

# European Energy Journal

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## Portugal

### New remuneration schemes for old wind energy investments:

#### *The Portuguese solution to the challenging balance between public and private interests*

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### I Introduction

The enactment of the Decree-Law no. 35/2013, of February 28, ("**Decree-Law no. 35/2013**") stemmed from an intention by the Portuguese Government to curb costs to the National Electricity System ("**SEN**") with renewable energy feed-in tariffs, in an effort to comply with the terms and conditions of the Memorandum of Understanding on Specific Economic Policy Conditionality entered into between the Portuguese State, the European Union, the European Central Bank and the International Monetary Fund on May 17, 2011, and successively amended.

Notwithstanding such political will to decrease the growing "tariff deficit" by (indirectly) reducing

the remuneration benefitting wind farm promoters, the innovative solution which came to be adopted by Decree-Law no. 33-A/2005 managed to reach a compromise between reducing the burden to SEN and maintaining the viability of on-going and prospective investments in wind farms (an industry in which Portugal still maintains a leading position, in particular in relation to the rest of Europe), notably with regards to financing and the amortisation of capital expenditures in such projects.

This compromise was the outcome of the negotiations held between the Government and the main wind farm promoters in Portugal, which were represented by the Portuguese association of renewable energies ("**APREN – Associação Portuguesa de Energias Renováveis**"), prior to the enactment of such Decree-Law.

### II The new alternative remuneration schemes for wind farms

#### 2.1 Applicable remuneration regimes

Decree-Law no. 35/2013 has, *inter alia*, approved the regime for the phase out of guaranteed remuneration for wind (and other renewable energy) power plants and introduced new alternative remuneration schemes to which producers of wind energy

may adhere and which shall become applicable at the end of such guaranteed remuneration period.

Decree-Law no. 35/2013 provides for the new remuneration schemes of renewable power plants ("**centros eletroprodutores**"), which shall differ depending on:

a) if the power plant is subject to the remuneration regime established in Annex II of Decree-Law no. 189/88, of May 27 ("**Annex II of DL 189/88**"), before its amendment by Decree-Law no. 33-A/2005 (which will hereinafter be designated as, simply, "**Remuneration Regime A**") and thus benefits from the tariffs, as calculated in accordance with the provisions of such Annex II of DL 189/88 before the entry into force of Decree-Law no. 33-A/2005;

Generally speaking, a power plant is subject to Remuneration Regime A if it obtained an establishment licence prior to the date of entry into force of Decree-Law no. 33-A/2005 (*i.e.* February 17, 2005) or obtained such establishment licence within a year from the date of entry into force of such Decree-Law.

b) the power plant is subject to the remuneration scheme established in Annex II of DL



189/88, before its amendment by Decree-Law no. 225/2007, of May 31, pursuant to the transition regime set out in Decree-Law no. 215-B/2012, of October 8 (which will hereinafter be designated as, simply, "**Remuneration Regime B**") and thus benefits from the tariffs, as calculated in accordance with the provisions of such Annex II of DL 189/88 before the entry into force of Decree-Law no. 215-B/2012, of October 8 ("**Decree-Law no. 215-B/2012**");

Generally speaking, a power plant is subject to Remuneration Regime B if: **(i)** it has obtained the respective operation licence prior to the entry into force of Decree-Law no. 215-B/2012 (*i.e.* November 8, 2012); **(ii)** it has obtained the establishment licence prior to the entry into force of Decree-Law no. 215-B/2012 and obtains the operation licence up to 12 months thereafter (*i.e.*, until November 8, 2013); or **(iii)** has been attributed with a reception point prior to the entry into force of Decree-Law no. 215-B/2012 and obtains the establishment licence up to 6 months thereafter, and the operation licence up to 12 months thereafter.

- c) finally, wind power plants which are not included in any of the situations provided

in a) and b) above (*v.g.* for which establishment licences have been attributed after the entry into force of Decree-Law no. 215-B/2012) are not entitled to benefit from such alternative remuneration schemes.

