



On the Subject

Italian Parliament Approves Final Rules on Changes to Feed-in Tariffs for Photovoltaic Plants

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On 7 August 2014, the Italian Parliament approved the conversion into law of Law Decree no. 91 /2014 (the Decree) regarding, amongst other matters, “urgent measures ... for the limitation of costs applied to electricity prices”. The approval law will enter into force at the day after its publication on the Official Gazette. As we reported in our [OTS of 25 June 2014](#), Article 26 of the Decree provided for a reduction of 8 per cent on the currently applicable feed-in-tariff (FiT) rates for photovoltaic (PV) plants with a nominal power exceeding 200 kW or, alternatively, a tariff reduction of between 17 per cent and 25 per cent against an extension of the payment period by four years.

In converting the Decree into law, the Italian Parliament has made several changes to the original version of Article 26. In particular, PV plants with a nominal power of 900 kW or less will suffer a slightly lower tariff reduction, and a third option has been added that redistributes the incentives without extending the 20 year payment period. In addition, all operators of renewable energy plants will be granted the possibility of an early redemption of up to 80 per cent of their incentives by selling them to a financial institution. An English convenience translation of new Article 26 of the Decree is provided at the end of this article.

Alternative Options

Paragraph 3, Article 26 of the Decree requires all owners of PV plants with a nominal power exceeding 200 kW to choose one of the following options by 30 November 2014.

The selected incentive mechanism will then apply to electricity produced on, or after, 1 January 2015.

OPTION 1: SPREADING THE FIT OVER 24 YEARS

Under the first option, the applicable incentive period is extended from 20 to 24 years in exchange for a reduction of the FiT rate per kWh.

The reduction has been determined to correspond with the number of years of the FiT that would still be available under the original incentive program, to ensure that approximately the same overall nominal amount of incentives will be granted to the operators as would have been granted during the 20 year period. The difference is that the FiT is now spread over 24 years:

Remaining Period (Years)	Reduction Ratio
12	25%
13	24%
14	22%
15	21%
16	20%
17	19%
18	18%
19 or more	17%

For PV plants that are entitled to the all-inclusive tariff (*tariffa onnicomprensiva*), which includes both the price for the sale of electricity and the incentive premium, the reduction applies only to the incentive component of the overall tariff.

OPTION 2: REDUCING THE FIT INITIALLY BUT INCREASING IT LATER TO COMPENSATE

Under the second option, the 20 year period can be retained but the FiT rate is significantly reduced at first. This initial reduction is followed by a corresponding increase in the subsequent years. By 1 October 2014, the Ministry of Economic Development, in coordination with the Italian Authority for Electricity, Gas and the Water System (AEEG), will issue a decree establishing the percentages of the FiT rate changes to ensure that, in the hypothetical case of all PV plant owners choosing this option, at least €600 million would be saved in the first four years from 2015 to 2019.

OPTION 3: NET REDUCTION OF THE FIT RATE

The third option is a reduction of the FiT rate for the residual incentive period in the following percentages:

Nominal power of PV Plant in kW	Reduction
200 < PV Plant ≤ 500	6%
500 < PV Plant ≤ 900	7%
900 < PV Plant	8%

Option 3 will automatically apply to PV owners that do not inform the *Gestore dei Servizi Energetici* (GSE) of their chosen option by 30 November 2014.

Subsidised Financing of the FiT Shortfall

To enable operators to plug the gap in their cash flow resulting from the implementation of one of the three options, paragraph 5 of Article 26 of the Decree provides for the possibility of obtaining bank financing for up to the difference between the current FiT and the reduced rate resulting from the changes.

The State-owned Cassa Depositi e Prestiti will either fund or guarantee the financing on the basis of special agreements made with the banking sector. Its exposure will be counter-guaranteed by the state.

Revised Payment Mechanism

Paragraph 2 of Article 26 of the Decree establishes that, irrespective of the size of a PV plant, with immediate effect from the second semester of 2014, the GSE will each month only pay fixed instalments amounting to 90 per cent of the plant's estimated annual electricity production.

The adjustment to take into account the actual electricity production in a given calendar year will be paid by 30 June of the following calendar year.

