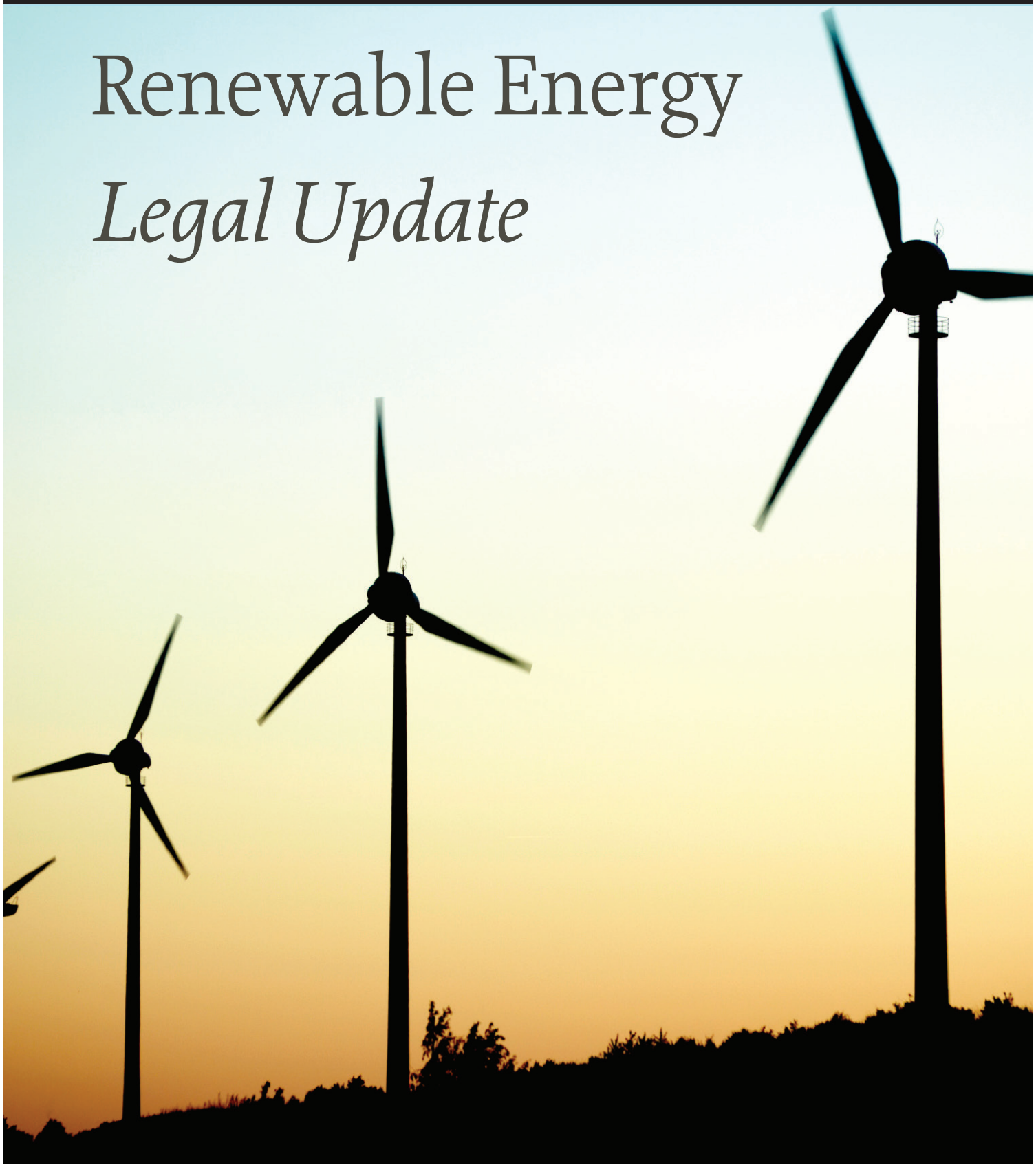
ARTHUR COX

Renewable Energy

Legal Update



ARTHUR COX - EXPECT EXCELLENCE

In this legal update we have summarised and commented on a number of recent legal developments and open issues that will be of interest to generators of renewable energy, their funders and offtakers in the SEM. This legal update is neither a complete nor a definitive statement of law or of regulation. Specific legal advice should be obtained before taking any action.

