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Client briefing
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The implementation of Directive 2009/28/CE in Italy on the promotion of renewable energies

Key Issues

Incentives

Authorisation procedures

Biofuels

Guarantees of Origin (GOs)

The Italian government has proposed a new draft Legislative Decree (the "**Draft Decree**") to implement Directive 2009/28/CE on the promotion of the use of energy from renewable sources, which was due to be transposed by all EU Member States by 5 December 2010. The Draft Decree is currently under review in the appropriate Parliamentary Commissions. The Draft Decree has also been made available to the industry operators for their informal review and comments.

The Draft Decree introduces significant changes in the legislative framework governing incentives, authorisation procedures, bio-fuels and guarantees of origin. As may be expected, given the potential economic impact of the Draft Decree on the industry, many operators have commented, offering mainly criticism.

This Client Briefing summarises the main provisions of the Draft Decree, and reports on the main observations raised by the industry and the institutional subjects.

General Principles

Article 4 of the Draft Decree sets forth a general principle, whereby two or more authorisation requests for projects that are: (a) powered by the same type of renewable source, (b) located on "contiguous" areas of land and (c) owned, directly or indirectly, by the "same subject", will be deemed to be requests for one single project, inclusive of all single the individual projects for which the several l authorisations were requested.

Comments from operators have mainly concentrated on the following issues:

- The term "contiguous" is not clear, and could potentially lead to litigation. The preference is that the term "adjacent" be used;
- The term "same subject" is not clear: does it refer to the owner of the site, the EPC contractor, the lender, the SPV, or the shareholders etc. The suggestion is that the "subject" be identified more specifically.

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Terms for the 'Single Authorisation'

Article 5.2 of the Draft Decree sets out a mandatory term within which the authority must complete the authorisation procedure and grant any related 'Single Authorisation'. Such term cannot exceed 180 or 240 days, depending on the outcome of the mandatory pre-screening phase. If the outcome of the pre-screening is that no environmental impact assessment (VIA) is required for the project, the term to grant authorisation is 180 days.

On the other hand, if the outcome of the pre-screening confirms that a VIA is necessary, the authorisation procedure must be completed within 90 days, and the VIA must be completed within a term of 150 days, as provided under Art. 26 of Legislative Decree 152/2006; therefore, the overall term to grant the authorisation is 240 days.

The industry would like this provision to be stronger, to prevent the authorities from ignoring the term without consequences. Therefore, the industry suggests that penalties be imposed on the authorities if they do not complete the procedure within the applicable term, especially if the delay is intentional, but also if it is the result of mere negligence.

Simplified Authorisation Procedure *(Procedura abilitativa semplificata)*

The 'Works Commencement Notice' (*Denuncia di Inizio Attività* or *DIA)*, currently used to authorise the power plants with a capacity below the thresholds set out in Attachment A of Legislative Decree no. 387/2003, is replaced, according to article 6 of the Draft Decree, by a new 'Simplified Authorisation Procedure', which applies to the same power plants and essentially consists of a simple notice, filed by the proponent at least 30 days prior to the commencement of works and then examined by the Municipality. Where any of the requirements are missing, the Municipality has the right to order a stop to the project (without prejudice to the filing of another notice subsequently). On the other hand, in absence of objections from the Municipality, the works can be effectively commenced once the 30-day term has expired.

Furthermore, article 6 of the Draft Decree states that the Regions and Autonomous Provinces are entitled to apply this procedure also for plants with a capacity of up to 1MW.

Finally, according to article 6 of the Draft Decree, the authorisation procedures still pending when the Legislative Decree comes into force will continue to be governed by the old framework, but with the possibility, for the proponent, to opt for the new Simplified Authorisation Procedure.

There are two main aspects on which the operators have focused their attention:

- The possibility, for the Regions, to set their own power thresholds to which the simplified regime will apply seems to represent a step back in the process of national harmonisation of the authorisation procedures, laid down in the Guidelines approved on 10 September 2010 and in Art. 17.1(d) of Law n. 96/2010, which requires the implementation of a simplified authorisation procedure for every project with capacity of less than 1 MW;
- A positive aspect of the new Simplified Authorisation Procedure, on the other hand, is that it is specific to energy production plants. The old DIA procedure, despite being substantially similar to this new regime, was originally created to authorise the construction of buildings, and not the construction and operation of power plants. The creation of a specific tool for the simplified authorisation of power generating facilities seems appropriate.

