Response by Energia to Department of Communications, Climate Action & Environment Proposed Decision Paper

Electricity Support Schemes: Transitioning to I-SEM Arrangements

11 January 2018

In Energia's view, the Options put forward by the Department in this Proposed Decision Paper, including the Department's Preferred Option, are contrary to domestic law so as to in turn render any subsequent decision unlawful. In summary, our views on the Proposed Decisions in the Paper are as follows:

1. **Proposed Decision 1**: REFIT imposes public service obligations ("PSOs") on participating suppliers to purchase electricity from certain renewable generators, in consideration of which such suppliers are entitled to recover their additional costs for performing such PSOs including reasonable rate of return on the capital represented by such costs. This proposed decision fundamentally and unlawfully changes the manner in which it is proposed that compensation for performing such PSOs will be calculated, such that participating suppliers, such as Energia, will no longer be compensated for their full additional costs of performing their PSO and/or generators will not receive the guaranteed minimum price for electricity promised by the Minister. As such, this proposed decision may not be lawfully implemented. Participating suppliers, such as Energia, have a legal entitlement, enshrined in statute, to be compensated for their additional costs in performing such PSOs, while REFIT generators have been given a guarantee that they will receive a minimum price for electricity which they generate for a period of 15 years or, if earlier, until the end of the applicable REFIT scheme. This proposed decision must be amended to reflect these entitlements.

2. **Proposed Decision 2**: For the reasons outlined above, this proposed decision is also unlawful insofar as participating suppliers will no longer be compensated for their full additional costs of performing their PSO and/or generators will not receive the guaranteed minimum price for electricity promised by the Minister. Both proposed decisions 1 and 2 appear to be premised on the erroneous assumption that the level of support to be afforded to REFIT participants is a matter of policy, in respect of which the Minister has a discretion, and not, as is in fact the case, a matter of law. This proposed decision must be amended to reflect the legal entitlement of suppliers to be compensated for their additional costs in performing PSOs and REFIT generators to receive a minimum price for electricity which they generate for the duration of the applicable REFIT scheme.

3. **Proposed Decision 3**: The REFIT schemes constitute State Aid, but have been approved by the European Commission pursuant to Community guidelines on State aid for environmental protection (2001/C 37/03) ("State Aid Guidelines"). As such, the Member State has very limited discretion as to what costs and revenues are taken into account in calculating aid payments. It is clear from the Paper that the Minister's decisions in relation to which costs and revenues should be included or excluded from the calculation of market revenues (eg. balancing costs, reliability option costs, DS3 revenues) is driven by policy considerations related to incentivisation of behaviours rather than strict requirements of State Aid law. While the policy objectives are laudable in themselves, these are not matters in respect of which the Minister has a discretion. All such costs and revenues must be taken into account in calculating the additional costs incurred by a supplier in performing a PSO.

4. **Next Steps**: Energia is concerned paragraph 6.2 of the Paper is potentially confusing insofar as it suggests, one the one hand, that changes of Supplier may be facilitated by the Minister "*to facilitate competition between PPA suppliers*", whilst on the other hand makes it clear that such changes may only be made "*in exceptional circumstances where it can be demonstrated that such as change is necessary for the continued operation of the project*". Energia is of the view that the latter test is consistent with the REFIT Terms and Conditions and reflects the appropriate approach and therefore

interprets the first statement as only applying in circumstances in which the second quoted test is satisfied. The process of renegotiating every REFIT power purchase agreement ("PPA") for the introduction of I-SEM, as will be required, will be sufficiently disruptive and time and cost intensive, without permitting generators and suppliers to commence parallel negotiations with multiple counterparties. We are strongly of the view that, consistent with the REFIT Terms and Conditions, facilitation of changes of supplier should only be permitted in the exceptional circumstances identified, namely where such "*change is necessary for the continued operation of the project*".

1. Introduction

Energia welcomes this opportunity to respond to the Department of Communications, Climate Action and Environment (DCCAE) proposed decision paper on the transitioning of REFIT to I-SEM. Energia is the largest offtaker of electricity from third party REFIT supported generators in Ireland, as well as being the ultimate owner of a number of REFIT supported generators, including the 95MW Meenadreen Extension Windfarm. Energia is a direct and indirect beneficiary of REFIT and, as such, is significantly impacted by the proposals in the Paper.

In Energia's view, the Department's Preferred Approach (Option B) is contrary to domestic law so as to in turn render any subsequent decision unlawful; it takes into account irrelevant considerations and fails to take into account relevant considerations; it proposes unapproved changes to a State Aid measure in contravention of EU law; and is profoundly inconsistent with both domestic and EU energy policy. It is incumbent on the Minister and the Department to adopt a lawful decision making process which observes the rights of REFIT suppliers and generators under domestic and EU law and honours the guarantees given to generators participating in the REFIT schemes.

