

## FER DECREE 2019: PRELIMINARY CONSIDERATIONS

On July 4, 2019 Italy also had something to celebrate: the long awaited FER Decree was finally signed. Such Decree regulates the method of access to the incentive tariff granted by the GSE to: (i) newly built plants, or to be considered as new since fully rebuilt and reactivated; (ii) repowered plants with a higher power capacity than that originally authorized; and (iii) partially or totally renovated plants (the qualification of renovation interventions has not been modified and is still governed by Ministerial Decree 23 June 2016, *i.e.* the previous FER decree, thereafter “2016 Decree”).

The FER Decree does not refer to all renewable energy plants, but only to the so called “mature” sources and technologies: on-shore wind farms; photovoltaic plants, provided that they are newly built with new components (non regenerated) and not located on agricultural areas; hydroelectric plants; and plants that produce residual gas from treatment processes (“residual gas plants”).

Other plants (such as off-shore wind farms, geothermal, biomass, biogas, thermodynamic solar plants and tidal power plants) will be regulated by a subsequent decree, currently being drafted, designed (we assume), to take into account their innovative and, therefore, higher cost of technology and, thus, investment.

### FER Decree main features

The main features of the FER Decree and, in a way, the most distinctive with respect to the past, can be summarized as follows.

The access to the incentive tariff is only granted through the register (as regards plants with a power capacity lower than 1 MW) or auctions (as regards plants with power capacity equal to or higher than 1 MW). No direct access is granted.

The FER Decree identifies 4 groups in relation to the register procedures and 3 groups with respect to auctions and sets out the following quotas for the 7 procedures:

- Group A, wind and photovoltaic sources (770MW for the register and 5500MW for auctions);
- Group A2, only for the register, roof mounted photovoltaic modules with asbestos removal (800MW, only for the register);
- Group B, hydroelectric and residual gas from treatment processes (80MW for the register and 110MW for auctions);
- Group C, renovated wind farms, hydroelectric and residual gas plants (120MW for the register and 620MW for auctions).

For Group A and B plants eligible for the register procedure quotas may be substantially accumulated, so that, for each procedure, the power capacity that has not been deployed by one of the groups may be transferred to the other in order to scroll through the ranking of the award of the relevant procedure (please note that the Decree does not expressly mention Group A2 but we expect that the GSE, in its applicative instructions, will clarify how to deal with the 800 MW quota for roof mounted photovoltaic plants with asbestos decontamination).

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As regards both register and auction procedures, from the second procedure, the power capacity made available is the sum of the quota set out for the new procedure plus the quota of power capacity that has not been allocated in the previous procedure.

The regulation of register and auction procedures is similar to the previous regulation under 2016 Decree. The first auction and opening of the register is scheduled for September 30, 2019. Another three procedures are already scheduled for the years 2020 and 2021, unless the FER Decree effects run out earlier due to the achievement of the incentives average annual indicative cost, equal to 5,8 billion Euro, also taking into account the energy costs of the photovoltaic plants that will be incentivized under the same FER Decree.

Some differences (in respect to the 2016 Decree) can be noted in relation to several aspects that are all relevant and worth mentioning.

First of all, the plant can be transferred even before the signing of the incentive tariffs agreement with the GSE, although such transfer is not granted for free, since it implies a 50% reduction of the offered tariff. However, as in the past, no reduction is provided in the event of the transfer of the shares or quotas of the SPV that holds the building authorizations and operate the plant.

The incentive tariff is granted for 20 years, which is the conventional average life of photovoltaic and residual gas plants as well as wind farms. The conventional average life of a hydroelectric plant with a power capacity equal to or higher than 1MW is 30 years, while it is 25 years for plants with a lower power capacity (20 years for flowing water plants with a power capacity equal to or lower than 400kW). Notwithstanding the incentivized period duration, it has been confirmed the extension of such a period as a consequence of issues deriving from: electric grid security, natural disasters (provided that they are recognized by the competent authorities) and force majeure causes recognized by the GSE. However, the extension of the incentivized period can last 12 months at most when it is due to carry out modernization or non incentivized repowering of the plants (in line with the 12-month deadline for completion of the works, which was envisaged as a condition for the incentivized upgrading of plants under the previous 2016 Decree).

