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PORTUGAL

Is there a future to the feed-in-tariff system in the European Union?¹

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Climate action, energy security and rational use of the resources

As it is undisputed, the natural resources are being cut off in an unsustainable rate that calls for action – article 191 (1), §3, TFEU. Accordingly, the renewable energy sources (RES) are being called upon to replace the fossil-based energy. This strategy is not new and various legal instruments were prepared in pursuance, such as the Kyoto Protocol (1997) or the recent Paris Agreement (2016).

Though the replacement of fossil-based energy for RES is progressively underway on the climate action level,³ the same cannot be said of the energy security concerns. We need to take into account that a considerable portion of renewable energy is intermittent on its capturing conditions. One can better understand this concern with a recurring question: “what happens to the grid when the sun stops shining or the wind stops blowing?” If we are too dependent on this kind of energy, energy security or availability can become compromised especially during demand peaks.⁴

One can always consider the storage of energy produced from RES as a means of avoiding issues caused by the lack of optimal conditions necessary for this process (no sun, insufficient wind...). However, investors find a problem in this train of thought. In a study carried out by the European Parliament it was identified that “*in some countries the electricity generator also pays grid fees for access to the grid. With storage, the electricity grid is used twice (supplying electricity to the storage and from storage to the final consumer), but the storage facility itself is neither a (first) generator, nor a final consumer.*”⁵

As can be seen, the obvious solution of storage to surpass the problem identified on intermittent RES also has, presently, problems. Therefore, investors are claiming for a regulatory solution that ensures security on the investments. As said in the same study, “*definite regulations are needed that specify questions of ownership of storage or levies that have to be paid.*”⁶

To sum up, the problem for investors/producers is not the cost of storage by itself, which has been decreasing in the last couple of years, but the feeling of uncertainty and the administrative/regulatory costs.

Feed-in-Tariff: an answer or a source of additional problems?

Economically speaking, RES were a risky investment proposition until public policies were put forward in the 1990’s to support their adoption. These policies and related support schemes introduced by the European Union led to an investment race on RES.



Among the different support schemes that were implemented, we can name the feed-in-tariff (FiT) as the most widely used. FiT works as a non-variable compensation for the production of energy. Therefore, once in the grid, one can say that renewable energy producers were not exposed to the free interplay of market forces, thus shielded from commercial risk.

The Government fixes the tariff, the producer produces and then gets his payment. *A priori*, there is no associated risk: consequently, renewable energy production rose exponentially in the last decade, sometimes even surpassing the political goals.

All positive effects notwithstanding, FiT creates a brand new set of additional problems: who pays for FiT?

“*The cost for FiT can be funded through tax revenues (i.e. the public budget), or be placed on market participants such as electricity suppliers or network operators, who then socialize these costs among electricity consumers.*”⁷ One way or another, the consumer pays for it, whether it be through tax revenues or through the electricity bill. With the FiT system the producer is relatively safe.

On top of this, there is another underlying fault to this plan, which may be surmised as a lack of adequacy to the current paradigm. Once the public policy goals of integration of RES are met, the need for new investments progressively ceases to exist. The tariffs de-

PURE FIT SCHEMES ARE A THING OF THE PAST, BUT WE ARE FAILING TO FIND A NEW COMMON MODEL THAT PROMOTES THE INVESTMENT IN RENEWABLES ON THE ONE HAND BUT DOES NOT HAVE AN IMPACT ON THE CONSUMERS ON THE OTHER

value and become unappealing to investors. In order to address the investors' needs, new supporting schemes are coming into being.

New problems, old solutions: alternatives to FiT

As popular as it may be FiT is not the only available supporting scheme: tax benefits, with all their known issues, feed-in-premiums (FiP), contracts for difference (CfD) and tenders/auctions are some of the other used mechanisms, namely by the Member-States of the EU leading to replace FiT.

Germany is currently adopting the auction system since its Renewable Energy Sources Act of 2014. This scheme is the exact opposite of FiT, since the production now gets exposed to the free interplay of market forces of supply and demand. This is only possible due to the success of FiT schemes that increased the production of energy from RES, paving the way for renewables to become integrated in the energy free market. Other mechanisms, like FiP, are also being used in Germany.

France adopted, with the Decree nr. 2016-682 May 27th 2016, the FiP scheme – also known as the “additional remuneration” system. This scheme has a free market component, but it adds a pre-fixed premium to the market-price, thus levelling up the revenue and protecting the investors' expectations at the moment of the investment.

The United Kingdom is using a mixed scheme: on the one hand, small investors are still covered by FiT; on the other hand, big investors are already using CfD. There is, however, a common feature to both – the quota obligation, by which producers are enforced to meet specific percentages of their energy production using RES.