2. Incompatibility of the Preferred Approach with the REFIT Guarantee

REFIT is a minimum price guarantee given by the Minister to participating generators for 15 years (or if earlier until the end of the applicable scheme) which is both legal enforceable and enshrined in law. The Department made numerous representations to Energia and other industry players that if successful in REFIT, market participants would be entitled to rely on a guaranteed level of support. Examples of these representations include:

(a) Paragraph 3.1 of the REFIT 2 and 3 Terms and Conditions provides that "*REFIT is a feed-in-tariff support scheme that operates by guaranteeing new renewable generation a minimum price for electricity exported to the grid over a 15 year period.*" (emphasis added)

(b) Paragraph 3.1 of the REFIT 1 Terms and Conditions provides that "*Each applicant declared successful in REFIT will receive a "letter of offer". The "letter of offer" will confirm to any licensed electricity supplier that in return for entering into a PPA to purchase the output from the proposed renewable energy powered plant, for 15 years, the supplier will, when these terms and conditions provide for it, be entitled to receive a REFIT payment, calculated in accordance with these terms and conditions.*" The relevant calculation is set out in paragraph 5 of the REFIT 1 Terms and Conditions and provides, inter alia, that "*If, in respect of any year, the BNE price[1] is less than the reference price in clause 5.1 (i) the supplier shall be paid the difference between the two for every kWh purchased under the PPA*".

[1] BNE was originally used as a proxy for *market price* and has been replaced with *market revenues* over the PSO year since a wholesale market price has been available.

(c) In the REFIT 2 State Aid approval at paragraph 58 and the REFIT 3 State Aid approval at paragraph 73 the European Commission expressly approved REFIT 2 and REFIT 3 as a "*guaranteed level of support*".

(d) REFIT 1 Letters of Offer appended an information note for retail suppliers participating in the REFIT programme. The Letter of Offer stated that this was enclosed "*following discussions with electricity suppliers*" and should be delivered to suppliers by the REFIT generator. Under the heading "*Reimbursement of additional costs to participating suppliers*" the information note confirmed that "*The published terms and conditions of REFIT make ex ante provision for suppliers to recover net additional costs incurred by participating in REFIT*" (emphasis added).

(e) In the published 2006 REFIT clarifications, the Department states that "*The undertaking to suppliers participating in REFIT is that such suppliers will be compensated for the net additional costs which the Department is satisfied have been incurred by a typical supplier participating in the scheme. This undertaking applies for the duration of the programme. There is insufficient detailed information on a future SEM to decide the detailed nature of proportionate compensation in the future SEM. However the broad undertaking to compensate for net additional costs will continue to apply in accordance with all other published terms and conditions.*" (emphasis added).

(f) By letter to Energia, dated 6 October 2006, ("**Departmental Letter**"), the Department confirmed that in the context of changes to the market "*the Department confirms that an alternative compensation will be instituted to compensate qualifying suppliers for the net additional costs incurred*" which "*ensures that those suppliers remain in the same commercial position that they were in when a BNE price (being a regulated market valuation of a market price pending an open market price) and avoiding any economic loss arising from the absence of a BNE/market price (sic)*" (emphasis added).

(g) Question 9 of the *Frequently Asked Questions* on Department's website states that CER 08/236 outlines how REFIT payments are to be calculated in accordance with the REFIT Terms and Conditions and that "*Total market revenues are compared to entitled REFIT costs to determine REFIT support under the REFIT Terms and Conditions*" on a PSO period basis. Furthermore, Department's REFIT Clarifications dated January 2009 provide that "*The REFIT programme establishes compensation payments to suppliers, inter alia, if BNE falls below the purchase price paid under REFIT. Since publication of the REFIT programme the SEM has emerged and BNE is increasingly obsolete. The compensation provision in Clause 5.4 of the REFIT terms and conditions shall be applied in accordance with the CER Decision Number CER/08/236 of November 2008*" (emphasis added).

There is no doubt that the Preferred Approach represents a departure from the guarantee given by the Minister in these representations, a fact acknowledged by the Department in the Options Paper which preceded the Paper, when acknowledging

that the price in the balancing market for renewables will be lower than in the Day Ahead Market .

On the basis of these representations and undertakings, every REFIT supplier and generator has a legitimate expectation that it will continue to be reimbursed for the "*net additional costs incurred*" of entering into REFIT PPAs following implementation of the I-SEM. Furthermore, in light of the letter to Seamus Hegarty of 6 October 2006, Energia received a further express assurance that it will remain in the same commercial position and will not suffer any economic loss as a result of changes in the manner in which market revenues are calculated for REFIT reimbursement purposes.

