

1 February 2022

## The new “cap” on the price of electricity from renewable sources: preliminary comments

On 27 January 2022, Law Decree No. 4, known as the “Sostegni-ter Decree”, (the “**Decree**”) was published in the Italian Official Journal and entered into force on the same date, in order to mitigate, among others, the impact of the recent energy price increases and to protect consumers. One of the most significant measures introduced by the Decree is the limitation of the windfall profits of certain renewable power plants that have been able to benefit from rising energy prices, set out under Article 16.

Set to be in place from 1 February to the end of 2022, the short-term measure forms part of a Euro 1.7 billion energy package aimed at curbing energy bills announced by Italy’s Government.

The following is a summary of the preliminary comments on Article 16.

### 1. The “cap” on electricity from certain renewable sources

From 1 February 2022 until 31 December 2022, a rebalancing mechanism in the form of a “cap” shall be applied by the GSE on the price of electricity injected into the grid by:

- i) photovoltaic plants with an output exceeding 20 kW which benefit from fixed feed-in tariffs under the *Conto Energia* scheme, which do not depend on market prices; and
- ii) plants powered by solar, hydroelectric, geothermal and wind power sources with an output exceeding 20 kW which do not benefit from incentive mechanisms.

In particular, the GSE shall calculate the difference between:

- a) a benchmark price (“**Benchmark Price**” or “**Cap**”) equal to the average hourly zonal prices recorded from:
  - i) the date of entry into operation of the relevant plant until 31 December 2020, increased on the basis of the annual rate of inflation, if the plants entered into operation from 1 January 2010;
  - ii) 1 January 2010 to 31 December 2020 increased according to the same criteria, if the relevant plant entered into operation before 1 January 2010.
- b) the hourly zonal market price of electricity sold from February to December 2022 or, with regard to fixed price power purchase agreements (PPA) entered into before 27 January 2022, the average price under such PPAs from February to December 2022 (in each case the “**2022 Price**”).

If the difference is positive, the GSE shall pay the relevant amount to the producers. Conversely, should the difference be negative, the GSE shall set-off, or request payment of the corresponding amount from the producer.

Assuming, for example only, a Benchmark Price equal to Euro 60 MWh, if (as expected) the 2022 Price will be higher, the producer shall pay to the GSE any amount received from the sale of electricity above the Benchmark Price:

$$\text{Benchmark Price} = 2022\text{Price} * \text{MWh.}$$

If (less likely), the 2022 Price shall be lower than the Benchmark Price, the producers will receive the difference from the GSE.

## **2. Implementation procedure to be adopted by ARERA**

Within 26 February 2022 (e.g. within 30 days from the entry into force of the Decree), the Regulatory Authority for Energy, Networks and Environment (ARERA) shall issue the procedures aimed at implementing the provisions set out above, as well as the terms whereby the relevant proceeds shall be paid into a special fund set up at the *Cassa per i Servizi Energetici e Ambientali* (Energy and Environmental Services Fund) and used to cut the energy bills.

## **3. Renewable power plants affected by the measure**

The renewable power plants affected by the adjustment mechanism shall be:

- a) photovoltaic plants above 20 kW, which benefit from fixed feed-in tariffs not linked to the electricity market price, and in particular:
  - i) the First *Conto Energia* (Ministerial Decrees dated 28 July 2005 and 6 February 2006);
  - ii) the Second *Conto Energia* (Ministerial Decree dated 19 February 2007);
  - iii) the Third *Conto Energia* (Ministerial Decree dated 8 August 2010);
  - iv) the Fourth *Conto Energia* (Ministerial Decree dated 5 May 2011).
- b) all merchant photovoltaic, hydroelectric, geothermal and wind plants, with a power capacity above 20 kW (e.g. any such plants which benefit from no incentives).

## **4. Renewable power plants which are not affected by the measure**

The Decree shall not apply to:

- a) any Fifth *Conto Energia* plants (e.g. those incentivised under Ministerial Decree 5 July 2012), since they are not based on a fixed feed-in tariff, but rather on the price for the sale of the electricity;
- b) any FER 1 photovoltaic plants (e.g. e plants incentivised under Ministerial Decree 4 July 2019), since the incentive to FER 1 plants is dependent on the price of electricity sold;
- c) photovoltaic plants, hydroelectric, geothermal and wind plants below 20 kW;
- d) all self-consumption photovoltaic plants, hydroelectric, geothermal and wind plants above 20 kW;
- e) all wind plants which benefit from any incentive, including:
  - i) "GRIN" incentives (e.g. previously green certificates);
  - ii) incentives under i) Ministerial Decree dated 6 July 2012; ii) Ministerial Decree dated 23 June 2016 and iii) the FER 1 Decree;
  - iii) all-inclusive tariffs (*tariffa omnicomprensiva*).
- f) biomass and biogas power plants;

- g) any PPA-based photovoltaic plants, hydroelectric, geothermal and wind plants, but only on the following conditions:
- i) PPA must have been entered into before 27 January 2022;
  - ii) the price under the PPA is fixed; and
  - iii) the 2022 Price under the PPA shall not be more than 10% higher than the Benchmark Price.

