



# Energy and Natural Resources Market Regulation Committee Newsletter

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## **INTRODUCTION: FEED-IN TARIFFS AS A TOOL FOR STATE REGULATORS TO PROMOTE CLEAN ENERGY**

**F. Jackson Stoddard**  
*Manatt, Phelps & Phillips*  
*San Francisco, California*

Due to inaction at the federal level, states continue to explore ways to promote renewable and clean generating technologies to reduce greenhouse gas (GHG) emissions and promote energy independence. While prices for solar generation technologies continue to fall, renewables remain significantly more expensive than natural gas and coal-fired generation.

States have a number of policy tools at their disposal to drive investment in and development of renewable and clean generation. Such tools include carbon pricing programs, renewable portfolio standards (RPS), feed-in tariffs, tax incentives, leasing and rebate programs, loan and loan guarantee programs, green building codes, net metering, and a number of other financial and regulatory programs. Currently, 33 states, plus the District of Columbia and Puerto Rico, have some form of renewable portfolio standard program in place.<sup>1</sup> Far fewer states have established mandatory feed-in tariff programs.<sup>2</sup>

Outside of the United States, however, feed-in tariffs have been the primary policy tool relied upon by governments to reduce dependence on fossil fuels.

While there is no fixed definition, “feed-in tariff” is generally understood to refer to a standard offer

contract with a retail electric utility to purchase electricity generated by specified technologies at a fixed, administratively determined price. In order to promote the investment in expensive renewable technologies, the price offered should be sufficient to cover the costs of development and operation of the facility plus a reasonable profit and the term of the contract should be long enough (10–25 years) to provide certainty to investors. Feed-in tariffs may also include cost containment safeguards, such as a cap on the total quantity of capacity that can sign up under the tariff or downward price ratcheting for newer vintage contracts as certain capacity targets are met or as technologies mature and become less expensive.

Feed-in tariffs are favored by project developers because they provide price certainty, which makes projects financeable, and have lower transaction costs than competitively bid and bilaterally negotiated contracts. Critics counter that feed-in tariffs are inefficient, result in higher costs for consumers, and create boom-and-bust technology cycles.

In 2010 the California Public Utilities Commission (CPUC) established a feed-in tariff for advanced combined heat and power at a price comparable to renewable generation pricing. Southern California Edison challenged the California feed-in tariff as an impermissible setting of wholesale rates in violation of the Federal Power Act. The CPUC sought a declaratory order from the Federal Energy Regulatory Commission (FERC) clarifying that it was not setting wholesale rates and was merely requiring that utilities *offer* a certain price. The subsequent FERC orders

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provide a road map for states that are considering establishing new feed-in tariffs, or revising existing feed-in tariffs to increase the price paid to generators. It remains to be seen whether the FERC orders will result in any significant increase in the use of feed-in tariffs or in modifications to existing programs.

While there is greater legal clarity for states interested in pursuing feed-in tariffs, policy questions remain. Chief among them is whether feed-in tariffs provide any significant value apart from what is provided by more competitive RPS programs. Also of concern is whether feed-in tariffs are the most economically efficient way to promote the development of clean generating technologies.

The following papers provide an overview of the central issues in the California feed-in tariff dispute, the potential for future litigation, and background regarding feed-in tariffs in Europe, where they have been much more broadly deployed.

**F. Jackson Stoddard** *is an associate at Manatt, Phelps & Phillips in San Francisco, California.*

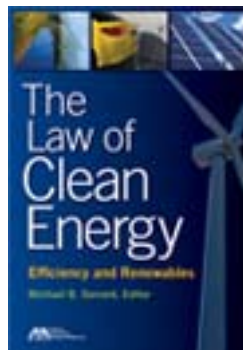
**Endnotes:**

<sup>1</sup> DATABASE OF STATE INCENTIVES FOR RENEWABLE & EFFICIENCY, SUMMARY MAPS, <http://www.dsireusa.org/summarymaps/index.cfm?ee=1&RE=1> (last visited Dec. 1, 2010).

<sup>2</sup> Feed-in tariffs have been established in California, Hawaii, Maine, Oregon, Vermont, Washington, Wisconsin, and Indiana, and cities, such as Gainesville, Florida, and Sacramento, California, have established feed-in tariffs for certain renewable technologies.

## THE LAW OF CLEAN ENERGY: EFFICIENCY AND RENEWABLES

MICHAEL B. GERRARD, EDITOR



Product Code:  
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Increasing energy efficiency and the use of renewable energy will likely be major economic engines of the coming decade. The Law of Clean Energy is a current, clearly written explanation of the laws that apply and the critical legal issues involved in the transition to a clean energy economy.

The Law of Clean Energy describes the most important provision to help practitioners work with these laws. The chapter authors, who bring the book knowledge and perspectives drawn from legal practice, law school and legal research, business, and nonprofit and advocacy organizations, demonstrate that abundant legal techniques are available at the federal, state, and municipal levels.

