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BRIEFING: ITALY

UPDATE ON THE ITALIAN "*SPALMA INCENTIVI*" DECREE

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THE CONSTITUTIONAL COURT HAS RELEASED THE MOTIVATION OF ITS JUDGMENT, THROUGH WHICH IT DECLARED THAT THE "SPALMA INCENTIVI" DECREE IS NOT UNCONSTITUTIONAL

On 7 December 2016, the Italian Constitutional Court issued an official press release confirming that the so-called "*Spalma Incentivi*" Decree relating to energy produced by photovoltaic (PV) plants does not contravene the Constitution.

In a quick turnaround, the decision was taken only one day after a public hearing on the question.

On 24 January 2017, the Constitutional Court finally released its full judgment, outlining the motivation behind its reasoning.

Tariff cut

Article 26 of Law Decree no 91/2014 (implemented with modifications by Law no 166/2014), the so-called "*Spalma Incentivi*" Decree (the "Decree"), provided that, as of 1 January 2015, the feed-in tariffs (FiTs) for PV plants with a capacity above 200 KW had to be redetermined and reduced. Operators had three options to choose from: (a) extending the FiT period from 20 to 24 years, but with cuts to the FiT depending on how long the plant had been operating; (b) a reduction of the FiT in a first five-year period, but with a corresponding increase in a second period; or (c) a 6%-8% reduction of the original FiT, depending on the plant's power, but without extending the FiT period to 24 years.

Legal challenge

A number of PV operators, producers and associations launched proceedings before Italy's Administrative Courts, asking for the Decree to be annulled as it contravened

several principles of the Italian Constitution. In June 2015, the Administrative Court of Lazio referred the question of the constitutional legitimacy of the Decree to the Italian Constitutional Court and the challenges before the Administrative Courts were stayed, pending its decision. The argument put forward was that *Spalma Incentivi* violated the legitimate expectation of the producers, as these would have expected the agreements (*Convenzioni*) entered into with the Italian Agency for Energy Services, the *Gestore dei Servizi Energetici* (GSE), to remain unchanged for the entire 20-year FiT period. It was also argued that the Decree was unreasonable, lacked proportionality, was discriminatory and that it violated the freedom to carry out (private) business.

The decision of the Constitutional Court came as a surprise. This was not only the case because of the reasonableness and strength of the claimants' arguments, but also owing to recent declarations by the European Commission, during preparatory works to the new Renewable Energy Directive, condemning the adoption of retroactive measures by Member States that may cause uncertainty for, and damage to, PV operators.

The Court's reasoning

The reasoning of the Constitutional Court appears superficial and likely stems from a lack of understanding of the renewables sector.

"THE COURT STATED THAT THE DECREE DID NOT VIOLATE THE LEGITIMATE EXPECTATION OF THE PRODUCERS."

The Court stated that the Decree did not violate the legitimate expectation of the producers. Having re-affirmed that laws should guarantee legal certainty, the Court then stated that this does not mean that the State cannot make decisions, *in pejus,* modifying unilaterally the long-term contractual relationships of private contractors when this is in the public interest, as long as the modification is reasonable, not sudden and not discriminatory.

According to the Court, the Decree was clearly reasonable. The Court noted that while the remuneration of the producers increased through the FiT system, the costs of the system were excessive for final consumers, so that the Decree aimed to balance these conflictual interests, namely sustaining renewable energy and spreading the costs more proportionally.

The Court disagreed that the Decree had been implemented "suddenly" or in an "unforeseeable" manner and that the rights to the FiT were not "acquired rights" (*diritti quesiti*) for a 20-year period. According to the Court, before the Decree was implemented, a careful producer could have noticed that the Parliament had introduced measures reducing the FiT according to the decrease of the investment costs and, in particular, the reduction of the main PV plant components. These measures aimed at creating a more appropriate remuneration of the investments made by energy players.

By stating the above, the Court seems to have ignored the history of the PV incentives system in Italy. The regime has its roots in European legislation implemented since 2003, which over time had established a stable framework, implementing the EU directives on the subject. The National Industrial Plan 2010 clearly established renewable targets to be achieved by 2020, with the incentives scheme playing an integral part in reaching these. Indeed, precise contractual agreements (*Convenzioni*) specifically guaranteed producers a 20-year FiT period. This stable framework meant that Italy was at the vanguard of the PV sector, through a stable legislation that was recognised by the banking sector that funded the underlying investments relevantly.