The GSE should have already issued more detailed rules on the implementation of this revised payment mechanism, but has not done so yet.

Early Redemption of 80 Per Cent of the Incentives

New paragraphs 7 to 13 of Article 26 of the Decree introduce an interesting way for investors to reduce the negative impact of the FiT changes and their exposure to future regulatory risk. This is can be done by means of a "securitisation" of up to 80 per cent of their residual incentives.

To this end, the AEEG will organise a public procurement process for the selection of a major European financial institution that will have to make available at least €30 billion for the purchase of incentive receivables from renewable energy producers. The AEEG, together with the GSE, will have an option, but not an obligation, to buy back the receivables from the financial institution by paying equal annual installments which include an interest rate T, corresponding to the depreciation of the costs sustained for the acquisition of the rights for a period of time equal to the time allowed for receiving the incentives. Interest rate T will be determined during the public procurement process for the selection of the financial institution, in which the lowest offered interest rate T is the major selection criterion.

In order to sell up to 80 per cent of their expected residual incentives to the selected financial institution, operators will have to participate in competitive bid procedures, which will be won by those offering the highest discount rate on the expected income. At a minimum, the discount rate must always be higher than the T interest rate. This ensures that, if the AEEG/GSE buys back the incentives from the financial institution, the financial institution cannot make a loss and the AEEG/GSE will always make a gain in comparison with paying the original incentives. This gain must be invested in the reduction of the A3 component for general system costs in end users' electricity bills.

Article 26 outlines only the cornerstones of this early redemption process. Most details still have to be defined by regulation, which the AEEG will issue within 90 days of the

entry into force of the conversion law. The regulation will also include the methods by which the value of the future incentives will be determined. In this respect, one important principle has been already established in paragraph 12 of Article 26 of the revised Decree: the changes to the FiT introduced by the Decree will not apply to those incentives that are assigned to the financial institution. This should allow the financial institution to offer price conditions based on the FiT rates that applied before the Decree.

The disclaimer comes at the end: Paragraph 13 of Article 26 states that the effectiveness of the afore-described redemption model is subject to verification of its impact upon the public finances and compatibility with the commitments undertaken on European level.

Unlawful Elements of The Decree

There is no doubt that all the options result in a reduction of the net value of the incentives and, thus, of the owner's investment.

In particular, the two options providing for a redistribution of the FiT over a 20 or 24 year period do not compensate for losses deriving from inflation or a the interest that would have accrued on an earlier payment of the full incentives. Given the degradation of modules, and thus their reduced productivity in the last four years of the incentive period, it is also likely that a redistribution of the incentives, whether over a 20 or 24 year period, will result in not even the full, nominal amount of incentives being paid. The reduction rate of 8 per cent for PV plants over 900 kW is probably a good approximation of the minimum losses that plant owners will suffer when choosing one of the other two options.

As the provisions in the Decree will apply retrospectively to plant owners that have previously been awarded the FiTs under any of the *Conto Energia* regimes, and whose entitlement to the FiTs has been written down in binding agreements with the GSE, it is questionable if the Decree is compatible with the principles of the Italian Constitution, EU law and Italy's obligations under international treaties.

ITALIAN CONSTITUTION

According to the case law of the Italian Constitutional Court, laws relating to economic benefits may only have retrospective effect to the extent they do not violate the principles of legitimate reliance (*principio del legittimo affidamento*) and the freedom of private economic initiative

(*libertà di iniziativa economica*), as provided for under Articles 3 and 41 of the Italian Constitution. The principle that laws must not have retroactive effect is also expressed in Article 11 of the *preleggi* of the Italian Civil Code, and the Italian Constitutional Court considers it a general principle of law (*criterio generale di diritto*).

EU LAW

Article 26 of the Decree could also be considered non-compliant with Directive 2009/28/EC on the promotion of the use of energy from renewable sources. Under preamble no. 25, Directive 2009/28/EC provides that

One important means to achieve the aim of this Directive is to guarantee the proper functioning of national support schemes, as under Directive 2001/77/EC, in order to maintain investor confidence and allow Member States to design effective national measures for target compliance.