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Requisites to be eligible for incentives

After one year from the Legislative Decree's enactment, access to the incentives for the photovoltaic projects located on agricultural sites will be only granted if: (a) the nominal power does not exceed 1 MW and (b) the ratio between the nominal power and the plant's surface area does not exceed 50 kW/hectare.

This provision has been heavily criticised by operators, on the grounds that:

- It discourages the installation of solar power plants under 1MW on agricultural sites and substantially eliminates any incentive for plants over 1MW. This will probably damage the total production of renewable energy and make it overall more difficult to comply with the Italian target set by the EU for the development of renewable energies (17% by 2020);
- Even accepting that the legislative policy aimed at favoring some types of power plants more than others, it would have been appropriate to provide for a gradual decrease of the incentive, rather than for a drastic abolition;
- The proposal does not seem to be entirely consistent with the Ministerial Decree dated 6 August 2010 *(Conto Energia)*, which states it is compatible to build photovoltaic projects on areas zoned for agricultural use;
- The proposal also does not seem fully in line with the recent Guidelines of 18 September 2010, which specifically allow the construction of photovoltaic projects on agricultural land.

The GSE, on the contrary, expressed a favorable opinion on this provision, seen as an effective way to safeguard agricultural lands, especially considering the rapid and ongoing development of photovoltaic plants in Italy.

Incentive mechanisms

With reference to the electricity produced by renewable power plants entering into operations after 31 December 2012, only two incentive mechanism will be available, both based on the same fundamental principles: (i) a fair compensation of the investments and operational costs and (ii) a constant economic support over the whole lifespan of the power plant.

Projects generating less than 5 MW (this power threshold can be modified by subsequent ministerial decrees but cannot be, in any case, inferior to 5 MW) will benefit from a predefined feed-in type tariff, predetermined and variable on the basis of power source used and capacity.

Power plants with a capacity in excess of 5 MW will benefit from an incentive assigned through descending-price auctions, managed by the GSE.

A detailed discipline of these incentive systems is due to be defined by ministerial decrees within one year from the entry into force of the Draft Decree. The risk of the new incentives being inadequate, in comparison with the current ones, should be mitigated by the clear principles set forth by the Draft Decree. According to these principles, as mentioned above, a fair compensation of the investments should always be granted and should cover the whole lifespan of the plant. The financial backing, necessary to fund the incentives, will come from the tariff's component named A3.

According to art. 22.5(c), the actual specific terms of the transition from the current forms of incentive to the new ones will be defined by ministerial decrees; the Draft Decree, however, only makes reference to the transition process from the green certificates system to the "incentive

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system set forth by art. 22.3" (i.e. the fixed incentive established for plants with a capacity of less than 5 MW), making no reference to the incentive set forth under art. 22.4 (i.e. the descending-price auctions established for the plants with a capacity exceeding 5MW).

This wording choice seems to denote a precise intention: to ensure that all plants already in operation as of the date of enforcement of the Draft Decree, which are currently awarded green certificates, are transferred to the new fixed incentive, irrespective of their capacity. The ; reason for this probably is the need to guarantee a consistent return of the investment, for the whole period of theoretical validity of the right to receive green certificates, that would not be guaranteed properly by an auction system. This interpretation has been supported also by the GSE.

