

JULY 2016

THE NEW FER DECREE (OTHER THAN PHOTOVOLTAIC): MAIN OUTLINES

As of June 30, 2016, Ministerial Decree of June 23, 2016, previously published on the Official Journal (no. 150) dated June 29, 2016 (the “**New FER Decree**” or the “**Decree**”) has entered into force.

The Decree provides for the mechanisms to obtain the incentives tariff for electricity produced from renewable energy sources other than photovoltaic ones and includes, as already set out under former FER decree dated 6 July 2012 (the “**Previous FER Decree**”), four different awarding procedures depending on

- (i) the type of works carried out (i.e. new facility construction or revamping);
- (ii) capacity of the relevant plant (with a distinction between small plants, enjoying a direct access to incentives; medium plants, subject to enrollment in a specific register and qualification under the eligibility list created therefrom; and big plants (i.e. those with capacity higher than 5 MW) that in order to be granted incentive tariffs must successfully participate in a Dutch auction procedure (allowances between 2% and 40% maximum));
- (iii) relevant facility available capacity quota (varying according to energy source, plant size and kind of works carried out).

The awarding procedures allow obtaining 20 years incentives consisting of (i) all-inclusive feed-in tariffs (save for limited exception concerning the duration in hydro, geothermal and solar thermodynamic installations), which is composed of the incentive and price for the electricity produced, if the facility has a capacity not higher than 500 kW or (ii) standard feed-in tariffs, for all other plants, calculated based on the following formula: **Base Tariff + Premium (potential)** [– Hourly Zonal Price (of the place where energy produced is injected into the grid), in case of new plants].

The Base Tariff is set forth in the Decree for each energy source and kind of installation. For big plants, the base tariff is determined by the allowance offered at the auction.

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For example, for off-shore wind plants with a capacity between 60 kW and 5 MW, base tariff varies between 160 €/kWh (max) and 130 €/kWh (min). The initial auction price on which such allowances are applied for plants with a capacity higher than 5 MW is equal to €/kWh 110. Therefore, the incentive to be awarded is comprised between € 66 (min) and € 107.8 (max), depending on the relevant allowances.

The key points of the New FER Decree are:

- (i) an incentives aggregate costs *caps* of € 5.8 billion per year, amount deemed appropriate by the Italian government to continue, on the one hand, supporting sector investments, and, on the other, in order not aggravate citizens costs burden. Upon reaching such threshold, no further new plants could be admitted to the incentive scheme, even in case of revamping; specifically, it could be possible for the Decree to cease being effective, notwithstanding whether or not the overall capacity equivalent to such threshold has been actually incentivized. As a matter of fact, before a new auction or the registers are opened (both scheduled on August 20, 2016) GSE must ascertain if such cap has been reached. Should it be so, (see further below), the auction or the register will not be opened and small plants could not access the incentive tariffs;
- (ii) evident favor for the technology considered as more “consolidated”, i.e. the on-shore wind plants with capacity higher than 5 MW, which retains the majority of the overall quota capacity made available (800 MW out of 1000 MW);
- (iii) introducing a rewarding policy for “virtuous” projects and leading the competition in the hands of those investors being capable to efficiently manage both the realization and the management of the relevant assets along their entire life cycle, with positive effects on auction base price reductions limitation (due to projects capacity) and technology investments. In light of that, we would reasonably expect a reduction in the equity IRR and dividend yields generated by the assets that will be awarded the tariffs.

Please note that, even though the New FER Decree has been enacted to allow a limited number of plants to access incentive tariffs, based on a predetermined capacity quota, on the other hand we do not deem such Decree be the last measure to recognize supporting scheme access to sources other than solar power, and that for a number of reasons.

First of all, it is obvious the cap will not be reached, even when all plants admitted to the tariffs would be all operating (at that time GSE counter will be updated), which depends also on the way the yearly indicative cost” is calculated under the Decree that provides for the energy price, conceived as “*the average of the previous 24 months and subsequent 12 months prices, based on the Day-Ahead Market trends published on GSE website*”, to be taken into consideration. Which compensates the energy price impact on incentive tariff determination.