## 5. Grey areas of the provision

### 5.1 Doubts about the Decree being in line with Italian constitution and EU principles

Practically all industry experts and trade associations, including EFET, have already raised concerns over the “cap” mechanism and its compatibility with the Italian constitution, the European Union rules and practices and the International investment law.

Even if the measure is temporary and connected to the energy crisis, this is the second time<sup>1</sup> that the Italian Government has adopted a detrimental measure on the renewable sector, thus generating uncertainty and regulatory distrust on the Italian market. Furthermore, whilst in 2012 the so-called *Spalma Incentivi* Decree intervened to mitigate the public cost of heavily incentivised plants (*i.e.* the various *Conto Energia* schemes), the new Decree affects, among others, (although only for 2022) the expected returns deriving from fully liberalised generation and sale of electricity by non-incentivised renewable plants.

Depending on the 2022 Price, the Decree may harm the legal and economic position of investors, *de facto* having a retroactive effect by re-capturing the expected returns on investment, with a potential loss of credibility towards the financial community.

Furthermore, the Decree may be considered discriminatory towards the renewable energy sector and contrary to the European Green Deal, having considered that the price adjustment of the electricity shall not apply to fossil power plants.

### 5.2 Aspects which still need to be defined

First of all, the Decree (which is a Governmental measure issued on an urgent basis) will need to be converted into a Law by the Parliament within 60 days from 27 January. Based on past experience, it is likely that some small or material amendments will be brought to the Decree during the conversion process, hopefully clarifying some of the grey areas remaining in the current wording. Furthermore, the Decree will also need to be followed by an implementing regulation to be issued by the ARERA and, as we expect, also by further GSE operative regulations.

Pending the rules which shall be adopted by the ARERA and the GSE, certain aspects arising from the implementation of the Decree need to be clarified.

The Decree does not provide for a Benchmark Price (and therefore does not allow to measure a Benchmark Price) for any plants which are subject to the Decree but entered into operation after December 31, 2020. Therefore, it is not clear if and how the Decree will affect such plants.

The Decree exempts PPAs with a fixed price if it is up to 10% higher than the Benchmark Price. Conversely, variable price PPAs resulting in the same average price in 2022 would be affected by the Decree and be subject to recovery from the GSE. This difference in treatment is difficult to justify.

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<sup>1</sup> Reference is to the so called *Spalma Incentivi* Decree (e.g. Law No. 116/2014 that ratified (with amendments) the Law Decree No. 91/2014).

Furthermore, in case of a fixed price PPA which is more than 10% higher than the Benchmark Price, the producer would have to pay to the GSE the entire difference between the Benchmark Price and the 2022 Price, resulting in a worse treatment than the one reserved to PPAs with an average price below the 10% threshold.

Another issue concerns the recovery criteria for the merchant plants. The ARERA will likely need to provide for a self-declaration system, to be set up by the GSE, for operators to communicate the pricing structure and the other relevant features for all relevant PPAs and establish accounts for the recovery of any proceeds above the Benchmark Price. Due to the large number of PPAs currently in place, this system will take time to be implemented and may generate potential conflicts and regulatory uncertainties. We assume that the ARERA and the GSE will also need to implement an adequate and efficient ex-post verification procedure.

In addition to the above, it should be clarified:

- A) whether the non-incentivised photovoltaic, hydroelectric, geothermal and wind plants entered into operation after 31 December 2020 would be affected by the Decree or not; and
- B) whether power plants having right to apply for incentives (e.g. wind farms), but which remain merchant for a while before the commencement of the incentivised period, would be affected by the Decree or not and to what extent.

### 5.3 Impacts on the loan facilities and/or purchase agreements

Operators with long-term PPA-based plants affected by the Decree will need to consider the effects on any hedging arrangements which they may already have concluded with respect to their long-term PPAs.

Also, operators with project financing facilities in place will need to discuss with their lenders appropriate amendments to the existing facility agreements. Whilst it is unlikely that the change in law provoked by the Decree constitutes a MAE, borrowers and lenders will need to take into account the potential cash exposure to the GSE, based on the 2022 Price received, compared to the Benchmark Price.

Furthermore, producers affected by the Decree may wish to invoke “change in law” provisions under their PPA to seek for a rebalancing of their PPA.

Finally, any earn-out clauses contemplated in SPAs for the acquisition of any of the plants affected by the Decree may also need reviewing.

## 6. Conclusions

We will certainly need to wait for some months before having a better picture of the actual impact of the Decree on the renewable sector.

However, it can already be anticipated that the Decree marks a turning point in policymaking in the energy sector. It is motivated by justified reasons in view of the extraordinary increase in all energy commodities, but it catches the sector by surprise and intervenes on the free market by adopting a measure that *de facto* constitutes a control on energy prices, with a possible *domino* effect on the rest of the renewable industry.

As it was in 2012 for the *Spalma Incentivi* Decree, today as well the impression of the commentators is that the regulatory burden of this measure will be relevant.

While Italy is not the first country to adopt urgent measures of this kind to mitigate the current spike in energy prices, the lasting result of the Decree could be a zero-sum game if the effect on future investments in the sector is taken into account.

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