The Court also ruled that the 6%-8% reduction of the FiT (see option(c) above) was "not excessive" and would not lead to an unsustainable situation for the producers since this was "only" one of three available options (see above).

"AN IN-DEPTH ANALYSIS OF THE SECTOR AND OF THE CONSEQUENCES OF THE THREE OPTIONS SEEMS TO BE MISSING."

Even here it appears that the Court did not make an in-depth analysis of the sector and of the consequences of the three options. Independent studies show that each option could lead to the producers breaching their banking covenants. First, option (c), with its flat reduction, will clearly negatively affect producers. Second, option (a), with its reduction of the FiT through an extension of FiT period from 20 to 24 years, will obviously have an effect on the costs of the investments that were initially lower since planned on a 20-year basis (e.g. financial loans, surface agreements, insurance costs etc.) and it also ignores the fact that PV panels will be less efficient after 20 years. Finally, option (b) ignores the fact that the loan agreements already entered into with the banks had different assumptions for the first five years and that the increase of the FiT will occur when the panels will have become less efficient, thereby affecting the revenue of the plants. The Administrative Court of Lazio articulated all these arguments before the Constitutional Court, but the judgment fails to address them.

The Court then stated that the Decree is not discriminatory. The judges deemed that reducing the FiT only for plants with a capacity above 200 KW was justified because most of the plants that receive the larger FiT amount are plants with a capacity above 200 KW.

The Court also deemed that the Decree does not discriminate against PV producers, as compared to other renewable energies, by reducing the FiT only for them, even though incentives for other renewable sources also derive from the same consumers bills (A3). The Court did not offer a clear explanation for this, even though this may amount to a form of discrimination distorting competition among producers.

Finally, the Court did not consider unconstitutional the new modality of payment of the FiT. Under this, producers receive an initial 90% down-payment based on an estimate of the plants' average annual energy production and the final balance based on the plants' actual production, paid by the end of June the following year. The Court stated that this system does not create problems for the producers as it creates a safer and more stable cash flow system.

Here again, the Court failed to consider that the producers had entered into loan agreements with banks foreseeing a certain income based on actual production, and not on the average of a general annual estimate, and did not consider that Public Administrations have to pay their debts within 30 days of invoices being issued.

What now?

"PRODUCERS MAY REFER THE DISPUTE TO INTERNATIONAL ARBITRATION."

The Constitutional Court's decision cannot be appealed further under Italian domestic law. As such, the decision is likely to influence the outcome of the proceedings still pending before the Italian Administrative Courts, as well as the potential further appeals before the High Administrative Courts (*Consiglio di Stato)*. Indeed, the Administrative Courts will certainly apply the outcome of the Constitutional Court judgment. Once the internal procedures of the Italian judicial system have been exhausted, PV plants operators will be able to refer the dispute to European Courts.

In the meantime, producers/operators seeking redress against the implementation of *Spalma Incentivi* may refer to international instruments, unrelated to domestic

jurisdiction, such as the Energy Charter Treaty (the "ECT"), a multilateral investment treaty that was adopted in Lisbon in 1994. Among other things, the ECT entitles investors in the energy sector to claim compensation before international arbitration courts, especially the ICSID (International Centre for Settlement of Investment Disputes) or the arbitral Institution of the Chamber of Commerce of Stockholm, for the harm that they have suffered as a result of a State implementing certain measures that impede investments in the Italian energy sector.

"PRODUCERS/OPERATORS HAVE BEEN AFFECTED BY A SUDDEN AND UNFORESEEABLE CUT TO INCENTIVES FOR THE PRODUCTION OF ENERGY FROM PV PLANTS."

In this case, it appears that producers/operators have been affected by a sudden and unforeseeable cut to incentives for the production of energy from PV plants, even though agreements (*Convenzioni*) entered into by the producers/operators and the GSE guaranteed these incentives for 20 years from the date on which the plant started operating. The ECT international arbitration gives operators an opportunity to seek damages irrespective of the annulment of the Decree, with independent international arbitrators assessing their cases based on the applicable international laws and awards. Some international third-party funds are available to finance the legal costs required for these proceedings.

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

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