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“A wonderful resource for lawyers and policymakers alike, *The Law of Clean Energy* provides an essential overview of the laws, policies, and incentives that govern energy efficiency and renewable energy. This book offers a crucial lay-of-the-land for anyone interested in how U.S. law and policy promote, or in some cases obstruct, the transition to a clean energy economy.”

**Jody Freeman**

Archibald Cox Professor of Law, Harvard Law School, Counselor for Energy and Climate Change in the White House, 2009-2010

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## **RENEWABLE ENERGY: CAN STATES INFLUENCE FEDERAL POWER ACT PRICES WITHOUT BEING PREEMPTED?**

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**Scott Hempling**  
**Attorney at Law LLC**

States with, or considering, renewable-purchase obligations for their retail electricity sellers are interested in setting or influencing the price paid to the producers. Their preferences can work in both directions: the lower the price, the more renewable kilowatt hours can displace fossil fuels at a given total cost to consumers; the higher the price, the more production can be stimulated.

Whereas states are free to set retail prices because their jurisdiction is exclusive, they have far less running room when the transactions are wholesale, as are sales of electricity from renewable producers to load-serving entities. Wholesale sales of electricity are subject to one of two federal statutes: the Public Utility Regulatory Policies Act of 1978 (PURPA) and the Federal Power Act of 1935 (FPA). PURPA applies to transactions in all states when the seller is a PURPA “qualifying facility” (QF). The FPA will apply when the seller is not a QF, provided the sale is in “interstate commerce.” (As all FPA practitioners know, all transactions other than those within Hawaii, Alaska, and most of Texas are deemed by the courts to be in interstate commerce, even if the contractual origin and destination are both within a single state, because the interconnected nature of our transmission grid causes electrons from all states to commingle.)

Both statutes create opportunities and constraints for states. Knowing these features will help those who draft and implement renewable legislation to avoid court challenges. This article focuses on one solution: that the state direct its retail utilities to *offer to buy* renewable power at a state-prescribed price. Federal Energy Regulatory Commission (FERC) precedent, however, bars this approach. This article explains the precedent’s error and recommends its correction.<sup>1</sup>

*Connecticut Light and Power*, 70 FERC ¶ 61,012 (1995), addressed a state statute requiring retail utilities to buy electricity produced by a municipal resources

recovery facility. The statute required the utility to pay the facility for electricity at the same rate the utility charges the municipality for retail electricity. FERC found the statute preempted because it was the equivalent of setting wholesale rates, an action preempted by the Federal Power Act: the Connecticut statute, FERC said, “cannot be applied to require particular rates for sales from facilities that are not QFs but are sales by public utilities at wholesale in interstate commerce because the rates for such sales are subject to exclusive Commission jurisdiction.” While FERC did not provide reasoning, its conclusion makes sense on grounds of “conflict preemption.” Given FERC’s exclusive authority over wholesale rates, the state statute’s command put the utility in an impossible position: were FERC to find the state-set price unjust and unreasonable, the utility could not comply simultaneously with both the state’s command to buy at that price and the FERC’s rejection of that price.

FERC’s reasoning became clearer in *Midwest Power Systems*, 78 FERC ¶ 61,067 (1997). The Iowa statute authorized the Iowa Utilities Board to order utilities to purchase power from entities (including non-QFs—thereby triggering Federal Power Act jurisdiction), and to set the price for those purchases. As with *Connecticut Light and Power*, FERC found the state preempted by the Federal Power Act, where the seller was a non-QF, because of the *combination of state order to buy and state-set price*. If the state statute had merely ordered its retail utilities to purchase a certain amount at wholesale, there would be no preemption:

[T]he Iowa statute and the orders promulgated by the Iowa Board are consistent with federal law to the extent that they provide that Midwest Power must purchase a certain amount of generation from the alternative facilities. However, to the extent that the Iowa Board, acting pursuant to the Iowa statute, has ordered Midwest Power to purchase from QFs at rates exceeding avoided cost, or has set rates for wholesale sales by FPA jurisdictional public utilities, its actions are preempted by federal law.

Neither *Connecticut Light and Power* nor *Midwest Power Systems* said that a state would be preempted

if it ordered the utility merely to *offer* to buy at a state-set price, rather than ordering the utility to buy at the state-set price. The distinction is not a small one. A state mandate to offer to buy at a state-set price creates no state-federal conflict because it does not place the buying utility in an impossible position. An offer creates no binding price; only the seller's acceptance does. If no seller accepts, there is no contract. If there is no contract, there is no FERC jurisdiction. And if the seller does accept, the contract has no effect unless FERC approves it. FERC is free to accept or reject the contract; its authority is unaffected by the state statute. The buying utility is not in an impossible position, because even if FERC disapproves the contract, the utility has obeyed the state statute's command, which was to make an offer at the state-set price, not to buy the electricity at the state-set price.