In the case of participation of repowered plants in the procedures (both auctions and register) that have already been repowered in the past, the plant can participate under the condition that at least three years have elapsed between the repower activities. As might be expected, a plant whose power capacity is higher than 1MW due to repowering cannot participate in the register procedure.

Aggregates of plants pertaining to the same technology group can participate in the procedures (both auctions and register). This is one of the most interesting developments of the FER Decree. Thanks to such aggregates, wind farms and photovoltaic plants can participate together to the procedures, provided that, in case of register procedure, each plant has a power capacity higher than 20kW and the overall power capacity of the aggregate is not higher than 1 MW. In case of auction procedures, however, the aggregate can participate if it has an overall power capacity equal to or higher than 1MW and each single plant belonging to the aggregate cannot have a power capacity lower than 500kW. The aggregated participation is one of the priority criteria, even if not the first, that the GSE shall apply in compiling the ranking.

When a plant placed in a good position will not be realized, the ranking cannot slide even when such circumstance is communicated to the GSE in due time. In this regard, it is worth noting that, under the previous 2016 Decree, renouncing to the construction of the plant had a twofold effect, on the one hand, the GSE could forfeit the guarantee paid and, on the other, the ranking slid so

that the first placed applicant obtained the incentive tariff and had the same time to realize the plant as the renouncing applicant had, now, with the new FER Decree, the waiver involves merely the forfeiture of the guarantee. Hence, the quota not granted, can only be used to increase the quota of the subsequent procedure according to the calculation criteria set out by Article 20.

## Priority criteria

There are some developments to be highlighted with regards to the priority criteria to be applied in hierarchical order to each of the groups.

- *Plants eligible for the register*

There are special priority criteria applicable to specific groups (e.g.: Group A, plants realized on closed or restored landfill, disused quarries, or decontaminated areas (including SIN); Group A2, plants mounted on school, hospitals, public buildings). In addition to these special priority criteria, the following criteria apply (to all groups) in hierarchical order:

- (i). plants connected to the grid with electric car recharging stations (under certain conditions);
- (ii). plant aggregates;
- (iii). higher reduction of the offered tariff;
- (iv). lower value of the offered tariff;
- (v). earliest date of completion of application to participate in the procedure.

In comparison with the 2016 Decree the following differences stand out: (a) the "downgrading", among the priority criteria, of the reduction offered on the reference tariff (the 2016 Decree provided a maximum allowed reduction equal to 90% of the reference tariff, therefore a reduction of 10% while the FER Decree provides maximum allowed reduction equal to 30%) and (b) the elimination as priority criteria of the anteriority for the authorization or concession, while the residual criteria of the anteriority of the final date of completion of the application to participate in the procedure remains.

- *Plants eligible for auctions*

In relation to plants eligible for auction procedures the main criterion is the higher percentage of reduction offered (each plants aggregate participate with the same percentage of reduction for all the plants belonging to the aggregate) and when the reduction offered is equal, the following criteria apply:

- (i). possession of a legality rating (also provided by the 2016 Decree);
- (ii). special criteria applicable to specific groups (e.g. Group A, plants realized on closed or restored landfill, disused quarries, or decontaminated areas (including SIN));
- (iii). earliest date of completion of application to participate in the procedure.

Also in this case, apart from the introduction of special criteria applicable to individual groups, with respect to the 2016 Decree, the criterion of the anteriority of the authorization or concession is eliminated, replaced by the residual criterion of the anteriority of the final date of completion of the application to participate in the procedure.

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## The incentive

Unlike the 2016 Decree, the recipient receives a “two-way” incentive also applied to eligible plants qualified under the auction procedures. Specifically the producer is paid the difference, if positive, between the awarded tariff (resulting from the percentage reduction on the reference tariff) and the energy hourly zonal price. In case such difference is negative, the producer will have to pay back the relative amount, except in case of balancing.