With reference to the proposed incentive systems, the industry has expressed the following considerations:

- The operators' associations appreciate the idea of more uniformity between the different forms of incentives. Nevertheless, they deem indispensable that the existing measures established for the photovoltaic sector not to be modified or terminated before their natural expiry; particular reference is made to the third *Conto Energia*, which has recently been approved (DM 6 August 2010) and was due to be applicable until the end of 2013;
- The operators deem that the one-year term set out for the approval of the ministerial decrees implementing the new incentive system is too long and exposes the industry to both significant risks and a high level of uncertainty; therefore, they propose that the term be reduced to 3 months;
- The associations also criticise the auction mechanism adopted by the Draft Decree, which would make the investments' remuneration uncertain and is also highly unfavourable to small and medium-sized operators. Their suggestion is to dismiss the whole system, replacing it with a simple feed-in tariff; alternatively, if the auction system is to be maintained, they deem indispensable to considerably raise the thresholds for the access to the auction-based incentive and to assure that the floor price is fixed consistently with the costs borne by the operators and the risks connected with the auction system;
- The operators have also recommended that efficiency improving works be eligible to receive incentives.

The Italian Authority for Electric Energy and Gas (**AEEG**) has also expressed some concerns, which differ in part from those raised by the operators:

- Firstly, the AEEG has pointed out that delegating to subsequent ministerial decrees the definition of the incentives could generate delays and a high level of uncertainty for the investors. In fact, the AEEG deems it necessary to: (i) set out the basic rules and criteria that the decrees should follow, leaving to the Ministry just the possibility to discipline particular aspects, (ii) put the AEEG in charge of the main regulatory tasks (e.g. definition and periodic update of the incentives etc.);
- The AEEG does not agree that fixed, feed-in type tariffs should be privileged, because the EU policy objective to minimise the overall costs sustained by the system by favouring competition could be better accomplished through market-based mechanisms;

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- The provision establishing that the financial resources necessary to fund the incentives will be taken from the tariff's A3 component is also, according to the AEEG, unreasonable and unfair, especially because the population is taxed at different levels. The AEEG deems preferable that the incentives be funded by the taxation system;
- Another concern is the 5MW threshold, above which the descending price auctions apply. The AEEG (together with the GSE) has pointed out that this threshold will probably induce the operators to split the projects with a capacity above 5MW into smaller projects, solely to avoid the auctions.

On the provision at issue, the GSE has observed that:

- The auction system, which was adopted by some European countries (Ireland, France, United Kingdom), has proven itself to be substantially inefficient and has therefore been abandoned;
- The fact that the auctions will take place *ex-ante* could generate speculations on the "market of the authorisations", encouraging subjects without the will or the industrial capacity to realise the plants to participate in the auctions just to be able to sell the projects to third parties at a higher price.

Green Certificates

Article 23 provides for the termination of the Green Certificates (also "**GC**") system in its entirety, by stating that, beginning in 2013, the proportion of the total production of electricity that should be produced from renewable sources (or covered by green certificates), pursuant to Art. 11 of Legislative Decree n. 79/99, will be gradually reduced, starting from its 2012 value, ultimately getting to nought by 2015. The GSE will mandatorily purchase, every year, the unsold certificates, at a price fixed at 70% of the value determined according to Art. 2.148 of Law n. 244/07 (i.e. the selling price of the certificates put on the market by the GSE, equal to the difference between a fixed value of 180 €/MWh and the average annual selling price of electric power, as set by AEEG, referred to the previous year).

The gradual but rapid elimination of the mandatory quota that has to be covered by GCs (or produced by renewable sources) is likely to unsettle the market and curb the price of the certificates. Even though the GSE will be compulsorily obliged to purchase the unsold certificates, it is not certain that the purchasing price will continue to be adequate; moreover, if the new price is used as the benchmark to determine the amount of the new incentives, it is likely to adversely affect the industry.

With reference to this provision, the industry has pointed out that:

- The transition between the old and the new incentive mechanism seems quite rapid and, coupled with the mandatory purchase regime, will probably imply an extremely relevant expense for the GSE (presumably over € 1 billion);
- On the other hand, the price value set by Art. 22 of the Draft Decree is considered insufficient to guarantee a fair remuneration to the operators, who have asked that the percentage of the price be raised to 85%;
- The operators would also deem advisable that the mandatory purchase regime be based on a six-month (rather than annual) time frame;

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- Lastly, operators consider indispensable that the overall value of the new incentive not be inferior to the amount received under the previous regime.