Yet in 2010 FERC rejected the state-prescribed offer approach, in *California Public Utilities Commission, et al.*, 132 FERC ¶ 61,047 (July 15, 2010) and 133 FERC ¶ 61,059 (Oct. 21, 2010). Acting under state statute, the California Commission required its utilities to offer to buy power under 10-year contracts from certain cogeneration facilities of 20 megawatts or less, at prices set by the California Commission. The state-set prices exceeded the cost of conventional electricity. California argued that it was not setting a wholesale price but instead ordering its utilities to offer to buy at the state-set price. The utilities challenged the commission's approach as preempted by the Federal Power Act and PURPA.

In the Federal Power Act portion of its decision, FERC rejected the California Commission's view that it was not setting wholesale rates but only ordering an "offering price":

We disagree with the characterization of the CPUC's AB 1613 Decisions as merely establishing an "offering price" by the purchaser of power. Rather, we agree with the Joint Utilities that the CPUC's AB 1613 Decisions constitute impermissible wholesale rate-setting by the CPUC. Because the CPUC's AB 1613 Decisions are setting rates for wholesale sales in interstate

commerce by public utilities, we find that they are preempted by the FPA.

Separately, FERC approved California's approach under PURPA. This article focuses on the FPA analysis.

The logic behind FERC's conclusion is missing. An offer to buy at a particular price is not establishing a price. Only FERC can approve a price. If a utility offers to buy at the state-set price, and if a seller accepts that price, there results a contract that has a price. That contract then requires FERC approval, through one of two processes. First, if a seller has received FERC pre-approval to charge market rates (*see* FERC Order 697),<sup>2</sup> that seller is free to enter into binding contracts at any price. The seller can take or leave the utility's offer. The state has not set the wholesale price; the seller's acceptance has. Second, if the seller has not received pre-approval under Order 697, then on accepting the utility's offer, the seller will have to submit the contract (with the state-set price) to FERC for approval. If FERC thinks the price is not just and reasonable, it can reject the contract. It is in no way bound by the parties' agreement. Again, the state has not set the wholesale price; the parties have, subject to FERC's approval.

One could poke two possible holes in this analysis, both relating to the nonmarket price option. The first is that under Federal Power Act procedure, when a seller files a contract, it can go into effect without initial FERC action. Still, the contract price results from the seller's acceptance, not from the state's action. And if FERC were concerned about the contract's effectiveness without FERC action, it could prescribe a special procedure under which contracts resulting from state-set offers require a FERC laying on of hands before effectiveness. States could reciprocate by requiring the utility's offer to be accompanied by a statement like "A contract arising from this offer shall not go into effect without FERC's approval." The second possible poked hole relates to the Supreme Court's recent interpretation of the *Mobile-Sierra* doctrine, requiring FERC to presume that contracts resulting from arm's-length bargaining are just and reasonable, absent harm to the public interest. *See*

*Morgan Stanley Capital Group Inc. v. Pub. Util. Dist. No. 1*, 554 U.S. 527 (2008). This decision limits FERC's ability to reject contracts that parties make. The fact remains that the price results from the seller's voluntary acceptance, not from the state's prescribed offer.

Assume, temporarily, that FERC is correct: that a state that prescribes the buyer's offer price is setting the wholesale price. Could a state commission instead direct its utility as follows?

Make binding offers to buy from 500 kwh annually from wind generators for 10 years. Make the offers as attractive to the generators as you can, without acting imprudently. This commission commits that it will not find you imprudent if your offer does not exceed 8 cents per kWh. Further, we will find that you have failed to make your offer as friendly as possible to the generators if you offer below 7.50 cents per kWh.

This not an attempt to be cute. On what grounds could FERC find this language preempted? The decision on the offer remains with the utility; the decision on acceptance remains with the renewable generator. The state has not touched FERC's authority to reject any contract arising from these facts. The state commission has left the utility with discretion, but it has also made clear that there will be consequences (in terms of prudence disallowance or other penalty) if the utility exercises its discretion unwisely. Now, what if the state narrows the discretion further, leaving the prudence cap at 9 cents but saying that an offer below 8.99 cents would be insufficiently attractive to the sellers? What difference, jurisdictionally, does the narrowing of discretion make?

## Conclusion

States are already influencing the supply of renewable energy through their renewable portfolio statutes. They can influence the price of renewable energy through their administration of PURPA. For renewable energy sales that occur outside of PURPA (that is, under the Federal Power Act), states should be able to influence the prices by directing their retail utilities to make offers to buy particular quantities of particular types of

renewable power at a state-prescribed price. Because the offer itself creates no contract and does not constrain FERC, the state directive should be seen as preempted. A FERC declaration on this subject would give states a cost-sensitive tool for managing their energy futures.