Moreover, please note that overtime the oldest plants would cease to operate, upon expiring of their incentive life period, thereby making room for other candidates.

Secondly, the national renewable energy based electricity generation *targets* have not been reached yet, also due to the investments break-out in the solar sector caused by the so called *Spalaminentivi*.

Furthermore, the technologies available on the market, jointly with the climate conditions and natural sources on the Italian land, have not allowed, so far, nor will shortly, *grid parity* achievement.

In addition, based on the fact current authorization procedures for partial or full revamping of plants will be (soon or later) simplified and streamlined, we deem the support – as per the incentives – to secure investment returns for a plant totally or partially subject to revamping would be much less than the one necessary for a new plant.

Finally, on several occasions the Italian Government and the MISE (Minister for Economic Development) confirmed that they are considering new measures to be implemented after 2016 with a time span of at least three years.

Please find below a summary of the main provisions contained in the New FER Decree where we have highlighted the main changes to the Previous FER Decree and to the previous drafts of the New FER Decree available during the last months before its final approval and publication.

A. INCENTIVE TARIFFS AWARDING PROCEDURES

1. Auction Procedure - plants exceeding 5 MW capacity

The auction procedure applies to (i) new, fully rebuilt, re-activated and hybrid plants with a capacity higher than 5 MW, and to (ii) re-powered plants, if the extra power capacity exceeds 5 MW.

Please find below the table identifying the available capacity quota for the auction procedure; we note that the entire available capacity quota will be made available at the first tender.

Type of source	MW
Onshore wind	800
Offshore wind	30
Geothermal	20
Solar thermodynamic	100

Biomass (article 8, paragraph 4, letter c) and d)	50
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<i>Key provisions to participate to the auction procedure</i>	
Publication of the tender notice	by 20 August 2016
Applications deadlines	applications shall be filed from the 10 th day after tender notice publication and until expiry of the 90 th day thereof
Main requirements	<p>(i) appliers shall hold the authorization, or, for offshore wind plants and geothermal plants the concession or, in all cases, the connection solution drafted by the grid operator and accepted by the applier;</p> <p>(ii) appliers shall provide evidence of their financial and economical capacity to be attested through one of the following:</p> <ul style="list-style-type: none"> – a declaration issued by a bank attesting the financial and economical capacity of the applier with respect to the relevant investment, taking into account the forecasted profitability of the relevant investment and the financial and economical capacity of the group to which the applier is a party or, alternatively, an undertaking of the same bank to finance the relevant investment; or, alternatively – capitalization (in terms of fully issued share capital and/or shareholders' advance payment for share capital increase) for the minimum amount

	<p>identified in connection with the envisaged investment relevant to the realization of the plant, conventionally identified as provided under table no. 1 of attachment no. 2 of the Decree, as follows:</p> <ul style="list-style-type: none"> • 10% on the part of the investment up to 100 million Euro; • 5% on the part of the investment exceeding 100 million Euro and up to 200 million Euro; • 2% on the part of the investment exceeding 200 million Euro. <p>(iii) provisional guarantee: to be issued for an amount equal to 5% of the envisaged investment value relevant to the realization of the plant (as set out under table no. 1 of attachment no. 2 of the Decree)</p>
Auction base incentive	this is identified by table no. 1 of attachment no. 1 of the Decree and it varies in relation to each type of plant
Allowed reductions	Reduction offers cannot be lower than 2% of the auction base incentive nor higher than 40% of the auction base incentive

In view of the above key provisions, it emerges that:

- (i) counter to the requests of certain market operators and to what was provided in the drafts of the New FER Decree available prior to its publication, the requirements above identified relevant to the economic and financial capacity of the applier are still alternative to each other (and not cumulative), as already provided under the Previous FER Decree;

