de Portugal (EdP).

There is also optimism in Portugal that the ongoing public tenders, which are attracting many bidders, including foreign players, will continue to involve a wide number of law firms. Once the bid progresses, new and disinterested law firms will be sought to advise successful consortiums.

But as is often the case, change can lead to an increase in disputes. Silvestre Arana at Garrigues in Madrid is advising on disputes arising from new legislation in the gas sector, often regarding gas supply agreements and third party access to gas facilities.

The result, say most energy lawyers is a market full of opportunities.

wind farms projects in different locations.

As with other sectors, private equity is also playing an increasingly important role.

Outside renewables, opinion is mixed within Spain's legal community as to which energy sectors will be the most demanding. "From a general point of view every aspect will need legal advice," says Carlos Vázquez Cobos at Gómez-Acebo & Pombo. "The gas and electricity sector will need advice on regulatory matters; power stations on environmental matters; and renewable energy on projects."

"It is very likely that all energy sources will benefit from the current restructuring that is underway in the energy market," adds José Giménez Cervantes of CMS Albiñana & Suárez de Lezo.



"MIBEL will force all the incumbent players to switch their existing national/regional approach to a more supranational focus."

Antonio Morales, Lovells

For Portugal, José Eduardo Martins of Abreu Cardigos & Associados agrees, but also highlights the growing demand for liquid natural gas – currently oil imports represent around 85% of Portugal's primary energy needs. But what is

first needed they say is market reform, and the creation of an Iberian gas market.

Like some, Jorge Santiago Neves of Barrocas Sarmiento Neves expects to see cross-border consolidation within the energy markets.

Others suggest the key strategic issue for Portugal is whether both energy majors – GALP and EDP – should merge in order to provide both gas and electricity, also a deterrent to foreign acquisition, or whether the government will encourage dual capacity in both entities within the framework of a competitive market.

MIBEL

The trend towards energy liberalisation has already brought substantial change to Europe's markets, and legal practice. It is a process that is further accentuated with the development of MIBEL (Mercado Ibérico de Electricidade) – an integrated Iberian electricity market.

Although MIBEL has yet to achieve its potential, Francisco Sá Carneiro of Uría Menéndez in Lisbon believes that it continues to encourage large-scale investment, particularly in areas such as interconnection. "It will certainly improve competition and security of supply, and may be considered as the first step – an important one – to the creation of an European energy market." He believes that the implementation of MIBEL will create

new opportunities, but only as long as the increase in investment in the sector continues.

For Antonio Morales of Lovells in Madrid, MIBEL signals a change of attitude "It will force all the incumbent players to switch their existing national/regional approach to a more supranational focus."

Change is already evident. "The increase in competition has already obliged our clients to improve their performance," says Alejandro Fernández de Araoz at Araoz & Rueda.

But not everybody sees MIBEL exerting a significant continuing influence. "MIBEL is supposed to have some impact, but it is still too soon to have a final opinion. We do not expect much change" says Ernesto García at Baker & McKenzie.

International impact

"The key international challenge," says Carlos Vázquez Cobos of Gómez-Acebo & Pombo, "continues to be the impact of EU legislation and decision-making."

Manuel de Andrade Neves points specifically to the introduction of the EU-Emission Trading Scheme, which



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José Guardo, Garrigues

he believes has significantly changed the Portuguese energy industry.

"Although these new provisions are mainly of a technical nature, they have nevertheless been very relevant as the market seeks a consolidated legal framework," says Antonio Morales of Lovells.

European Directives obliged Member States to open their gas and

electricity markets for all businesses by July 2004 – although many have yet to comply – and for all consumers by 2007.

June 2005 saw the European Commission launch an inquiry into both sectors, in response to rising wholesale prices, and issues surrounding barriers to entry and



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José Giménez Cervantes, CMS Albiñana & Suárez de Leza

consumer choice. The result has been dawn raids by the European Commission (EC) on some of Europe's largest players – including E.ON – in order to investigate alleged market-sharing.

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THE PROBLEM WITH ENDESA

When it comes to assessing the legacy of the Endesa takeover battle, lawyers across Iberia agree that whatever the outcome the Iberian energy and utilities sector is likely to see further change, and Europe further reorganisation.

A significant result, believes Miguel Temboury of Perez-Llorca – the firm acting for E.ON – will be increased interest in Spain's markets from international players, and very likely more takeovers.

Although some in Portugal believe it is too soon to speculate, João Macedo Vitorino believes that the outcome will define how Iberia faces the final steps of liberalisation in the energy sector.

The integration of such large-scale players will inevitably have repercussions, believes Manuel Santos Vitor of PLMJ but nonetheless it is indicative of a very dynamic European market. "Our expectation is that as part of the process of additional convergence and integration into a single European energy market it is likely that more national, regional and cross-border transactions will happen."