**Scott Hempling** is an attorney and expert witness. He is currently under contract to the American Bar Association to write a book on public utility law, with the working title *Public Utility Performance: Legal Principles and Modern Applications*, to be published in 2013. His Web site is [www.scotthemplinglaw.com](http://www.scotthemplinglaw.com)

## Endnotes:

<sup>1</sup> This article assumes a general working knowledge of both statutes. A detailed discussion of the statutes and the options appears in S. Hempling, C. Elefant, K. Cory & K. Porter, *Renewable Energy Prices in State-Level Feed-in Tariffs: Federal Law Constraints and Possible Solutions*, National Renewable Energy Lab Technical Report NREL/TP-6A2-47408 (Jan. 2010), available at [http://nrii.org/pubs/electricity/NRRI-NREL\\_renew\\_energy\\_prices\\_jan10.pdf](http://nrii.org/pubs/electricity/NRRI-NREL_renew_energy_prices_jan10.pdf).

<sup>2</sup> Order 697, *Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, 72 Fed. Reg. 39,904 (July 20, 2007).



## AFTERMATH OF FERC'S CALIFORNIA FEED-IN-TARIFF (FIT) ORDERS: IS A LITIGATION STORM BREWING?

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**Jennifer L. Key**  
**Of Counsel**  
**Step toe & Johnson**  
**jkey@step toe.com**

*(An earlier version of this article was presented at the 2011 Fall Meeting of the American Bar Association's Section of Environment, Energy, and Resources).*

The aftermath of the recent Federal Energy Regulatory Commission (FERC) *California FiT Orders* likely will be an increase in administrative agency and federal court litigation (*Cal. Pub. Utils. Comm'n*, 132 FERC ¶ 61,047, *clarified*, 133 FERC ¶ 61,059 (2010), *reh'g denied*, 134 FERC ¶ 61,044 (2011) (collectively, *California FiT Orders*). Those California FiT orders confirmed that utilities could be compelled to purchase energy under feed-in tariffs (FiTs) only if such programs were implemented by the states under the rubric of the Public Utility Regulatory Policies Act of 1978 (PURPA). The orders also confirmed that states could establish varying tiers of avoided costs under certain circumstances, for example, where the state has mandated purchases from certain types of technologies. The resulting litigation will largely fall into three types—preemption litigation, avoided cost litigation, and Commerce Clause litigation.

### Preemption Litigation

State legislatures and commissions adopting FiTs still have a choice, either to implement a PURPA-compliant FiT (PURPA FiT) or to implement a non-PURPA-compliant FiT (non-PURPA FiT). PURPA FiTs come in two flavors—avoided cost based rates and negotiated rates (that are presumably above avoided cost). A non-PURPA FiT is unlikely without the purchasing utility's agreement in light of the *California FiT Orders*. If a utility is unwilling to pay the price set by the state under a non-PURPA FiT price, it cannot be forced to do so. Indeed, the California PUC, much like the Iowa Utilities Board more than a decade before in the *Midwest Power*

*Systems, Inc.*, case (78 FERC ¶ 61,067 at 61,244 (1997)), did not bother to appeal FERC's preemption ruling in the *California FiT Orders*. It is unlikely a court will overturn FERC on this issue.

However, preemption litigation is not inevitable where a non-PURPA FiT is adopted *with* the consent of the purchasing utility. A non-PURPA FiT is highly unlikely to be challenged *sua sponte* by the current FERC. Several non-PURPA FiT programs exist today and they have not been challenged by FERC. For example, the current FiT adopted by Vermont does not mention PURPA, has no QF requirement, and requires Vermont utilities to pay a rate that has no relationship to avoided cost. (Vermont Energy Act of 2009, H. 446, 2009–10 Legis. Sess. (Vt. May 27, 2009)). Yet, no utility or other entity with standing has challenged that Vermont FiT at FERC. Disturbing a non-PURPA FiT would not be a valuable use of FERC resources because where market participants are not in disagreement, a FiT program can readily be made compliant with PURPA and the FPA—for example, by adding a QF requirement and by cloaking the program with the veil of a negotiated rate under PURPA. It is important to appreciate that a PURPA FiT can provide a rate for FiT sellers that is above avoided cost if everyone agrees to it. There is a drawback to negotiated rate PURPA FiTs in the sense that it is unclear that total participation can be capped due to PURPA's non-discrimination requirements.

Another example of preemption issues that may arise if a non-PURPA FiT is adopted, is a recently resolved Indiana Utility Regulatory Commission (IURC) case, which is the poster child for the impact that *California FiT Orders* can have on non-PURPA FiTs (Cause No. 44018). Here, Indianapolis Power & Light Company (IP&L) had filed a FiT offering to pay a certain rate, called "Rate REP," to certain types of customer-generators. Rate REP had all the characteristics of a FiT. After a short period of time, IP&L decided to amend that Rate REP. Specifically, IP&L wanted to limit availability of the rate to legitimate retail customers, not stand-alone generation developers. IP&L was not seeking to turn the non-PURPA FiT into a PURPA FiT. Rather, it was merely seeking reforms which, if not granted, might cause it to invoke the preemption precedent and withdraw its non-PURPA

FiT, in an exercise of its legal rights not to be compelled to purchase power at above an avoided cost rate. The IURC ruled on March 7, 2012, in an order of the commission, that the REP was a not an avoided cost rate and a wholly voluntary offering. It granted IP&L's request to make a variety of changes to its Rate REP.