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BALANCING RISK IN I-SEM AND THE NEED FOR CLARITY ON REFIT

An important feature of the I-SEM will be the ability of market participants to trade in different time frames: ahead of, during and after the Trading Day. There are significant advantages in ex ante price disclosure in any market and having a highly liquid, actively traded day-ahead market will be an important indicator of the success of the I-SEM. However, trading in a day-ahead market creates particular challenges for generators who have a more limited ability to predict their output for the following day.

In particular, if there is a mismatch between what the generator sells into a day-ahead market and what it actually generates on the day, it will need to either sell any additional excess generation into the within day or balancing market or, if it is short generation, will need to purchase power in the within day or balancing markets to cover its contract position. Important questions remain as to how this "*balancing risk*" is to be allocated in the I-SEM, and in particular whether it will be compensated through the REFIT reimbursement methodology.

At present, pursuant to Decision Paper CER/08/236, REFIT reimbursement for offtakers is calculated as the amount, if any, by which the applicable REFIT payments in respect of a generator under the PPA exceeds the total revenues received from the market. This figure is calculated as the total of all revenues from the market over the entire PSO year, taking into account energy payments, constraint payments and capacity payments for every individual trading period in the year. If this principle is applied in the I-SEM, as we believe it should be, offtakers will be kept whole for the amount, if any, by which the applicable REFIT payments in respect of a generator under the PPA exceeds the total revenues received from the market (irrespective of the time periods within which they trade and whether they are forced to purchase electricity to cover a short generation position). This is consistent with the current operation of REFIT, the applicable State Aid notifications and the expectations of market participants.

It has been suggested, however, that REFIT may only compensate offtakers in respect of differences between the applicable REFIT Reference Price plus supplier balancing payment and a single "*reference price*". If the reference price was an ex ante price this would create a material new balancing exposure for market participants and would give rise to an unprecedented level of regulatory uncertainty for REFIT generators. Any such balancing risk would then fall to be allocated between generators and offtakers under the terms of the PPA. It is not expected that offtakers will readily accept this risk and so it is expected that new PPAs will expressly allocate this risk to generators. Where this risk is not expressly allocated to generators, it is expected that PPAs will permit the offtakers to terminate the PPA when I-SEM is implemented if this issue is not addressed to the offtaker's satisfaction.

Offtakers under existing PPAs will be examining rights under market change and REFIT change clauses to ensure that they are not exposed to this risk.

It is therefore critical for both existing projects and the development of new capacity to meet Ireland's 2020 targets that certainty in relation to REFIT continuing to reimburse all out of market costs be given as a matter of urgency.

PLANNING UPDATE: IMPORTANT DEVELOPMENTS FOR WINDFARMS

A number of recent cases in the Irish and European Courts have potentially major implications for developers of wind farm projects.

Following the recent decision of the Irish High Court in *O Grianna v An Bord Pleanala (12 December 2014), developers of wind* farm projects now must **assess all works** which will form part of the overall project at planning application stage. This includes the grid connection, the substation, haul routes and any borrow pits. In *O Grianna*, the High Court quashed a planning permission granted by An Bord Pleanála ("**ABP**") for a 6 turbine wind farm in Co. Cork because the planning application in accordance with the then accepted industry practice had not included any information on the works required to connect to the grid. This meant that ABP had, in turn, not assessed the cumulative environmental impacts of these works (which the High Court held are an integral part of any wind farm project) as part of its environmental impact assessment before granting permission.