Accordingly, Article 23 of Legislative Decree 28/2011, which implements Directive 2009/28/EC into Italian law, establishes that the new legal framework promotes energy produced from renewable sources by guaranteeing the stability of the incentives schemes over the relevant period. On this basis, Article 26 of the Decree does not appear to comply with the requirements of imposed by Directive 2009/28/EC and Legislative Decree 28/2011.

INTERNATIONAL TREATIES

Italy is a party to more than 90 bilateral investment protection and promotion agreements, commonly known as bilateral investment treaties (BITs). In addition, there are multilateral investment treaties, such as the Energy Charter Treaty (ECT) that protects investors in the energy sector.

Like all investment treaties, the ECT aims to promote and protect foreign investment. Among other things, it also obliges its member states to offer investors fair and equitable treatment; treatment no less favourable than required by international law; compensation in the event of expropriation; and protection of contracts, licenses and concession agreements. In cases of a violation of these commitments, the ECT provides investors with the right to seek indemnification through international arbitration.

Legal Protection for Investors

Investors cannot directly challenge the new Decree before the Italian Constitutional Court, as Italian law does not allow the direct protection of individuals against legislative measures. Investors can raise a complaint with the European Commission, hoping that this may result in the Commission starting an infringement proceeding against Italy. This is, however, not likely to produce tangible results for the individual investor in the short or medium term. It might even be counter-productive if the Commission finds that the entire incentive system qualifies as unauthorised state aid.

Investors can, however, challenge GSE and AEEG administrative resolutions and decisions and ministerial decrees that may be issued to implement and apply the Decree. In addition, foreign investors can seek compensation through international arbitration under the ECT or bilateral investment protection treaties.

APPEALS TO THE ADMINISTRATIVE COURTS

Investors can challenge the legitimacy of administrative resolutions or ministerial decrees implementing the Decree before the Regional Administrative Court (TAR). Challenges could relate to, *e.g.*, the payment of the new, reduced incentives, or the Ministerial decree determining the redistribution of the FiT within the 20 year period.

During proceedings before the TAR, the investor could raise the argument that Article 26 of the Decree is incompatible with principles of the Italian Constitution. The investor could then ask the TAR to refer to the Constitutional Court the question of whether or not Article 26 is constitutional.

If the TAR does decide to refer the issue to the Constitutional Court, it would suspend its decision until the Constitutional Court issues its ruling.

The problem is that the TAR's decision and the ruling of the Constitutional Court may come too late to make a difference. It is unlikely that an administrative act that could be challenged before the TAR will be issued before 30 November 2014, which is the date by which all plant owners must choose their option. Selecting their option may jeopardise the plant owners' chances of success in a subsequent appeal, but not selecting it means the 6-8 per cent tariff cut will apply automatically as of 1 January 2015.

The key to a successful strategy for a legal challenge before the TAR is therefore to identify a way to file an appeal before 30 November 2014 and, at the same time, request interim measures for the preliminary suspension of the application of the new rules.

INTERNATIONAL INVESTMENT ARBITRATION

Foreign investors have an additional option for obtaining relief, which is unavailable to Italian domestic investors. They can seek indemnification for the financial losses suffered from the Decree by initiating an international arbitration procedure and claiming damages for Italy's breach of its obligations under international treaties.

In assessing a potential investment treaty claim, it is important to look at the text of the relevant treaty and related arbitral decisions to determine who qualifies as an investor, what qualifies as an investment and which treaty offers the best relief. In the case of investments from an EU Member State into Italy, the ECT provides the best available protection. The ECT is currently being invoked by a number of foreign investors against Spain in relation to Spanish renewables reform.

The ECT provides foreign investors with the option to enforce their claims in an international arbitration before an independent tribunal, which may be the International Centre for Settlement of Investment Disputes (ICSID), a sole arbitrator or an *ad hoc* arbitration tribunal established under the rules of the United Nations Commission on International Trade Law (UNCITRAL) or the Arbitration Institute of the Stockholm Chamber of Commerce.

An arbitration tribunal cannot annul the Italian legal provisions for being in breach of the ECT. At most, it could rule that Italy is "obliged" to take back the measures, but in practice this cannot be enforced.