It is somewhat surprising the degree to which utilities, commissions, generators, and stakeholders genuinely seem unaware of the preemption issues. The *California FiT Orders* have raised awareness of preemption issues and they reflect 15 years of precedent. However, it appears many simply forgot. In addition, several state commissions (including the Indiana and Vermont commissions mentioned above) have adopted non-PURPA FiTs with seemingly no acknowledgment of FERC jurisdiction over the wholesale power under the FiTs. The California legislature passed several FiT laws and simply asserted that the CPUC would be able to set wholesale electric prices. Sellers need to be aware of their legal obligations under PURPA and/or the FPA whenever selling power to a utility. FiTs may lead generators into a false sense of security that they are not subject to federal regulation. They could lure sellers into selling power without bothering to self-certify at FERC for QF status. For generators over one megawatt, a failure to obtain QF status can mean that they are subject to costly penalties and refunds if they also fail to file for market-based rates. The IURC addressed this issue, agreeing with IP&L that the Rate REP inform potential sellers of the need for QF status or to otherwise be authorized to sell wholesale power under federal law.

## **Avoided Cost Litigation**

In the post-*California FiT Order* world it is likely that avoided cost rate issues will also result in litigation. Those states that accept the results of FERC's *California FiT Orders* likely will design FiTs that fall under the rubric of PURPA. If utilities, states, and generators fail to negotiate a rate, a PURPA FiT is likely to trigger avoided cost litigation. Litigation is likely where one or more stakeholders do not like the level at which the avoided cost rates are set. And, that litigation may be all the more likely and even more complex if the state adopts multitiered avoided cost

rates, as FERC indicated was permissible in the *California FiT Orders*.

The concept of multitiered avoided cost rates has been percolating for years before being introduced by the *California FiT Orders*. The commission merely affirmed that multitiered avoided cost rates were acceptable. In so finding, FERC explicitly overturned a prior decision also involving the California utilities. That prior decision determined that regardless of how a state commission determines avoided cost, it must, in its process, reflect prices available from all sources able to sell to the utility whose avoided cost is being determined.

The reason avoided cost litigation will likely be robust is that there are many ways to determine avoided cost and to assess the interplay such rates have with rights to renewable energy credits. Litigation over such issues has occurred in Oregon, which recently adopted a separate avoided cost rate for renewables for Portland General and PacifiCorp because those utilities were subject to renewable mandates. *Investigation into Resources Sufficiency Pursuant to Order No.06-538, Order 11-505* (Ore. PUC Dec. 13, 2011). The renewable resource avoided cost rates will vary depending on whether the utility is renewable resource "sufficient" or "deficient." During periods of renewable resource sufficiency, the rate will be based on market prices. During periods of deficiency, the renewable avoided cost would be based on the next utility-scale renewable resource acquisition in the utility's integrated resource portfolio. This issue of how to set a renewable resource avoided cost rate has been litigated along with other proposals including the use of a proxy wind resource. The QF may keep its renewable energy credits when the utility is sufficient and must provide them to the utility if deficient. The Oregon order did not set the actual avoided cost rates. However, it allows base load QFs to be paid the standard QF rate, in which case it need not turn over its renewable energy credits.

## **Commerce Clause Litigation**

Although preemption litigation and avoided cost litigation are more obvious results of the *California FiT Orders*, Commerce Clause litigation involving FiTs also can be expected. Laws that require meeting



renewable energy targets with in-state generation are extremely vulnerable to Commerce Clause challenges, despite legal advice that renewable mandates, whether or not a FiT, should not require utilities to purchase energy from in-state generators.

Assuming most states will not directly prohibit out-of-state generation participation in FiTs, location-based eligibility for FiTs, which serve the same purpose, arguably can also run afoul of the Commerce Clause, if not structured properly. For example, eligibility for a FiT may be tied to the generator being *directly* interconnected to the purchasing utility. This limit typically makes out-of-state generation ineligible as most utility operating companies do business in only one state. Such a limit can be justified, but only if carefully designed to also justify the locational requirement. Using the PURPA FiT example, a state could have one avoided cost rate for generators

interconnected to the utility distribution system that includes the avoided cost of transmission and could have another separate avoided cost rate for other QFs that does not reflect the avoided cost of transmission. But, even such a program is vulnerable. Some in-state generators connected to distribution may be located where transmission costs are not avoided. Differentiation in avoided cost prices paid based on location has to be justified by the facts.