For the purposes of this article, only provisions applicable to wind power plants shall be analysed, notwithstanding the fact that Decree-Law no. 35/2013 also provides for relevant changes in the remuneration schemes of small hydro power plants.

## 2.2 Remuneration Regime A

Regarding the power plants which are subject to Remuneration Regime A, Decree-Law no. 35/2013 establishes that wind farm promoters shall benefit from such regime: **(i)** for a period of 15 years counting from the date of entry into force of Decree-Law no. 33-A/2005, if already in operation; and **(ii)** for a period of 15 years, counting from the date of issuance of the relevant operation licence.

After the end of such 15 year period such wind farm promoters shall be subject to either: **(i)** a five year transitional tariff defined by the government, which shall take into account the economic and social sustainability of the costs associated with SEN; or **(ii)** to one of the new alternative remuneration schemes detailed

below. To be subject to the latter, wind farm promoters should have adhered to one of the new alternative remuneration schemes within 30 days after the entry into force of Decree-Law no. 35/2013 (*i.e.* April 1, 2013). Following the end of any of the aforementioned remuneration schemes, operational wind farms shall sell the electricity generated in the open market.

## 2.3 Remuneration Regime B

Regarding the power plants subject to Remuneration Regime B, Annex II of DL 189/88 establishes that wind farm promoters may benefit from such regime for a period of 15 years counting from the date of grid connection of the relevant power plant.

Such wind farm promoters may also, after the end of such 15 year period, adhere to the alternative remuneration schemes of Decree-Law no. 35/2013 provided that certain criteria set out in Annex II of DL 189/88 are met (notably, that the injection capacity of the wind farm has resulted from public tenders held pursuant to the provision of Article 14 of Decree-Law no. 312/2001, of December 10). Unlike Remuneration Regime A, adherence to the new remuneration regimes must be requested within 2 years counting from the date of entry into force of this Decree-Law no. 35/2013 (*i.e.*, until March 2, 2015).

## 2.4 The new remuneration schemes

Adherence to the alternative remuneration schemes of Decree-Law no. 35/2013 entails the payment of an annual compensation to SEN during an eight year period (*i.e.* (i) for wind farms which fall under Remuneration Regime A: between 2013 and 2020; (ii) for wind farms which fall under Remuneration Regime B, eight years counting from the date of effectiveness of the adherence to the alternative remuneration scheme) of either (pursuant to the choice made by the promoter of the plant): (i) € 5,000.00 per MW of installed capacity of the wind farm; or (ii) 5,800.00 per MW of installed capacity of the wind farm.

The payment of such compensation grants the wind farm promoter the right to benefit from the following remuneration schemes after the end of the guaranteed remunerations of Remuneration Regime A or Remuneration Regime B:

- a) a tariff whose base price corresponds to the wholesale electricity market price<sup>1</sup>, but has a floor at a value of € 74MWh and capped at a value of € 98 MWh;

- b) a tariff whose base price corresponds to the wholesale electricity market price, but has a floor at a value of € 60MWh (and not capped).

This special tariff shall be granted: (i) for an additional five years after the term of the relevant remuneration regime, if the compensation that the promoter chose to pay to SEN corresponds to € 5.000,00 per MW of installed capacity; and (ii) for an additional seven years after the term of the relevant remuneration regime, if the compensation that the promoter chose to pay to SEN corresponds to € 5.800,00 per MW of installed capacity.

The minimum and maximum limits of the tariffs established above, as well as the compensation payable to SEN, shall be updated: (i) between 2013 and 2020, pursuant to the multiplication of such tariffs by a correction factor; and (ii) from 2021 onwards, in accordance with the inflation rate (excluding housing).

The electricity sold pursuant to the alternative remuneration scheme established above shall be acquired by the electricity offtaker (in Portugal, currently EDP – Serviço Universal, S.A., the “Offtaker”). Accordingly, pursuant to the provisions of ERSE (**Entidade Reguladora dos Serviços Energéticos** – the regulatory authority for the transmission, distribution and

supply of electricity and natural gas) Directive no. 9/2013 and ERSE Directive no. 11/2013, the payment of the compensations to SEN shall also be done to the Offtaker. The attribution of the income to SEN, resulting in the subsequent reduction of the burden of renewable energy feed-in tariffs to the tariff deficit in future years, is done indirectly, via the decrease in the remuneration payable by SEN to the Offtaker resulting from the purchase by the latter of electrical energy from renewable energy producers.