The application of the **Habitats Directive** has also given rise to much litigation. In particular, the Court of Justice of the European Union has decided, in *Briels v Minister van Infrastructuur en Milieu* (15 May 2014), that where protected European habitats are concerned, it is not enough for a developer to compensate "*after the fact*" for the permanent loss of a protected European habitat caused as a result of the proposed project, by providing for the replacement of the protected habitat elsewhere. A developer must instead seek to eliminate or minimise the negative effects that are likely to arise as a result of a project by way of mitigation measures. These measures should inform and be incorporated into the project design from the outset of the project planning phase.

The Irish High Court in *Kelly & Ors. v An Bord Pleanala* (25 July 2014) considered the application of the Habitats Directive, and provides clarity on how a consenting authority should undertake an Appropriate Assessment. It is a very stringent and comprehensive analysis. What is required, in summary, is identification, in the light of the best scientific knowledge in the field, of all aspects of a development project which can, by itself or in combination with other plans or projects, affect the relevant European Site in light of its conservation objectives. This requires both examination and analysis. An Appropriate Assessment must contain complete, precise and definitive findings and conclusions and may not have lacunae or gaps for completion at some later stage after consent is granted.

From a project planning perspective, where a developer does not own all or a portion of the lands which are to be included in its application for permission, the decision of the High Court in *McCallig v An Bord Pleanala* (24 January 2013) outlines what form of written consent should be secured from the relevant landowner(s). The High Court provided what might be described as a novel 'good, better and best' approach for the consent to be obtained.

COMMERCIAL RATES: IMPLICATIONS OF THE LIMERICK REVALUATION

With any form of investment (including foreign direct investment), regulatory stability and certainty is and should be a pillar of the Irish renewables and wider projects sector.

There has been well-reported concern as to the impact the recent re-valuation exercise undertaken by the Valuation Office on certain operational wind farms in County Limerick; the revaluation led to a reported threefold increase in rates payable. Moreover, concern has been expressed on the extent to which the Valuation Office will apply the same rating methodology to similar wind farm (and possibly other energy) assets in other counties. We understand that the Limerick revaluation is the subject of an ongoing appeals process within the Valuations Office and, if necessary, the Valuations Tribunal (an external body).

Pending the outcome of any appeal or other reduction in the rates valuation, there are clear short term consequences for development and operational projects. The magnitude of this impact is estimated to be equivalent to an increase in the rate of corporation tax from 12.5% to 25% for the affected wind farms. Development projects will likely need to have a higher proportion of committed equity whereas the economics of operational projects will be immediately impacted by higher operational costs. At a national level, to the extent the rate of wind farm build is delayed, there will be an adverse impact on Ireland's ability to meet its 2020 targets. In addition, this materially changes the cost assumptions (of which rates and local taxes formed part) underpinning the REFIT support calculations, thereby resulting in REFIT undercompensating projects in respect of this cost item by reference to the calculations submitted as part of the State Aid notification to the European Commission.

COMPANIES ACT 2014: IMPLICATIONS FOR ALL PROJECT SPVS

The Companies Act 2014 (the "**Act**") will take effect on 1 June 2015. Directors of every company will need to appreciate the significance of certain key changes. Specifically, the Act will replace the existing private company limited by shares ("**EPC**") with two new company types, the:

» new private company limited by shares, which will have the suffix "*limited*" or the Irish equivalent or an acceptable abbreviation (referred to here as the "**LTD**"); and

» designated activity company, which will have "*designated activity company*", the Irish equivalent or an acceptable abbreviation as a suffix (the **"DAC"**).

Every EPC will be required to choose whether to become either an LTD or a DAC. The Act sets out a simple procedure for doing so, and allows an 18-month transition period for EPCs to take the necessary action. For single purpose project-financed vehicles, the DAC may be the preferred option. In the event that no action is taken by the board of an EPC, the EPC will automatically convert to an LTD at the end of that period. This 'default' position (and knock on implications) needs to be carefully considered in that the resulting "*imposed*" standardised company constitution could conflict with prior terms covering, for example, preference shares, share pre-emption rights, minority shareholder protections, voting rights and dissolution provisions.

