

CLIENT ALERT

Chile to Reform Legal Framework for Distributed Generation Facilities (PMGDs)

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Summary

- The Chilean government is proposing a major reform of the principal regulation governing small-scale or distributed generation facilities (i.e., PMGDs, as defined below) with the objective of providing a clearer and more stable legal framework for a booming industry.
- The proposed regulation would replace the current 24-hour, average stabilized price with a price regime determined on the basis of six four-hour blocks, intended to better reflect changes in electricity demand and variations in the marginal costs of various generation sources. This change would likely affect the electricity price received by photovoltaic plants as they can supply energy only during daylight hours when the energy prices would likely tend to decrease under the new pricing mechanism.
- The reform would allow operating projects and certain new projects to remain under the current stabilized price regime for a period of 13 years and nine months, starting from the publication of the final version of the regulation.
- The sector may see a surge in new small-scale projects, as developers may rush to secure access to the current stabilized price mechanism.
- Other changes to the regulation seek to improve the interconnection process and to provide more certainty to developers during the construction phase.
- The final regulation proposed by the Ministry of Energy will have to be approved by the Comptroller General, after which it will become effective 30 days after its publication in the Official Gazette, subject to certain exceptions.

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Introduction

In recent years, distributed generation facilities, referred to as PMGDs² in Chile for their designation in Spanish (*Pequeños Medios de Generación Distribuida*), have driven the renewable energy revolution in the Chilean energy market. The incentives established in the existing regulations and the limited size of the projects, which allowed them to be deployed close to major load centers, afforded PMGD developers easy access to financing and a more streamlined development process (e.g., more limited environmental assessment requirements). Currently, the distributed generation industry represents a considerable portion of installed renewable generation capacity, particularly of solar,³ and has shown a steady, sustained growth, within the larger context of the rapid development of renewable energy in Chile.

With the goal of maintaining the expansion of the industry at a sustained pace and solving some practical and legal issues arising from the current regulation, the Chilean government is advancing a structural reform of the PMGD legal framework. On September 2, 2020, the Ministry of Energy submitted to the Comptroller General (*Contraloría General de la República*) a new draft of Supreme Decree No. 88 (“Decree No. 88”), which would replace Supreme Decree No. 244, dated September 2, 2005 (“Decree No. 244”), the primary regulation for the PMGD industry in Chile.

This summary reflects the main changes proposed in the current draft of Decree No. 88,⁴ and may need to be updated once the final regulation is published. Please note that given Chile’s extensive regulation of the energy market as well as the complexity of the legal framework administered by its local authorities, a further evaluation of the potential effects of the reform discussed herein will require careful consideration on a case-by-case basis by local counsel. Our team is available to discuss and answer any questions on the issues raised above and to liaise with our extensive contacts in Chile.

² Under Chilean regulations, PMGD refers to generation facilities that are connected either to the transmission grid or directly to the distribution network, with a capacity equal to or lower than 9 MW, and that are so designated by the National Energy Commission (*Comisión Nacional de Energía*). Once operational, PMGDs are able to dispatch energy independently (*auto-despacho*), meaning that the facility would be able to decide when and how much energy will be injected into the grid, as opposed to the general regime in which the National Coordinator (*Coordinador Eléctrico Nacional*) dispatches power plants under a strict cost-benefit scheme. Also, PMGDs are partially or totally exempt from transmission tolling and have access to a special stabilized price regime that may be elected instead of the general rule for the wholesale market, which entails selling energy into the spot market at variable marginal cost.

³ According to data collected by the Chilean Superintendent of Electricity and Fuels (*Superintendencia de Electricidad y Combustibles*), the PMGD industry has registered more than 5,800 connected facilities, with a current installed capacity of over 1,200 MW, and expected installed capacity of more than 2,000 MW taking into account projects in development. Moreover, PMGD facilities represent 25% of the total photovoltaic industry and roughly 2% of total energy generation in Chile, according to a report from the Chilean Solar Energy Association. During 2017 and 2018, the distributed generation industry almost doubled its capacity. In 2019, this market registered 40% growth, adding more than 300 MW of capacity. The industry is expected to experience similar growth continuing from 2021 onwards.