In sum, there are many legal issues to be sorted out relating to FiTs including preemption issues, avoided cost issues, and Commerce Clause issues, and all parties should carefully consider existing precedent.

**Jennifer L. Key** is of counsel at *Steptoe & Johnson* in their Washington, D.C. office. She may be reached at [jkey@steptoe.com](mailto:jkey@steptoe.com).

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## **EUROPEAN FEED-IN-TARIFF POLICIES AS INSTRUCTIVE FOR THE UNITED STATES**

**Grace S. Kurdian**

In contrast to the United States, where the growth of renewable energy generation to date has been driven primarily by tax incentives and tax policy coupled with differing state and local incentives, in many European countries renewable energy development has been driven by feed-in-tariff (FIT) schemes. A brief look at FITs and how they have driven investment in renewable energy facilities in Europe, namely FIT schemes, is instructive as we look to leverage lessons learned by other countries' policies to further fuel the growth of renewables here.<sup>1</sup>

In the United States, federal tax policy and changes to the tax code have primarily driven renewable energy investment. Focusing on tax policy to drive renewable energy development requires the involvement of taxpayers with large tax appetites: entities otherwise eligible to offset their taxable income by the available tax credits, which have historically been large financial institutions. As the tax equity market in the United States shrank during the global economic recession, competition to tap the more limited tax equity market as a means to finance renewable energy projects became more heightened. The §1603 Treasury Grant program, which was a temporary incentive developed under the American Recovery and Reinvestment Act of 2009, provided much needed liquidity to the market.<sup>2</sup> Indeed, as of March 29, 2012, the §1603 Treasury Grant had provided \$11.2 billion for eligible renewable resources, providing much needed liquidity during a constrained period. As a result of the Grant's expiration on December 31, 2011, the focus has returned to the remaining federal tax incentives (Investment Tax Credit or Production Tax Credit and accelerated depreciation), as well as differing state incentives, the most prominent of which are Renewable Portfolio Standards.

Renewable Portfolio Standards (RPS)—rather familiar in the United States—either mandate or target a proportion of a particular renewable energy resource that load-serving entities must incorporate into the fuel

supply mix used to serve customers within a particular state, often with alternative compliance payments due from entities that fail to meet the RPS. The focus of the RPS is on the utility or competitive electricity supplier and on requiring such load-serving entities to adjust their fuel portfolios to ensure that a certain quantity (generally a percentage) of the total electricity *sold* to retail customers derives from renewable energy. In contrast, the European FIT distilled to its essence is a long-term, guaranteed, fixed payment made by the relevant grid operator to the renewable energy facility based on the electricity *generated* by an eligible renewable resource. The focus is on the investor/developer of the renewable facility and ensuring that such developer/investor is incentivized to develop and connect renewable facilities to the electricity grid.

### **Cornerstone of European FITs: Long Term Revenue Stream and Grid Access**

EU Directive 2009/28/EC (the EU Renewable Energy Directive) established a mandatory target of increasing the generation of electricity from renewable energy to 20% of the European Union community's consumption by 2020 and set mandatory national targets for each of the 27 individual EU Member States.<sup>3</sup> Member States develop national renewable energy action plans to meet their requirements while containing and controlling the costs of their individual schemes.<sup>4</sup>

The European Directives implementing FITs are significant for another reason: they provide priority access to the grid for the electricity generated by eligible renewable facilities.<sup>5</sup> The grid operator is *required* to accept the electricity fed into the grid. Such priority access, coupled with the guaranteed fixed payment for electricity generated, ensures that an eligible renewable energy facility will be compensated for the electricity it produces. In contrast, given the energy regulatory policy in the United States, developers lacking a long-term power purchase agreement entered into with a creditworthy offtaker face critical challenges financing their proposed projects.

As an example of one Member State's efforts, the enabling legislation for the current FIT system in

Germany is the Renewable Energy Source Act (Erneuerbare Energien-Gesetz—“EEG”). FIT prices are fixed for a long term for the particular renewable generation plant, typically 20 years in addition to the year in which the plan is placed in service. Tariffs differ depending on the relevant technologies/renewable resources. In order to encourage anticipated technological advancements that drive down equipment and component costs of future renewable facilities, countries such as Germany also provide for a degression of tariffs in future years. Therefore, while the FIT for a particular offshore wind facility placed in service in 2012 will remain unchanged for 20 years, providing regulatory certainty to investors and lenders, a similar renewable resource placed in service next year will have a different, lower guaranteed fixed payment.