The GSE has commented as follows:

- Instead of setting out a three-year transition period, it would be preferable to dismiss the GC system in its entirety starting from 2013, thus reducing the overall levels of uncertainty and the economic impact generated by the obligation to buy GCs;
- The GCs' acquisition price under the mandatory purchase regime, set at 70% of the market, price, is adequate and should not be raised.

Cumulative Incentives

According to Article 24 of the Draft Decree, the incentives offered in accordance with Article 22 of the Draft Decree are not cumulative with any other public incentive, except in few circumstances. As set out in the Draft Decree, for example, it will be possible to benefit, concurrently, both from the incentives of Article 22 and the favourable taxation regime set forth by Art. 5 of Legislative Decree No. 78/09 (*Tremonti-ter*), applicable to capital expenses for equipment and machinery for the production of renewable energy.

Biofuels

With Art. 29 of the Draft Decree, the government updated the minimum quota of biofuel that, pursuant to Law No. 244/07, fuel producers must input into the market. In 2013, each fuel producer will be required to input into the market an amount of biofuel equal to at least 5% minimum of its total production; with the quota increasing to 5.5% for 2014. After 2014, the percentage will be updated, and may be further increased, by the Ministry of Economic Development, with the publication of new ministerial decrees.

The associations representing the oil industry have criticised this provision, especially on the grounds that fuel producers did not have an adequate opportunity to express their comments on the Draft Decree and to play a role in the legislative process.

Guarantees of Origin

According to Art. 30 of the Draft Decree, Guarantees of Origin will lose any and all relevance as indications that the energy is to be recognised as renewable for the purposes of incentives. Moreover, Guarantees of Origin will not count towards Italy's renewable energy production targets.

Opinion of the Industry Commission of the Chamber of Deputies

The Industry Commission of the Chamber of Deputies has expressed its final opinion on the Draft Decree, suggesting some amendments and proposals. As for the amendments, the Commission deems it necessary:

- To provide for consideration to be paid by the developer in order to 'book' the grid capacity necessary to connect the plant (the reason for this is to avoid speculations);
- To reduce the terms for the applicability of art. 8, regarding the limitations on agricultural sites, from one year to six months;
- To eliminate the threshold of 1 MW for the installation of PV plants upon agricultural areas and provide for an "adequate" threshold;

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- For agricultural sites bigger than 5 hectares, to limit the surface that can be occupied by PV plants to a maximum of 20%;
- To eliminate any limit in relation to dismissed or polluted industrial areas, and let the Regions raise those limits for "marginal" areas, not usable for agriculture;
- To provide for the extension of the incentives to partial or total refitting works enhancing the plants' efficiency;
- To reduce the term for the adoption of the ministerial decrees, from one year to six months;
- To modify the wording of art. 4, by substituting the reference to "contiguous areas" owned by the "same subject" with the following: "...areas ascribable to the same subject, or upon which the same subject holds a dominant decisional power, adjacent one to the other and connected to the grid via a single connection point".

Furthermore, the Commission proposed that:

- A "burden sharing" system be introduced on a regional basis;
- The financial backing necessary to fund the incentives be taken from tax revenues rather than from electricity bills;
- Some forms of liability be prescribed if the public administration does not issue the 'Single Authorisation' within the relevant term;
- The threshold for the access to the descending price auctions be raised;
- In relation to the auctions, a floor value be fixed by the Draft Decree, consistently with the need to guarantee a return for the investments.

Next Steps

On 16 February 2011, the Senate's Industry Commission has released (similarly to the Chamber's Industry Commission) a positive opinion on the Draft Decree. Now, the Draft Decree is due to be submitted to the Council of Ministers for final approval.

Conclusions

The Draft Decree undoubtedly constitutes a positive effort towards the creation of a coherent and harmonised legislative framework for renewable energies. Nevertheless, some of its provisions also imply significant regulatory and economic consequences, which could potentially affect both the achievement of the European targets, and the revenues of the sector's operators.

Therefore, it seems crucial that, during this last critical stage of the legislative process, the Draft Decree be subjected to an in-depth analysis and all the potentially critical issues be addressed, taking into account the positions and observations of all the potentially affected stakeholders.

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