Finally, payment of the compensations to SEN may be performed by third parties, subject to the authorisation of the debtor, that is, the entity which holds the licences for the operation of the wind farm. Payment is due monthly and failure to comply with the payment of such compensation for a period of over 60 days shall determine the loss by the relevant power plant of the guaranteed remuneration<sup>2</sup>, and the electricity generated by such power plant shall be sold on an open market basis.

<sup>1</sup> Decree-Law no. 35/2013, defines “market price” as the arithmetic average of the hourly prices of the national daily market, as published by the market operator responsible by the spot market price for the previous 12 months.

<sup>2</sup> Notwithstanding the special request for relief by wind farm promoters of payment of the compensation due to SEN established in Ministerial Order no. 119/2013, of March 25.





## 2.5 Adherence to alternative remuneration schemes

Still relevant for the wind farms or wind farm projects which are subject to Remuneration Regime B (to which, as mentioned above, the respective promoters may adhere until March 2, 2015), adherence to one of the alternative remuneration regimes must be communicated to the member of Government responsible for energy matters (currently, the State Secretary of Energy) through the General Directorate of Energy and Geology (**Direção General de Energia e Geologia** - DGEG), which shall decide within 30 days (except if further documentation is requested) on the adherence of such wind farm or wind farm project to the new alternative remuneration scheme.

As mentioned above, compensation to SEN shall be payable, in the case of wind farms or wind farm projects subject to Remuneration Regime B, for an eight year period counting from the date of effectiveness of the decision of acceptance to the adherence to the alternative remuneration scheme.

### III Advantage of the new alternative remuneration schemes

These new alternative remuneration schemes represent a compromise between reducing costs to SEN and the "tariff deficit", a growing burden on the State

Budget in Portugal, while not hindering the development of the wind farm industry and the legitimate expectations of wind farm promoters.

Firstly, the compensation payable to SEN provides a significant revenue stream to counter the growth of the tariff deficit, in effect retroactively cutting the applicable feed-in-tariff for wind farms. This measure also sends a strong signal to European and international institutions that the Portuguese State is bent on complying with the obligations assumed in the "**bail-out programme**", notably in diminishing alleged excessive rents in the energy sector.

Secondly, the establishment of a "floor" for the remuneration in the additional guaranteed period allows wind farm promoters to hedge the price risk for an additional period of time after the term of guaranteed remuneration, which in turn substantially increases the "bankability" of projects which are, for the most part, financed on a non-recourse project finance basis. In fact, promoters and financing banks for renewable energy projects require predictability and stability of cash flows to minimise default risk (in projects which are, for the most part, highly leveraged), which in this case can still be assured for an extra 5 or 7 years after the term of the period of guaranteed remuneration. This extra guaranteed remuneration

period is paramount for certain wind power plant projects to be able to fully amortise financing of the investments (shareholder and bank debt), while covering ongoing operation and maintenance costs and still providing a satisfactory risk adjusted return on investment to the benefit of the respective promoters.

It should be noted, in this respect, that, as of this date, the remuneration schemes, in which tariffs carry a floor of either € 60MWh or € 74MWh, incorporate attractive figures **vis-à-vis** the option of going "**to the market**", as they both exceed the current electricity wholesale market price (the arithmetic average of the wholesale price of electricity during June 2014, in accordance with the latest report of the Iberian Electricity Market – MIBEL, was of € 51.19)<sup>3</sup>.

### IV Conclusion

The new remuneration schemes implemented by Decree-Law no. 35/2013 have received generally favourable acceptance by its recipients (**i.e.** mainly wind farm promoters), and the adherence rate was 100%, showing that a compromise between fiscal sustainability and maintaining the competitiveness of investments in renewable energies can be successfully implemented.

<sup>3</sup> Information available at [www.mibel.com](http://www.mibel.com).