- (ii) the attestation relevant to the economic and financial capacity of the applier can only be issued by a bank as opposed to what provided under the Previous FER Decree which also considered valid attestations issued by financial intermediaries;
- (iii) as opposed to what provided under the Previous FER Decree, in case the applier elects to give evidence of its economic and financial capacity by submitting evidence of its capitalization (whether this is in terms of fully issued share capital or shareholders' advance payment for share capital increase), the percentage of capital to be paid-in decreases proportionally to the increase of the investment value;
- (iv) the provisional guarantee shall be valid until the expiry of the 120th day after the date on which the applier is made aware of the outcome of the auction procedure (as opposed to what provided under the Previous FER Decree, according to which such provisional guarantee should have lasted until the applier was made aware of the outcome of the auction procedure);
- (v) reduction offers cannot be higher than 40% of the auction base incentive (as opposed to 30%, as provided under the Previous FER Decree). No changes have been made to the minimum allowed reduction (i.e. 2%);
- (vi) the New FER Decree does not longer provide for a *decalage* mechanism: lack of entry into operation by the deadlines identified under the New FER Decree will trigger the loss of the right to obtain the incentives.

2. Register - plants with a capacity lower than 5 MW

The register procedure applies to (i) new, fully rebuilt, re-activated, hybrid plants with a capacity lower than 5 MW, and (ii) re-powered plants, if the extra power capacity is lower than 5 MW.

Please note that there will be one registry only with the following available capacity quota:

Type of source	MW
Onshore wind	60
Hydro	80
Geothermal	30

Biomass and biogas (article 8, paragraph 4, letters a), b) and d)), gas cleaning and exhaust gas, sustainable bio liquids	90
Wave energy source plants (including tidal and wave power)	6
Solar thermodynamic	20

<i>Key provision to participate to the registry procedure</i>	
Publication of the tender notice	by 20 August 2016
Applications deadlines	applications shall be filed from the 10 th day after tender notice publication and until expiry of the 60 th day thereof.

3. Register for partially or totally refurbished plants

Please note that there will be one registry only with the following available capacity quota:

Type of source	MW
Onshore wind	40
Hydro	30
Geothermal	20

<i>Key provision to participate to the registry procedure</i>	
Publication of the tender notice	by 20 August 2016
Applications deadlines	applications shall be filed from the 10 th day after tender notice publication and until expiry of the 60 th day thereof
Admitted plants	<p>(i) plants that have been in operation for a period not shorter than 2/3 of the relevant conventional life expectancy;</p> <p>(ii) plants that do not benefit, at the date the tender notice is published, from incentives on energy production granted by national laws;</p> <p>(iii) comply with the requirements set out under the ministerial decree date 6 November 2014.</p>

In connection with the above two registries, please note the following:

- (i) plants admitted to the above registry procedures will benefit from the incentives set out under the Previous FER Decree to the extent the relevant date of entry into operation occurs by 30 June 2017. Such a provision, however, shall be read together with paragraphs 5 and 6 of article 4 of the New FER Decree, according to which, in case such plants have not already applied to be admitted to the auction or registry procedures under the Previous FER Decree or are entitled to direct access to the incentives pursuant to the same decree, obtainment of the incentives is subject to commencement of the construction works, as identified in the relevant commencement of works' notice filed with the competent public authority, after the date such plants are included in the relevant rankings;
- (ii) the New FER Decree has provided that should successful bidders elect not to complete the relevant plant or intervention (within 6 months from the date the ranking is published), the GSE shall award the incentive to the next plant in the ranking. Please, however, note that plants identified following such ranking scrolling procedures shall, in any case, enter into operation within the deadlines set forth by the New FER Decree;

(iii) in case of lack of compliance with the entry into operation deadlines defined under the New FER Decree, a curtailment of 0,5% per each month of delay will be applied to the tariff awarded to the plants enrolled into the registries, provided that such delay does not exceed 6 months (compared to the 12 months provided under the Previous FER Decree).