The support schemes in the UK are paid for the consumers through a surcharge on the electricity bill. That is why, in order to protect the consumers, the UK is since 2015 trying to progressively devalue the tariffs. Once the political goals are achieved, the Government will also tone down the quota obligations. At the end of this process, RES energy should be fully integrated in the free energy market.

In the UK the CfD generally works with a fixed tariff for a period of 15 to 20 years. Afterwards, the energy is produced and sold on a market-based price. At the end of each year there is a pay-off and the producer will either receive compensation or return the surplus, depending on whether the annual value is under or above the pre-fixed tariff.

The difference of this mechanism to a FiT scheme is that in CfD the energy needs to be sold by the producer on a market-based price. Therefore, the producer must be aware of market demands to avoid surplus-related costs. In contrast, the producers in FiT schemes must only focus on producing, not selling, which makes FiT schemes undesirable in terms of controlling the State expenditure or protecting consumers from overpaying.

Other countries such as Spain, in an effort to manage the State Budget and the implications of the FiT on the consumer's bill, de-

cidated more drastically to establish retroactive corrections to support schemes, especially FiT, in such a way that was strongly condemned by the European Commission (EC): “A need to make changes in regulatory conditions in response to developments in the market does not justify applying such changes retroactively to investments already made (...) Applying retroactive changes in such situations will seriously undermine investor confidence.”⁸

In Portugal the main sources of renewables are wind and hydro. Further to the Troika intervention, the Government was also forced to alter its traditional FiT scheme to these investments, not so harshly as in Spain but with substantial effects in the local renewables market.

Broadly, Portugal brought down FiT to new investments and adopted a more strict system of regular periodic review of the tariffs in order to avoid overcompensation, thus reducing the tariff deficit on State Budget. It is a political strategy designed to integrate the RES production in the free energy market ending with the typical shielding offered by FiT.

In its replacement of FiT, Portugal is beginning to adopt an auction system and other contracting mechanisms as a predecessor regime to the free energy market. As a matter of fact, Portugal is also trying to adopt a slightly modified CfD scheme.

In conclusion, it is possible to say that following the European Union Guidelines, Portugal is meeting the great lines of substitution of FiT after Germany, France or the UK.

Conclusions

As seen, we are facing a highly complex and ever-changing outlook. There are, however, some ideas which seem to become clear and almost universal to the renewables market in the EU.

The FiT system is disappearing due to its effects on the State Budgets and is in need of deep reforms – as can be understood by the Guidelines set by the EC in its Communication of November 5th 2013.

Several Member-States have put forward alternative policies: Germany with its auction system and FiP; France with a clear FiP strategy; the UK with a mixed policy of FiT and CfD. Some countries, like Spain, were compelled to retroactively change the rules of the game because of its investment in a pure and highly remunerated (naturally arguable, depending on the point of view) – FiT scheme. In Portugal FiT was strongly reduced and replaced with an hybrid solution, some would say deriving from the European Union strategy.

Pure FiT schemes are a thing of the past, but we are failing to find a new common model that promotes the investment in renewables on the one hand but does not have an impact on the consumers on the other. A stronger effort must be made on the energy storage system, as it is paramount to set clear regulations in order to allocate costs, especially administrative/regulatory ones, in a fair way and alleviate both producers' and consumers' uncertainty.

¹ This article is intended for publication under the “Euromoney's Energy and Environmental Expert Guide 2017”.

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³ See *Promotion of renewable energy sources in the EU (EU policies and Member State approaches)*, European Union, June 2016, p. 9, available here: [http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/583810/EPRS_IDA\(2016\)583810_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/IDAN/2016/583810/EPRS_IDA(2016)583810_EN.pdf); “the use of renewable energy sources in the European Union has resulted in around 388 million tonnes of avoided CO₂ emissions and a reduction in the European Union demand of fossil fuels by 116 million tonnes of oil equivalent”.

⁴ *Idem*. pp. 14 and 15.

⁵ See *Energy storage: which market designs and regulatory incentives are needed?*, European Parliament Directorate-General for Internal Policies of the Union (IPOL, August 2015, p. 34, available here: [www.europarl.europa.eu/RegData/etudes/STUD/2015/563469/IPOL_STU\(2015\)563469_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563469/IPOL_STU(2015)563469_EN.pdf)).

⁶ *Idem*, p. 40.

⁷ See <http://climatepolicyinfohub.eu/renewable-energy-support-policies-europe>.

⁸ Communication C(2013) 7243 of 5 November 2013 on *Delivering the internal electricity market and making the most of public intervention*, p. 12, available here: https://ec.europa.eu/energy/sites/ener/files/documents/com_2013_public_intervention_en_0.pdf.