All companies are advised to review their existing constitutional documents, for example to remove references to redundant legislation and ensure consistency with the Act. Companies should look to engage at an early stage with third parties (e.g. lenders), where their consent to such changes is required by contract.

The Act also sets out a number of provisions intended to facilitate doing business in Ireland. A new optional two-stage procedure for the registration of charges will give greater certainty to borrowers.

The Act is intended to consolidate Irish company law, making it more coherent for investors, directors and regulators. The implementation of the Act does however require directors of EPCs to take action to decide whether to continue as a LTD or a DAC. Companies will also need to consider whether rights or obligations will be triggered under existing contracts in making the necessary changes.

NORTHERN IRELAND CONTRACTS FOR DIFFERENCE

On 26 February 2015, the Department of Energy and Climate Change (**"DECC"**) published the outcome of the first allocation round for Contracts for Difference (**"CfDs"**), the new regulatory regime for supporting low carbon generation in Great Britain and part of the UK Government's programme of Electricity Market Reform.

A total of 27 contracts, with an estimated annual budget spend of £315 million by 2020/21, have been offered to projects with a combined total of over 2GW of capacity across England, Scotland and Wales. CfDs were awarded to 15 Onshore Wind projects with a total capacity of over 745MW, along with two large Offshore Wind projects (1,162MW). The remaining contracts were awarded to various Advanced Conversion Technologies (62MW), Energy from Waste with CHP (94.75MW) and Solar PV projects (71.55MW).

It is understood that those who have been successful in the auction will have until 27th March 2015 to sign the CfD. The contracts will be signed between developers and the Low Carbon Contracts Company (the CfD Counterparty).

The Northern Ireland Renewables Obligation ("**NIRO**") will close to new generation and additional capacity after 31st March 2017. The NIRO will be replaced by a CfD for large scale renewable electricity generation (greater than 5 MW) which will also be allocated by auction. It is envisaged that the first allocation round for NI applications will commence in Autumn 2016.

REFORM OF THE FELLING LICENCE REGIME: WHAT TO EXPECT UNDER THE FORESTRY ACT, 2014

Although not yet in force, the Forestry Act 2014 will impact (in several respects positively), amongst other things, some of the challenges faced by wind farm developers under the current legislative regime. Part 4 of the 2014 Act sets out the new regime for applying for a felling licence. Wind farm developers should be aware of the following key points:

» The maximum term of a licence will be 10 years, but may be extended for a further period up to 5 years.

» The application must be made by either (i) the owner of the land, or (ii) someone who can demonstrate to the satisfaction of the Minister for Agriculture, Food and the Marine (the **"Minister"**) that they are acting with the consent of, and on behalf of, the owner.

» The Minister may attach conditions to a felling licence, including the following:

  » The Minister may impose a condition to replant trees "*at such places, of such species, in such numbers, of such surface area and density, within such period of time*" as may be specified in the licence. The licensee will no longer be required to own the land on which the replanting must be carried out.

  » The Minister may also impose a condition of "*effective protection*" for replanted trees to be maintained, for such a period of time as the Minister may specify. This gives the Minister flexibility to tailor the conditions as appropriate for each licence.

  » The 2014 Act also allows the Minister to request a "*forestry management plan*" to be submitted and approved by the Minister. The rationale is to ensure that felling is carried out in accordance with good forest practice.

It is an offence to carry out tree felling without a licence, or in breach of a licence. On summary conviction, the liability for the offence is a fine not exceeding €5,000 and/or imprisonment for a term not exceeding 6 months, and on indictment, a fine not exceeding €1,000,000 and/or imprisonment for a term not exceeding 5 years.

Section 18 of the 2014 Act helpfully provides that the Minister must aim to process applications for felling licences within a period of 4 months from the date of the application.

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