In Spain, according to Royal Decree 661/2007, renewable energy facilities submit their selling offers into the Spanish electricity pool managed by the Electricity Market Operator along with conventional energy plants. Offers to sell and buy are matched, starting with the lowest bids and increasing until demand is fully matched. The price then paid to all generators (renewable as well as conventional fuel plants) whose offer was matched, known as the pool price, corresponds to the price of the last offer matched. Renewable facilities are then entitled to receive the FIT (an incentive amount added to the pool price). The total paid to a renewable facility is equivalent to the pool price and FIT, which differs depending on type of technology.<sup>6</sup> Having experienced a striking spike in solar photovoltaic (PV) installations due to a particularly rich solar PV FIT under Royal Decree 661/2007, Spain modified its system through Royal Decree 1578/2008, establishing a system of calls through which a limited quantity of power may be installed each quarter and a calibration/reduction of the FIT if power supply outstrips demand. A Central Registry was also created through which every new solar PV facility must be recorded following receipt of relevant permits before it may participate in the FIT regime of Royal Decree 1578/2008.<sup>7</sup> As with other FITs, Spain’s FIT is established for a long period, generally between 15 and 30 years from the

commercial operation of the renewable facility, depending on the type of renewable resource.

In Greece, the grid operator is required to enter into a power purchase agreement with each holder of a license for a renewable energy facility. The renewable energy facility is entitled to receive payment for the aggregate production absorbed by the system or network based on the FIT, which is set by Law 3468/2006 (the Renewable Energy Sources Law or RES Law), as amended from time to time. The power purchase agreements have a term of 20 years with a possibility of extension. Greece provides higher FIT tariffs for emerging and technologically more complex renewable energy systems in order to further encourage the investment in same.

Just as different states here have RPS goals or requirements as well as tax or other incentives that differ and therefore impact investment, each Member State’s implementation of the FIT programs requires separate attention. The current FIT scheme in the United Kingdom is focused on stimulating investment in smaller scale renewable energy projects, sized up to 5MW.<sup>8</sup> Larger projects are encouraged through another mechanism, Renewable Obligations Certificates (ROCs) issued to eligible generators by the Office of Gas and Electricity Markets (Ofgem).

### **Allocating the Cost of FITs**

The cost of FITs is ultimately passed through to retail consumers. Details as to procedure and mechanism differ, but ultimately the costs are borne by the customers.

The grid operator in Germany is required to purchase all electricity generated by a renewable resource generator and pay the established FIT. The grid operator is, in turn, paid by the transmission system operators, who sell the electricity on the spot market and receive reimbursement from the utilities, which impose an “EEG surcharge” on the retail customers’ electricity bills.

The FIT incentives in Spain are paid for by the tariffs imposed for access to the electricity grid, which is

ultimately passed to retail customers. The access tariffs are used not only to pay for FITs, but also for other costs, including: investments to the transmission and distribution system; generation costs for islands off the Spanish mainland; operating costs of the national energy regulator, market operator, and system operator; payments to wind operators when the intermittent resource is not available; and certain generation costs for the Spanish coal industry. There currently exists a substantial tariff deficit where the revenue from the access tariffs fails to cover all the costs. Therefore, Royal Decrees issued in 2010 establish limits on operating hours for existing and future wind and solar PV plants that operate within the FIT regime. Finally, it is noteworthy that due to the tariff deficit in Spain and the fact that installed capacity there already exceeds electric demand, in January of 2012, the government issued Royal Decree-Law 1/2012, suspending the FIT regime for all new renewable facilities. Such moratorium is expected to last until the government addresses the existing tariff deficit.

### **Other Incentives or Alternatives to FITs**

In addition to the FIT or as an alternative to it, some countries, such as Germany, offer a market premium for renewable electricity that generators directly sell and system operators may choose between the FIT and the market premium. Greece provides an incentive (through Law 3851/2010) for developers who do not use public grants to develop certain kinds of renewable projects.

As alluded to above, the primary financial incentive in the United Kingdom for spurring large-scale renewable development is the ROC scheme.<sup>9</sup> One ROC is issued for each megawatt hour (MWh) of eligible renewable output, with differences for some resources, such as offshore wind, which receives two ROCs per MWh. While initially technology-neutral, banding was introduced in 2009 to provide different levels of support for different technologies based on maturity, development cost, and resource/technology risk. At a basic level, the ROC scheme is reminiscent of an RPS in a state that has a requirement that a proportion of the energy is derived from renewable resources as

evidenced by tradable certificates, coupled with a payment scheme for failure to meet such requirements (akin to the alternative compliance payments required in New Jersey and other states), although the details as to how compliance or shortfall payments are calculated can radically impact the effect of otherwise similar programs.

### **Changes to FITs and Legal Challenges**

In several countries, the generous FIT tariffs available for certain technologies (solar PV in particular) along with the reduction in capital investment due to technology improvements and efficiencies resulted in an unexpected boom in renewable energy development. The governments in many FIT regimes were then forced to review and adjust (decrease) their FIT tariffs.