Should zero hourly zonal prices be registered for more than 6 consecutive hours, the payment of incentives is suspended throughout the whole of such period, however, the related support period is extended accordingly. The same would apply in case of negative energy prices, once they will be introduced in the Italian electricity market regulation.

Plants may access incentives provided that the related construction works have commenced after being placed in an qualifying position in the rankings, as demonstrated by the communication of works commencement sent to the competent authorities.

This affects not only new initiatives, but also and maybe to a greater extent, those already ongoing (i.e. already authorized), causing a significant extension of the implementation and construction period of a project and implying, from an authorization perspective, the need to keep the project “on hold” by extending the terms of works commencement and conclusion (extension that, at least for the oldest projects, i.e. the ones authorized pending the tormented drafting of the FER Decree, have been already granted once).

The only exception to this rule is made for plants which had direct access to the incentives pursuant the 2016 Decree and plants that while being eligible for incentives under such Decree were placed in an unsuitable position in the rankings, provided that they enter into operation after being placed in a qualifying position in the rankings drawn up pursuant to the FER Decree.

With regard to the works' execution time, without prejudice to the final deadlines established under the FER Decree for the entry into operation of each kind of plant, it is worth noting the application, starting from the month following the 15<sup>th</sup> month after the date of notification of the positive outcome of the auction and registration procedures, of a 1% reduction per year up to the date of entry into operation.

Compared to the last auction procedures held, it is possible to offer a maximum reduction on the reference tariff up to 70%. The previous threshold under 2016 Decree was 40%. Moreover, the FER Decree provides that in the event that one or more offers with a 70% reduction in value are received in one procedure, offers with a reduction up to 80% could be presented in the next procedure. Accordingly, if one or more reduction offers are received at 80% value in subsequent procedures, offers with a reduction up to 90% could be presented in the next procedures.

With such a high percentage reduction it will be more difficult for operators to implement their auction strategy, given that it will be quite surprising to imagine maximum reduction offers, which in the past were the underlying cornerstone of the bidders' strategy to the auctions held in 2016. In other words, while in the previous round of auctions, all bidders submitted the maximum allowed reduction, as it would guarantee anyway an adequate return on the investment, this will not happen in case of offers equal to 21 Euro/MW (i.e. the value resulting from the 70% maximum allowed reduction applied to the reference tariff for wind farms and photovoltaic plants). Given the incentive amount calculation formula and the “two-way” character of the mechanism, except in the case of negative or very low energy prices, offering 21 Euro/MW means (also depending on

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the location of the interested plant given prices are expected to be lower in Southern Italy) often having to pay back the negative difference (or balancing out).

Finally, a few words on the provisions concerning fully or partially renovated plants, which, while being based on auction and registration procedures, are largely similar to the ones under 2016 Decree. It must also be noted that access to incentives in the case at issue is limited to plants that do not benefit from any state incentive on the energy production as of the date of publication of the relevant procedure call notice.

The provision also suffers from the limitation introduced under the so called *Destinazione Italia* decree, which actually precludes the possibility for plants that have not adhered to the option of voluntary remodeling (the majority) to access new forms of incentives, including the case of renovations, for a period of ten years from the end of the period of entitlement to the incentive scheme from which they currently benefit (and with reference to the older plants close to the end of the incentive period).

The foregoing considerations and the high level of development that the PPAs market may reach in the next 3/4 years, on one hand, and the further reduction of technology costs on the other hand, clarify the reason underlying the FER Decree provision regulating the faculty of producer to waive at anytime the right to the incentive tariff during the support period, after the relative disbursement has started and as long as the net amount received until then is paid back to GSE. This provision is justified (and can be applied) because of the high reduction rates allowed at auction base, on one hand, and the possible trend of energy prices on the other. This situation, thanks to a possible more advantageous future negotiation of a PPA and / or to a clearer and / or more defined possibility for renewable sources to participate in the dispatching services market, could lead the interested party to consider more convenient "turning" the project in grid parity rather than remaining bound to regulatory support and related limitations and controls that comes with it.