4. Direct Access for smaller plants

The direct access procedure applies to the following plants:

Type of plant	capacity
wind plants and wave energy source plants	up to 60 kW
hydropower plants (meeting certain criteria)	up to 250 kW
biomass plants	up to 200 kW
biogas plants	up to 100 kW
re-powered plants	if the extra capacity does not exceed the above thresholds
re-furbished plants	if the overall power capacity does not exceed the above thresholds
plants built by public authorities (following public tenders)	having a capacity up to twice the above thresholds
solar thermodynamic plants	up to 100 kW

Please note that the above identified plants are entitled to benefit from the incentives set out under the Previous FER Decree to the extent they entry into operation by 30 June 2017.

B. DURATION OF THE DECREE

With the exception of the plants which will be admitted to the auction procedure or to one of the above two registries, application for the obtainment of the incentives shall be filed within 30 days from the earlier of (i) 1 December 2016, or, for plants admitted to the direct access mechanism, from 1 December 2017 and (ii) the date on which the average yearly cost of the incentives exceeds 5.8 billion Euro (achievement of such threshold shall be communicated by the AEEGSI on the basis of the date provided by the GSE)¹.

Although the wording of the above provision is far from being clear, it emerges that the purpose of the New FER Decree is to allow (i) the impletion of the 2016 auction procedure, (ii) the opening of the 2016 registry procedure and (iii) the implementation of the direct access mechanism for the eligible plants for the entire duration of year 2017.

The only exception to the above principle would be the case of achievement of the 5.8 billion threshold before the end of the year. Should that be the case, the auction and registry procedures could be stopped (reference to article 27 paragraph 4 of the New FER Decree). In any case, we deem that such a risk is remote in light of the new calculation mechanism of the above threshold provided by the NEW FER Decree².

C. INCENTIVE'S CALCULATION

For new plants and solar thermodynamic plants, the incentives are identified based on (i) the production data relevant to the net energy injected to the grid and (ii) the hourly zonal prices, in accordance with the formula below:

$$I_{new} = T_b + P_r - P_z$$

T_b	this is the base incentive identified for each source and type of plant by table no. 1 of attachment no. 1 of the Decree which, in case the plant has participated to the auction procedure and was included in the relevant
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¹ Please note that the GSE counter, as at 31 May 2016, was set at 5.554 billion Euro. In this respect it is important to highlight that the New FER Decree has provides that the GSE counter will only be updated once plants have entered into operation (and not, as it used to be, at the filing of the relevant incentive request). In addition, we note that the New FER Decree has corrected its previous drafts providing that the relevant threshold shall be calculated as the average of the three following years of the monthly incentives expenditures calculated by the GSE and not as the maximum value achieved in a given month. These are important amendments in order to avoid that the 2016 threshold will be reached before the year-end (as, of course, the average value is lower than the maximum value reached in a given month).

² Please refer to footnote no. 1.

	ranking, shall be reduced for an amount equal to the decrease in the incentive offered during the auction (the “awarded tariff”)
Pr	this is the aggregate amount of eventual premiums to which the relevant plant is entitled
Pz	this is the hourly zone price, relevant to the zone in which the plant injects the electric energy
<p><i>If the incentive value is below zero:</i></p> <p><i>a) for plants which obtain the incentive following participation to the auction procedure, the incentive shall be equal to “zero”;</i></p> <p><i>b) for the other plants, the incentive shall be equal to the relevant negative value and the GSE shall be responsible to perform the relevant adjustments, in accordance with article 22 of the Previous FER Decree.</i></p>	

For fully re-built, re-activated, refurbished, re-powered plants and for hybrid plants, the incentive is determined as follows:

$$I = I_{new} * D$$

D	this is the gradation ratio identified in attachment no 2 of the Decree
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D. INCENTIVE’S DURATION

The incentives is granted from the date the relevant plant commercially enters into operation and until expiry of the life expectancy of the relevant plant, which is equal to 20 years in the majority of the cases with certain exceptions (for example, life expectancy of solar thermodynamic plants is defined in 25 years). Such life expectancy is calculated net off operation interruptions of the plant which are (i) required by public authorities in connection with grid health and safety issues, provided

that these have been recognized by the grid operator or (ii) caused by natural disaster events recognized by the competent authorities or other force majeure events identified by the GSE. In such cases, the incentive's duration is extended for the number of days in which the plant did not operate.