Unsurprisingly, changes to FIT regimes, particularly where existing or pending projects may be impacted by a change in policy or in law, have sparked legal challenges. For example, the limitations in tariffs available for Spanish solar PV plants have been challenged based on constitutional grounds.<sup>10</sup> In France, too, there have been some legal challenges to changes to Ministerial Tariff Orders (for solar and wind). In prior challenges to Tariff Orders, after the cancellation of a Tariff Order, the Ministry in charge of energy set up a transitory regime for ongoing and future projects, maintaining regulatory stability. Unlike the recent activity in Spain, the French challenges pending before the French Administrative Supreme Court (*le Conseil d'Etat*) were not accompanied by new legislation placing a moratorium on the overall FIT scheme.

In FIT schemes as well as RPS programs, public policy affects markets. Regulatory certainty and investor confidence are impacted by the intricacies of how a particular Member State's FIT scheme is crafted and how the Member State proposed to change its FIT regime, including details as to which projects (existing, pending, or future) are impacted by the change.<sup>11</sup> As we consider alternatives to a primarily tax incentive-based system, the details of the FIT schemes implemented through the various Member States of the European Union (including the tariffs that

spurred exponential growth followed by the adjusting or reining in of such generous tariff payments) are worth an even deeper look.

**Grace S. Kurdian** is a partner at Watson, Farley, & Williams (New York) LLP. Her practice focuses on energy and renewable energy project development and regulatory law. She is grateful for the contributions and insight of her colleagues from the Competition, Regulation and Networks group at Watson, Farley & Williams, who have contributed insights as to the FIT programs in effect in six countries in which the firm has a presence.

### Endnotes:

<sup>1</sup> The FIT schemes considered in preparing this ABA article include those in effect in France, Germany, Greece, Italy, Spain, and the United Kingdom. Due to publication/space constraints, this article does not address each of these schemes in detail, but instead generally provides an introduction into the FIT schemes to guide a consideration of lessons to be learned from the European experience.

<sup>2</sup> The § 1603 Treasury Grant comprised a cash grant of 30% of eligible project cost for qualified renewable technologies, and was available to the applicant once a project was placed in service. Although the § 1603 Treasury Grant expired as of December 31, 2011, applicants meeting specified criteria who had commenced construction before the end of 2011 have until October 1, 2012 to submit their applications. See [www.treasury.gov/initiatives/recovery/Pages/1603.aspx](http://www.treasury.gov/initiatives/recovery/Pages/1603.aspx)

<sup>3</sup> The EU Directive 2009/28/EC and the targets of the 27 Member States are available at: [http://ec.europa.eu/energy/renewables/targets\\_en.htm](http://ec.europa.eu/energy/renewables/targets_en.htm)

<sup>4</sup> Although some countries, such as Spain, previously had different subsidies for renewable generation based on geographic regions, the FIT is now (and for several years has been) the dominant incentive scheme for most European countries.

<sup>5</sup> See Article 16 of EU Directive 2009/28/EC for more detail as well as individual Member States' laws including, for example, Germany's EEG.

<sup>6</sup> As an example, in Spain, under Royal Decree 661/2007, solar PV facilities (sized between 100 kW and 10 MW) were entitled to a FIT incentive comprised of 46.34 Euro cents/kWh; for onshore wind farms, the FIT incentive was 8.13 Euro cents/kWh. Meanwhile, the pool price at the time was approximately 5 Euro cents/kWh. Due to the particularly rich incentive for solar PV under Royal Decree 661/2007, Spain far exceeded its solar target (which was 370 MW installed solar by 2010) and exceeded 3,000 MW of installed solar capacity by 2008. In the United States, this may be reminiscent of the Solar Renewable Energy Credit (SREC) market in New Jersey, where SREC policy and high SREC market prices catapulted New Jersey to quickly become second only to California in terms of installed solar capacity soon after it established its SREC program.

<sup>7</sup> A similar Central Registry has since been established in Spain to record all other renewable energy resources before they may participate in the FIT regime.

<sup>8</sup> The maximum capacity for a combined heat and power plant, however, is 2 MW.

<sup>9</sup> Note that through the Electricity Market Reform issued by the Department of Energy and Climate Change (DECC), the United Kingdom will be transitioning toward a new system (Parliament was to begin legislating the central elements starting in May 2012). The new system will focus on long-term contracts in the form of FITs with Contracts for Difference, which is intended to allow for more flexibility to ensure that the rate of return remains competitive in light of market conditions.

<sup>10</sup> Decisions as to the constitutional challenges are expected to take a few years.

<sup>11</sup> Although the issue of recent challenges to FIT programs is certainly worthy of further examination, several of the challenges have yet to be resolved and such a detailed analysis is beyond the scope of this ABA article.

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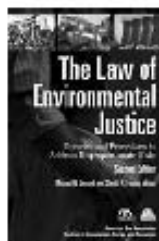
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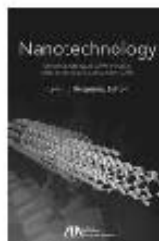
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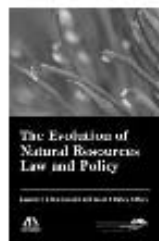
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