Thanks to a higher degree of competition on price offers, it is likely that the requirement consisting in holding a legality rating will be less critical than under the procedures regulated under the 2016 Decree, when it had created many problems to those applicant believing to possess it and, especially, to those that had been not able to obtain it in time to participate in the procedures.

## **Limitations to photovoltaic plants participation in the auction procedures under the FER Decree**

Among the main novelties of the FER Decree is the "readmission" of photovoltaic plants. Which, on one hand, is not without criticism, given the alleged *grid parity* status of such technology that seemed to be an established fact; while on the other hand, it faces limitations by nullifying its scope. Such as, for example, the impossibility to access incentives in case of plants built on agricultural areas which implies a series of consequences. First, and paradoxically, the prohibition of building on agricultural areas does not actually prevent interested parties from changing the destination of use of the areas into areas for photovoltaic plants (contrary to the aim of the prohibition). In fact, also because of the lack of interventions supporting the possibility to execute bankable long-term PPAs, a huge and increasingly growing number of authorization applications for *grid parity* large plants on agricultural areas are being submitted. Moreover, if one considers such limitation (that applies not only to newly built plants but also in case of upgrading or reconstruction) combined with the reduced number of available industrial areas (either closed or

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restored landfills), as well as with the fact that wind and solar sources compete under the same power quota, it is clear how low the possibility of photovoltaic plants being actually awarded the incentives is.

In addition, please consider that (with the prohibition applied to plants located on agricultural areas): (i) owners of photovoltaic plants subject to full reconstruction cannot participate in the auction and registration procedures; (ii) no power quota is available to fully or partially renovated photovoltaic plants; (iii) on top of the ranking priority positioning criteria there is the one related to the construction on closed and restored landfill sites and lots, quarries no longer susceptible to further extraction or recovered areas (including National Interest Sites – SIN). A specific power quota is also made available to plants below 1 MW built on the roof of buildings and rural buildings as replacement of Eternit or asbestos coverage, as long as the panels occupied surface is not larger than the one of the removed cover. These plants would also benefit from a 12 Euro/MW bonus on top of the awarded incentive.

Unlike other kinds of plants, photovoltaic plants could only access incentives if made of new and non-regenerated components.

That said, it seems the legislator introduced corrections relating to wind and solar (or hydroelectric and residual gas from treatment processes) plants being placed in the same group given that under Article 20, paragraph 4, starting from the third procedure and only in relation to Group A and Group B of auction procedures, according to the conditions provided for therein, the GSE, will compile two separate rankings for the power sources of the relevant group, thereby granting to the minority source a 30% maximum share of the available power quota.

## **Long-term contracts**

In addition to the above the FER Decree also provides for the creation of a web platform regulated and managed by GME (Electricity Market Manager) for the negotiation of long-term contracts in order to, in theory, favor the matching of supply and demand of end customers, thereby answering the often reiterated need (also under the 2017 National Energy Strategy) to clear the path to PPAs.

However, the functioning and mechanism of the platform have been deferred to further measures to be adopted following a public consultation by the GME within 180 days of the FER Decree publication and by ARERA (Italian Regulatory Authority for Energy, Networks and Environment).

The participation to such mechanism is also limited to plants that qualify for accessing the platform and meet all the following features: (i) newly built, fully rebuilt or reactivated or subject to renovation or repowered plants as per 2016 Decree; (ii) entered into operation after 1<sup>st</sup> January 2017 and (iii) not benefiting from any public incentive.

Moreover, plants admitted to the long-term negotiation platform cannot access the auction and registration procedures under the FER Decree.

Therefore, it seems the legislator tried, even though without much conviction, to regulate long-term negotiation, without however establishing a common framework (indeed, the above does not affect the possibility to execute long-term contracts outside the proposed mechanism).

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The Energy, Project and Infrastructure Department of Legance is available to provide any clarifications, also in respect of any specific situation which may be of interest to you.

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