We note that, for the first time in the renewable market regulation (including photovoltaic), the New FER Decree provides that granting of the incentives is “*suspended during the hours in which the registered hourly zone prices are equal to zero, for a period of time longer than 6 consecutive hours*”(…) “*the same provision applies in case negative prices are registered, when these will be introduced in the Italian electric market's regulation*”.

E. PROCEDURAL RULES

The Decree provides that the GSE shall issue the procedural rules by 15 July 2016.

Please find below a list of provisions included in the New FER Decree which, given their content, might raise discussions between the operators and clarifications request.

A. The definition of power's capacity has been amended in the following cases:

- wind plants with turbine generators having nominal capacity equal or lower than 0,5 MW, in respect thereof “***the capacity is given by the sum of individual nominal capacity of each generator comprising the plant, as defined under CEI EN 1400 regulation***”;
- for hydro plants, in respect thereof “*the capacity is equal to the nominal water flow linked capacity allowed*”;
- for solar thermodynamic hybrid plants, having an integration coefficient higher than 35 degree, in respect thereof “*it is assumed a reference capacity, expressed in kW, calculated according to the following formula: $P_n = m_q * 0.1$ where m_q is the receptive surface of the plant expressed in squared meters, as defined under paragraph 1.1.9 of Annex 2. Such value is taken as reference even for hybrid structure plants, with regard to incentive tariffs determination under Annex 1, of threshold value as of art. 5 and of the capacity under auction and register procedures under articles 9 and 12*”.

B. For the purpose of calculating the plant's power capacity, in addition, the New FER Decree, provides that this shall be calculated as the aggregate of the power capacity of all plants, powered by the same source, connected to the same connection point, specifying that:

- “*for the hydroelectric plants, a plant realized based on a specific authorization, notwithstanding the fact the plant shares the same connection point with other facilities, is considered as a single installation*” and

- *“several plants powered by the same source, managed by the same producer or ascribable, at the corporate level, to one producer and located on the same cadastral parcel or on several adjacent parcels are considered as one single facility, with a capacity equal to the sum of each of its components”.*
- C. The New FER Decree has provided that hydropower plants, in order to obtain the incentives (and be enrolled in the registries) shall file a declaration issued by the competent authority which shall ascertain or confirm that the concession act does not prejudice the maintenance or the achievement of the quality goals determined for the interested water stream. We note that such a declaration shall be issued by a public authority and, therefore, delays in the issuance of such act might trigger the loss of the incentive for the relevant plant. Hopefully the GSE will provide, within the procedural rules to be issued by the 15th of July, interpretation rules which will allow a mitigation on the impact of the above mentioned provision so to alleviate eventual prejudices on the energy producer (also based on the case law relevant to the suitability declarations which were required under the 4th *Conto Energia* to be issued by the competent public authorities in connection with the simplified construction permits in order to be enrolled in the registry).
- D. The New FER Decree has also attributed to the GSE, also in connection with photovoltaic plants, a new power to (i) evaluate fraudulent fractioning of the plants (to be identified if the connection point is the same one) and, in case of non-compliances, to (ii) redefine or revoke the incentives. Please note that such a provision does not seem to be compliant with the principles of legality of the administrative acts, statutory reserve of economic freedom restriction acts and non-retroactivity.
- E. The New FER Decree has also given the GSE the power to issue, by 28 September 2016, also in connection with photovoltaic plants, the procedural rules applicable to the examination of the intervention made or to be made on the plants and the relevant impacts on the incentives.