⁴ Note that this regulation is not expected to become effective until it is approved by the Comptroller General (and 30 days after the final version is published in the Official Gazette). The latest draft of Decree No. 88, dated as September 2, 2020, is available [here](#).

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1. Energy Pricing: Change to the Stabilized Price Mechanism

The modification to the stabilized price mechanism available to PMGDs is expected to be the most significant change introduced by Decree No. 88. Currently, the Chilean General Electricity Act⁵ (as implemented by Decree No. 244) grants these projects the option to inject and withdraw electricity under a stabilized price mechanism rather than having to sell and buy it on the spot market at the current marginal cost, which is the general rule for the Chilean wholesale electricity market.⁶

The stabilized price mechanism under Decree No. 244 currently allows distributed generation companies to sell energy at a unique, 24-hour average price equal to the short-term node price, which is a hybrid market value with an element of a forecasted wholesale spot price. The short-term node price is established semiannually by the Ministry of Energy and is based on a technical report issued by the National Energy Commission.⁷

Under Decree No. 88, PMGDs will still have access to a stabilized price mechanism, but that value will no longer be determined by the short-term node price described above. Instead, the stabilized price will be a tariff based on a new formula included in Decree No. 88 as determined for each of the six four-hour blocks.⁸ Although the components of the pricing mechanism would not change radically, the incorporation of new indexation formulas and the shift from 24-hour to four-hour periods will result in a different stabilized price for each period, which is intended to more accurately mimic the changes in electricity demand and the variation of the marginal costs of generation throughout the day.

This new regime would mostly impact photovoltaic PMGDs as these can only inject energy into the grid during daylight hours which generally coincide with periods of lower energy demand and higher energy supply. Under the new scheme, those blocks of time during daylight hours are expected to be associated with a reduced stabilized price that more closely mirrors the changes in marginal cost.⁹ This reform may encourage suppliers affected by the price reduction to incorporate

⁵ See Article 149 of the Chilean General Electricity Act (*Ley General de Servicios Eléctricos*).

⁶ In Chile, as in other similar electricity markets, generators participating in the spot market will receive remuneration for dispatched energy equal to the marginal cost which, in general terms, represents the last unit of energy dispatched by the less cost-efficient facility, at every hour and in every particular node. Since the marginal cost depends on factors such as electricity demand, generation availability, transmission restrictions, and power supply, among others, the price would be highly volatile.

⁷ More specifically, the current stabilized price is equivalent to the short-term node price (*precio de nudo de corto plazo*), a value contained in a decree issued by the Ministry of Energy and calculated by the National Energy Commission taking into account the spot price forecast for the next four years (*precio básico de la energía*), adjusted by the average price in private commercial power purchase agreements (based on information reported by generators to the National Energy Commission) (*precio promedio de mercado*), under a range adjustment method (*banda de precios de mercado*) at the closest node.

⁸ Under Decree No. 88, the stabilized price would be calculated according to a new formula and would be published by the Ministry of Energy in May and November of each year, on the basis of a technical report and calculations issued by the National Energy Commission, that take into account projected national grid operations in the context of the price setting process for the short-term node price, which is then applied to six four-hour periods each day.

⁹ The average price of energy in a 24-hour day under the proposed formula would not be expected to be different from the current price range since the stabilized price implicitly accounts for marginal cost variations during different parts of the day. Nonetheless, the new formula includes stabilized price blocks in an attempt to create a system that more precisely reflects marginal cost fluctuations throughout the day, which would tend to increase in the early nighttime hours and approach zero around midday. Therefore, since photovoltaic plants mostly inject electricity during daylight hours,

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storage technology into PMGD projects which may allow them to shift the hourly blocks during which they would inject energy into the grid to blocks with higher stabilized prices.