Importantly, however, investors can claim damages for breach of the ECT, requesting that the successful claimant is restored to the same financial position as if no breach occurred. An award for damages would be enforceable against assets that are not covered by sovereign immunity.

THE FORK-IN-THE-ROAD CLAUSE

Italy has included a provision in the ECT that investors must decide between bringing claims in international arbitration or national courts (the fork-in-the-road clause).

Under this provision, an investor's choice of a dispute settlement procedure may be binding. This means that foreign investors that have chosen to file an appeal before the TAR might be barred from resubmitting this dispute to international arbitration. The key question will be whether or not an arbitration tribunal will find substantial "identity" between the scope of the appeal before the TAR and the arbitration claim, and between the parties involved in both proceedings. A decision to go before the domestic administrative courts should therefore only be made after careful analysis to determine whether or not the appeal can be structured in such a way as to exclude or reduce the risk of being barred from subsequent arbitration.

Annex

Article 26 - (Intervention on feed-in tariffs for energy produced by photovoltaic plants)

English convenience translation

1. In order to optimize the time for collecting and distributing feed-in tariffs and to foster more sustainable policies supporting renewable energy, the feed-in tariffs for electricity produced by photovoltaic plants, pursuant to art. 7 of legislative decree no. 387 of 29 December 2003 and pursuant to art. 25, par. 10 of legislative decree no. 28 of 3 March 2011, shall be allocated according to the provisions provided for under this article.
2. Starting from the second half of 2014, the *Gestore dei Servizi Energetici S.p.A. ("GSE")* will distribute the feed-in tariffs under section 1 in fixed monthly instalments equal to 90% of the estimated average yearly production of each solar plant and the balance calculated on the actual production will be paid by 30 June of the following year. Operating procedures will be promulgated by GSE within fifteen days from the publication of this decree, and approved with a decree by the Minister of Economic Development.
3. Beginning on 1 January 2015, feed-in tariffs for energy produced by photovoltaic plants with nominal capacity exceeding 200 kW will be reformulated, at the operator's election, according to one of the following options, to be communicated to the GSE by 30 November 2014:

- a. the feed-in tariff is granted for a period of 24 years from the date upon which the plant went into service, and is accordingly reduced by the percentage indicated in the table attached hereto as annex 2;
- b. the feed-in tariff period remains 20 years, but the tariff is recalculated so that, for a first period the feed-in tariff is lower than the current one and, for a second period, the feed-in tariff increases by a like amount. The reformulation percentages will be determined through a decree by the Minister of Economic Development, in coordination with the Italian Authority for Electricity, Gas and the Water System (*Autorità per l'energia elettrica, il gas e il sistema idrico*), to be issued by 1 October 2014, so as to allow, in the event that all eligible parties elect this option, savings of at least 600 million Euros per year for the period 2015-2019, compared to the outlays projected under the existing tariffs;
- c. the feed-in tariff period remains 20 years, but the tariff is reduced by a defined percentage of the feed-in tariff in effect as of the date of this decree, for the remainder of the incentive period, in accordance with the following amounts:
 - 1) 6 percent for plants with nominal capacity exceeding 200kW and up to a nominal capacity of 500kW;
 - 2) 7 percent for plants with nominal capacity exceeding 500kW and up to a nominal capacity of 900kW;
 - 3) 8 per cent for plants exceeding nominal capacity of 900kW.

If the operator does not communicate a choice to the GSE, the GSE will apply the option under letter c.

4. For the all-inclusive feed-in tariffs (tariffe onnicomprensive) granted pursuant to the decree of the Minister of Economic Development of 5 May 2011 (published in the Official Gazette no. 109 of 12 May 2011) and pursuant to the decree of the Minister of Economic Development of 5 July 2012 (published in the Official Gazette no. 159 of 10 July 2012), the reductions indicated in the table of annex 2 only apply to the incentive component, calculated

according to the second sentence of art. 5, par. 1, of the above-referenced decree dated 5 July 2012.