Covadonga Del Pozo at Cuatrecasas senses that the deal "could be seen as a first step towards a new European energy market scenario".

Friction

Many sense however that the deal is causing friction between EU member states and the European Commission over the balance between the strategic nature of the energy sector, and the need to liberalise markets to increase competition.

Member States are reluctant to open their markets, notes Raimundo Ortega at Jones Day. "Spain is one of the few EU members where the state does not retain any shareholding over energy companies, and therefore is unhappy with companies controlled by foreign governments taking stakes in domestic energy companies."

"Endesa's acquisition by E.ON will represent the end of national protectionisms and the redefinition of the Spanish government's strategy for the defence of the national interest in the energy sector," believes João Macedo Vitorino.

"Up to now every match between a Member State and the Commission has been won by the latter and, in the case of Endesa, the Commission has shown that it will no doubt open infringement procedures against Spain if their regulatory authorities decide to block a merger that has been

cleared by the Commission merger task force," believes Luis Muñoz at Jones Day. "The Endesa bid is the perfect case study for conflict on energy regulatory trends".

"Both in terms of the energy and the stock market, this matter is providing a number of precedents, which can be important when designing and analysing energy operations in Spain in the future," says Vicente Sierra of Freshfields Bruckhaus Deringer.

One further consequence believes João Macedo Vitorino may be the Portuguese government's ability to retain 'golden shares', and potentially its strategy for the re-privatisation of EDP and GALP. "Both these companies will be much more exposed to takeover bids from foreign utilities fighting for market share on an EU scale."

But Dolores Sancha of Bartolomé & Briones, like others, believes that a successful takeover, depending upon who is successful, will create further disposals.

"It is therefore likely that the front pages of European newspapers will continue to be periodically covered with headlines on transactions between energy companies," adds Manuel Santos Vitor.



"It is clear the government wants a national champion in Gas Natural while the EU believes in a more harmonious market with more intervention by foreign parties."

Luis Muñoz, Jones Day

"Also very significant," says Francisco Escat at Baker & McKenzie in Spain "has been the growth of the EU." Enlargement they believe is the key factor driving the strategies of most operators within the European energy sector.

Javier Torre De Silva of CMS Albiñana & Suárez De Lezo agrees. "Without a doubt, the emergence of

the East-European energy markets is the most important occurrence relating to the energy market as a whole, and also with regard to the interests of our Spanish clients."

A level playing field

While there is agreement that the harmonisation of EU Member State's energy policies is inevitable, opinions differ over the commitment of the Spanish and Portuguese governments to the creation of a true European energy market.

The publication of the Portuguese government's Energy Policy Strategy is highlighted by many in Lisbon as clear evidence of its dedication towards market liberalisation. "We would say that the harmonisation between the Portuguese energy strategy and that sought by the EU has been gradually achieved, although with some relevant delay."

"Over the last few years legislation has been approved in compliance with EU decisions, including emission limits, the use of alternative energy sources and the implementation of a market for emission licences," says

Miguel Lorena Brito at F Castelo Branco.

While for Nuno Galvão Teles at Morais Leitão Galvão Teles Soares da Silva & Associados it is a very positive sign that Portugal is omitted from the list of Member States criticised for their delay in implementing legislation by the EC.

However, Luís Muñoz at Jones Day in Madrid notes the self-interest of the Spanish government. "It is clear the government wants a national champion in Gas Natural while the EU believes in a more harmonious market with more intervention by foreign parties. The largely socialist governments of Europe are not likely to try to make it a reality soon," he says.

Antonio Morales however stands out with his belief in the strength of Spanish moves to promote the harmonisation process. "Spain has made significant efforts to align its strategies to those sought by the EU and this intention will continue to inspire its future steps in the following years," he says.

Although many believe the route towards harmonisation is the right one, they admit that it will not be an

easy journey. While in private, some lawyers say they applaud the idea of national champions, and governments' desire to protect industries.

Despite the Portuguese government's good intentions EU-wide harmonisation remains a long-term goal, believes João Macedo Vitorino. "As the E.ON / Endesa case shows, the EC and the national governments are still far apart on how the energy markets should be structured," he says.

"It is quite apparent that many governments within the EU have different views with regard to national energy markets," say José Giménez.



"Kyoto has given the renewables market a real impetus."

Manuel Protasio, Vieira de Almeida.

Cervantes. "It is likely that there will be greater resistance with regard to harmonisation of national and EU strategies."

Javier Junquera at Baker & McKenzie is more pessimistic, however, "To be honest I do not see any harmonisation across the EU," he concludes. **IBL**



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