Notwithstanding the foregoing, Transitory Article 2 of Decree No. 88 allows PMGDs that wish to remain with the current block stabilized price regime (which does not involve the new four-hour block pricing or selling into the spot market) to elect to do so for a period of up to 13 years and nine months from date of the publication of the final decree (the “Transition Period”), provided that prior notice is given to the National Coordinator and at least one of the following conditions is met:

- (a) The PMGD is in operation as of the date of publication of Decree No. 88;
- (b) The PMGD (i) has obtained a valid Interconnection Criteria Report (*Informe de Criterios de Conexión*, or “ICC”) within the first seven months following the publication of Decree No. 88, and (ii) is declared “under construction” within 18 months after the publication of Decree No. 88; or
- (c) The PMGD (i) has submitted an environmental impact study or an environmental impact statement to Chile’s Environmental Evaluation Service (*Servicio de Evaluación Ambiental*) within seven months after the date of publication of Decree No. 88, and (ii) has obtained the “under construction” declaration¹⁰ issued by the National Energy Commission within 18 months after the publication of Decree No. 88.

Any PMGD that has elected to remain in the existing stabilized price mechanism as described above must provide notice to the National Energy Commission prior to the expiration of the Transition Period in order to opt into the new stabilized price regime under Decree No. 88. Otherwise, the PMGD will default to selling into the wholesale spot market at the end of the Transition Period.

2. Clarification of PMGD Facility Aggregation¹¹

Another issue affecting PMGDs that is currently left unresolved under the existing regulation is the uncertainty regarding the circumstances under which a project shall be deemed to be aggregated with others and, therefore, potentially ineligible for PMGD treatment.

Chilean environmental regulations address situations in which PMGD developers knowingly or intentionally divide or stagger projects in order to avoid a material environmental assessment that would be triggered by a single, larger project.¹² Current

with a peak at the highest radiation hours around noon, a price reduction affecting those hourly blocks would likely affect cash flow projections for this type of facility to a greater extent.

¹⁰ This declaration generally constitutes an approval by the National Energy Commission to begin construction on a project, before the interconnection process begins, in accordance with the provisions of Decree No. 244 and Exempt Resolution No. 659.

¹¹ Referred to as “*Fragmentación Eléctrica*” in the Chilean market.

¹² Law No. 19,300 (Environmental Act) regulates the division of projects from an environmental perspective and for purposes of determining the necessity of an environmental assessment. Generally, the sanction for failing to properly aggregate projects is to require a complete environmental assessment instead of an abbreviated assessment (*Declaración de Impacto Ambiental* or “DIA”). Note that PMGDs with an installed capacity between

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electricity regulations, however, do not establish parameters governing the proper treatment of proposed PMGD facilities when two or more are located in close proximity to each other,¹³ owned or controlled by the same entity,¹⁴ or interconnected with the grid at the same point.¹⁵ This lack of guidance leaves developers facing uncertainty as to whether a project will be deemed to be aggregated with others and thus not constitute a PMGD and thereby lose access to the corresponding benefits.

To address the foregoing difficulties, Article 6 of Decree No. 88 introduces a special rule for evaluating whether two or more projects should be treated as a single generation project for purposes of determining whether the PMGD requirements are met. Under Decree No. 88, the National Energy Commission will consider the ownership structure and the geographical location¹⁶ of a project to decide whether it should be deemed to be aggregated with another or whether it should be considered a standalone facility. Further, the National Energy Commission may consider other factors such as the facility description used for purposes of obtaining permits (including for environmental assessments), the type of technology used in the project, the grid interconnection point, and other criteria not expressly contemplated by the regulation.

3. Simplified Interconnection Process and New Interconnection Requirements

Decree No. 88 also establishes a simplified and faster interconnection process for qualifying projects that (a) do not require additional grid interconnection works,¹⁷ and (b) are classified as “non-significant impact” projects.¹⁸ For such qualifying PMGDs, Decree No. 88 will decrease the cost and time required for interconnection by eliminating or reducing the documentation and studies involved in the interconnection process.