5. The beneficiary of feed-in tariffs described in sections 3 and 4 above is entitled to obtain bank financings for a maximum amount equal to the difference between the tariffs applicable as of 31 December 2014 and the tariffs recalculated pursuant to sections 3 and 4 above. Such financings may benefit, cumulatively or alternatively, on the basis of specific agreements with the bank system, from dedicated funding or security granted by *Cassa depositi e prestiti S.p.a.* (Cdp) on those funds indicated under par. 7, letter a) of art. 5 of legislative decree no. 269 of 30 September 2003 (converted into law, with amendments, by law no. 326 of 24 November 2003). The exposure of Cdp is secured by the Italian State as per art. 1, par. 47 of law no. 147 of 27 December 2013, in accordance with criteria and conditions established by a non-regulatory decree of the Ministry of Economy and Finance.
6. Within their respective competences, regions and local authorities will adjust, if necessary, the length of time of the validity of permits, however denominated, issued for the construction and operation of photovoltaic plants falling under this article, to the duration of the tariffs as recalculated pursuant to above section 3, letter a.
7. The beneficiaries of multi-year incentives, however denominated, for the production of electricity from renewable sources are entitled to sell a portion of such incentives, up to a maximum of 80%, to a purchaser selected from among the major European financial institutions.
8. The purchaser mentioned in section 7 succeeds to the beneficiary's rights to receive the multi-year incentives from the paying entity, provided that the Italian Authority for Electricity, Gas and the Water System will be entitled to exercise, each year, the option to purchase such rights (also through the entity distributing the incentives) by paying equal annual installments which include an interest rate T, corresponding to the depreciation of the costs sustained for the acquisition of the rights for a period of time equal to the time allowed for receiving the incentives.
9. Within ninety days from the effective date of the law implementing this decree, the Italian Authority for Electricity, Gas and the Water System will:
 - a. establish the conditions for the selection of the purchaser described under section 7 through a competitive and non-discriminatory procedure having as its main selection criteria the lowest offered value of interest rate T mentioned in section 8;
 - b. establish the minimum amount (not less than 30 billion Euros) that the purchaser under section 7 pays for the acquisition of portions of the multi-year incentives;
 - c. define the conditions, the procedures and the modalities for collection, by the purchaser mentioned in section 7, of the purchased portions of multi-year incentives or, alternatively, in case of exercise of the option under section 8, of the annual amounts;
 - d. establish the criteria and the procedures for determining the uniform annual quota of multi-year incentives that could be sold by each beneficiary, taking into account the type and location of the plants;
 - e. define the conditions, the procedures and any other criteria applicable to regulating the sale of the portions of multi-year incentives which shall be effected by means of auctions awarded on the basis of the discount rate offered (whereby such discount rate shall not be lower than the T rate granted to the purchaser) and within the limits of a maximum amount for the acquisition of the portions of long-term incentive determined for each single auction;
 - f. establish, for each single auction, the attendance procedures, the minimum discount rate and the maximum amount of the long-term incentives quotas that may be acquired, taking into consideration the type and size of the plants, the specific numbers, estimated capital cost and capability to manage complex procedures;

- g. define any further terms relating to the procedure for selecting the purchaser and the auctions, applicable to maximizing participation, including forms of guaranty which are not directly or indirectly backed by the Italian State.
10. In compliance with the specific policies set by the Minister of Economic Development, the Italian Authority for Electricity, Gas and the Water System will assign any difference between the annual costs of the incentives acquired by the purchaser mentioned in section 7, on one side, and the annual amount under section 8, on the other, to the reduction of the component A3 of the general system costs.
11. The Government will take any measures useful for the full execution of the provisions under this article, including possible agreements with the banking system in order to simplify the complete or partial withdrawal of the beneficiaries of multi-year incentives from the stipulated financing agreements.
12. The reformulation measures under section 3 shall not apply, from the date of sale, to the portions of incentives sold under section 9.
13. The effectiveness of provisions under sections from 7 to 12 is subject to verification by the Ministry of Economy and Finance of the impact of these measures upon the public finances, in order to honor the commitments which have been undertaken on the European level.

ANNEX 2

Remaining Period (Years)	Percentage of Incentive Reduction
12	25%
13	24%
14	22%
15	21%
16	20%
17	19%
18	18%
19 or more	17%

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