The fact that REFIT participants have developed projects and entered into REFIT PPAs based on the representations outlined above is a matter of fact. The level and duration of support required to secure renewable investment was fundamental to the State Aid approval submitted by the Irish Authorities. It would not be credible to suggest that this level and duration of support was not relied on by individual market participants.

The representations contained in the Departmental Letter formed a fundamental part of the REFIT 1 PPAs entered into by Energia. This Departmental Letter was appended to Energia REFIT 1 PPAs (and so was presumably also relied on by both generators and their lenders) and Clause 10(b) of the PPA expressly provided that "*The Generator acknowledges and confirms to [Energia] as follows:.....[Energia] has entered into this Agreement on the basis of the [representations in the Departmental Letter] being materially correct and the Generator has considered and, to the extent necessary, discussed the [representations in the Departmental Letter] with [Energia];*". All generators are required to provide the Department with copies of their PPAs as a condition to the letter of offer, so you will have copies of these PPAs in your records.

There is also no doubt that if the Minister resiles from the representations on which such market participants have relied by adopting the Preferred Approach market participants who relied on such estimates will have done so to their determinant. The existence of a representation and reliance by a party to its detriment are the key elements of a claim in legitimate expectation.

3. Incompatibility of the Preferred Approach with Irish Law

Article 6D(1) of the Electricity Regulation Act 1999 (Public Service Obligations) Order 2002, as amended (the "**PSO Order**"), imposes a public service obligation on certain licensed suppliers, including Energia, to purchase electricity from certain generators under REFIT PPAs.

[2] In the discussion of Option 1, the Option Paper states that : "*This 'revenue only' model would ensure that REFIT payments reflected the revenues obtained from trading in the reference market without incorporating any balancing risk arising from the supplier's ex-ante trading. This option encourages suppliers to trade in the reference market and not just trade or take any price that might be available outside of this, which result in upward pressure on the PSO levy.*" The only way that this can put upward pressure on the PSO Levy is if prices in the Balancing Market are lower than in the Day Ahead Market.

Section 39 of the Electricity Regulation Act 1999, as amended (the "**Act**"), pursuant to which the PSO Order is made, provides at subsection 5(a) that "an order under this section *shall provide for* the recovery, by way of a levy on final customers, of the *additional costs* ..... in complying with an order under this section including costs incurred after the variation or revocation of such an order" (emphasis added). It is therefore a statutory requirement of the Act that the PSO provides for the recovery of "*additional costs*" of parties complying with the public service obligation to purchase power under a REFIT PPA.

Article 2(3C)(a) of the PSO Order provides that "'*additional costs*' includes *costs incurred by a supplier in complying with its obligations under Article 6D* either before or after the coming into operation of this paragraph *and which are not otherwise recovered*" (emphasis added). Reading the Act and the PSO Order together, it is therefore clear that a supplier *shall* recover costs incurred in purchasing electricity under a REFIT PPA which are not otherwise recovered. This is not an entitlement in respect of which the Minister has any discretion, it is an express legal requirement.

This appears to be acknowledged on page 3 of the Paper which states that "*...the REFIT schemes offer the renewable generator a floor price tariff and, to the extent that total market revenue (see further below) falls short of the revenue deriving from this floor price, revenue from the Public Service Obligation levy (PSO levy) makes up the balance*". This entitlement to be kept whole for the difference between total market revenue and the floor price is then ignored in the Preferred Approach which will not compensate a supplier for its costs incurred in complying with its obligations under Article 6D which are not otherwise recovered. Indeed, the Preferred Approach has specifically been designed to ensure that such costs are not recovered by suppliers in an effort to reduce the PSO Levy burden on consumers. As such, the Preferred Approach is manifestly incompatible with Irish law.

Pursuant to Article 9(2I) of the PSO Order, the PSO Levy in respect of the obligation imposed by Article 6D shall be determined by the CER. The methodology pursuant to which the CER makes such determination is set out in Decision Paper CER/08/236. As part of that Decision Paper, "*additional cost*" (also referred to in CER/08/236 as "*opportunity cost*") is calculated as follows:

(a) in the case of participating generators "the difference between the *total revenues received from the market* versus the total cost of purchasing metered energy from the generator, based on the REFIT reference price for the relevant PSO period" ; and

(b) in the case of non-participating generators, "the difference between the cost to suppliers at the REFIT reference price and *what it would have cost them to buy the equivalent volumes from the market*" .

In determining what is meant by *additional costs*, the meaning of "*total costs*" or "*costs to suppliers*" is clear, namely the applicable REFIT reference price plus the

[3] The phrase "*additional costs*" in the PSO Order has been used interchangeably with the phrase "*net additional costs incurred*" (used in the 2006 REFIT Clarifications) and "*opportunity cost*" (used in CER/08/236).

[4] CER/08/236 at paragraph 4.8.

[5] CER/08/236 at paragraph 4.9.