In addition, Decree No. 88 establishes new interconnection requirements for PMGDs under development in order to reduce speculative interconnection requests submitted without the backing of an actual developed project (referred to as “back-up requests”). In particular, the interconnection request may be declared inadmissible (i) if the applicant does not commit to paying 20% of the total costs of all technical and safety interconnection studies (as determined in accordance with the

3 MW and 9 MW are only required to obtain a DIA before submitting the project for approval from the National Energy Commission, as opposed to utility-scale projects, which must complete a full environmental assessment. PMGDs with an installed capacity below 3 MW should not have to obtain an assessment at all.

¹³ Note that the current regulation does not define the concept of geographical proximity for the purposes of deemed aggregation. This ambiguity has been partially addressed through administrative proceedings before the Superintendent of Electricity and Fuels adjudicating cases where developers artificially segregated a utility-scale facility into small projects for the purpose of qualifying for and benefitting from the PMGD framework.

¹⁴ Within the meaning of Article 100 of the Securities Act (i.e., generally, parent companies, subsidiaries, affiliates, or similar equity-method investments; directors, managers, officers, and spouses or blood relatives to the second degree; persons under a joint action agreement; among others).

¹⁵ Within the meaning of the applicable provisions of Decree No. 244 and the Technical Regulation of Connection and Operation (*Norma Técnica de Conexión y Operación*).

¹⁶ Please note that Decree No. 88 has not expressly defined the concept of geographical proximity for the purposes of deemed aggregation. This will need to be evaluated on a case-by-case basis taking into account the particular facts and circumstances for the project.

¹⁷ As determined by the distribution company approving the interconnection request.

¹⁸ Meaning projects with a generating capacity no greater than 1.5 MW, among other technical requirements set forth in Articles 2 through 19 of the Technical Standards for Connection and Operation of PMGDs in Half-Tension, Exempt Resolution No. 437, dated July 30, 2019.

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values set forth in Article 32 of Decree No. 88), or (ii) if the project is located, totally or partially, at the same site as another with a previously submitted interconnection request.

4. Extended Validity for Interconnection Criteria Reports

One of the highlights of Decree No. 88 is the extension of the validity period for an ICC (as defined above) and its linking to the “under construction” declaration by the National Energy Commission. Under the current interconnection process, the PMGD developer must present a request to the applicable distribution company, which generally takes the form of a formal technical proposal, or Grid Connection Request. Then, the distribution company would issue an ICC either approving or rejecting the developer’s Grid Connection Request. Once an ICC is accepted, it would be valid for a period of nine months, with a one-time renewal option for an additional nine months in case of wind and solar facilities (or an additional 18 months in all other cases).

Under Decree No. 88, an ICC will be valid for nine months in the case of a “non-significant impact” project (i.e., with a capacity no greater than 1.5 MW), 12 months for a PMGD with a capacity greater than 1.5 MW and less than 3 MW, and 18 months in all other cases.¹⁹

Importantly, Decree No. 88 also creates a new link between the validity periods of the “under construction” declaration issued by the National Energy Commission and an ICC to keep them coterminous. Under the new regulation, PMGDs that are declared as “under construction” can maintain their ICC as valid for the duration of the “under construction” declaration (i.e., through commercial operation) even if the ICC would otherwise expire. If the declaration is subsequently revoked or expires, an ICC will also lose its validity.

However, the distribution company may declare an ICC invalid unilaterally (i.e., without consent of the National Energy Commission)²⁰ if the developer does not provide evidence of the satisfaction of any milestone set forth in the construction schedule²¹ by the last day of the month following such milestone deadline. If a developer files a request within 10 days after an ICC is declared invalid, the Superintendent of Electricity and Fuels may restore that ICC, provided that the developer has demonstrated it is exercising proper diligence in the development of the project.²²

¹⁹ In all cases, the validity of an ICC shall be counted from the date of acceptance of it (see Form 8 in Decree No. 88).

²⁰ See Paragraph 3 of Article 64 of Decree No. 88.

²¹ See Articles 44 and 64 of Decree No. 88.

²² Article 67 of Decree No. 88 does not define “proper diligence” but allows the developer to report the progress made on the project and to indicate what circumstances have caused the delay with respect to the applicable milestone or reporting requirement.

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