

## RES/COGEN PRODUCERS FORCED TO THE FREE MARKET - AMENDMENTS TO THE BULGARIAN ENERGY ACT AND THE RENEWABLES ACT REPEAL THE RES AND CO-GENERATION SUPPORT SCHEMES

On 27 March 2018 the Bulgarian Parliament published a Bill for amendment and supplementation of the Energy Act ("EA") and the Act on Energy from Renewable Sources ("AERS"), which in practice repeals the support schemes for energy generated from renewable energy sources ("RES") and from highly efficient cogeneration ("CoGen"). The most critical amendments include (i) termination of the obligation for buy-out under long term power-purchase agreements ("PPAs") of electricity generated from RES and CoGen which have 4MW or more installed capacity, and (ii) replacement of the fixed preferential prices ("FiTs") by limited fixed premiums provided as a mark-up on the free market prices.

### BACKGROUND

In the last seven years the Bulgarian energy sector underwent significant financial imbalances, which led to worsening of the financial status of the state owned incumbent wholesale public provider - National Electricity Company (NEK). As compensatory measures to tackle the deficiencies in the financial flows, a number of measures were introduced reducing the revenues of RES producers and providing for additional funds to NEK.

In 2015 the Bulgarian government mandated the World Bank to analyse the electricity market and to propose stabilization and restructuring measures. In 2016 the World Bank issued its first report which proposed measures to (i) address energy poverty, (ii) reduce of the burden from the long term PPAs (with Maritsa East 1 TPP operated by AES and Maritsa East 3 TPP operated by Contour Global, the RES and CoGen producers) by way of introduction of Contracts for Differences, (iii) increase the role of the Bulgarian power exchange - IBEX as a competitive trading platform by opening intraday electricity market, and (iv) strengthen the supervisory powers of the energy regulator - Energy and Water Regulatory Commission ("EWRC").

In March 2018, members of Parliament proposed a Bill for amendment and supplementation of the Energy Act (the "**Bill**"). The Bill introduces major structural changes to the Bulgarian electricity market to take place as of 01 July 2018.

### THE PROPOSALS

Among others, the Bill proposes the following changes to the Energy Act:

- **Termination of the mandatory buy-out of RES and CoGen produced electricity**

The RES and CoGen producers will sell their generated electricity at the IBEX at freely

negotiated market prices, thus bearing the financial and market risks from price fluctuations or shortage in demand. The Bill also envisages the RES and CoGen producers to have the possibility to sell the produced electricity on the IBEX via coordinators of balancing groups. It is still to be seen how the balancing group coordinators and the producers will negotiate the terms for sale of RES/ CoGen electricity on the IBEX since the new amendments remain silent on the specific conditions. However, this is a possibility which is expected to be explored by RES producers since at present they are not equipped to participate actively on the electricity trade market.

However, in the first draft the Bill does not provide for automatic termination of the existing PPAs with NEK and End-Suppliers. Considering that the texts of the PPAs in place differ greatly from contract to contract, it will be based on an ad-hoc assessment in each case to determine whether NEK/ End-Supplier could terminate unilaterally an existing PPA.

- **Abolished preferential prices for RES and CoGen  $\geq$  4MW**

For the electricity sold on the IBEX the RES/ CoGens will have the right to claim from the Security of the Energy System Fund (“SESF”) payment of an additional amount defined in the Bill as a *premium*.

The *premiums* will be a fixed amount set by the national energy regulator each year by June, 30<sup>th</sup>. EWRC will calculate the *premiums* as a difference between *forecasted market prices* (“FMP”) for the respective group of producers and the preferential prices currently in place. The FMPs will also be set by the EWRC each year by June, 30<sup>th</sup> based on a Methodology adopted by EWRC as a weighted average price for the previous 12-month period for electricity generated from solar, wind hydro (up to 10 MW), biomass and other RES /CoGen producers.

The Bill remains silent on how the EWRC will determine in 2018 the average weighted RES price for the initial 12-month period considering that currently the RES and CoGen electricity is purchased under FiTs and not at freely negotiated prices. The potential outcome could be unreasonably high FMPs (above market prices) resulting in low *premiums* leading to further increased market risk and financial exposure for RES and CoGen producers at the free market.

According to the proposed Bill, the *premiums* paid by SESF shall cover only electricity generated by the respective RES producer up to the Net Specific Generated Electricity (“NSGE”) thresholds set in the currently in force FiT decisions of EWRC.

Each RES/ CoGen producer should sign Contracts for Compensation with Premiums with SESF by 30 June 2018. **Condition for payment of the *premiums* by SEFS are guarantees/ certificates of origin. There is not much clarity on other substantial provisions of the Contracts for Compensation since the Bill is focused on assuring payments to the SEFS, but not as much on detailed obligations by SEFS regarding payment of the *premiums*.**

- **Change in structure, functions and increased liquidity of SESF**

### ***Contributions to SESF***

At present, SESF has a role to reimburse NEK for the electricity purchased from RES, CoGen and under the long term PPAs from Maritsa East 1 TPP and Maritsa East 3 TPP. With the current system of setting of the premiums, it is highly likely that the outgoing payments to the RES/ CoGen will be lower than the current compensations paid to NEK.

On the other side, the contribution to SESF are to increase. So far, SESF was funded by mandatory contributions at the amount of 5 % of revenues from (i) electricity generated and sold by any electricity producer in Bulgaria, (ii) net imported and sold electricity in Bulgaria by electricity traders, (iii) access to the (electricity) grid and transmission/distribution fees of the TSO and electricity distribution companies ("**EDCs**"), (iv) access to (gas) grid and transmission/distribution of natural gas fees of the TSO and gas distribution companies, and (v) fees for access to and storage of natural gas.

Pursuant to the Bill SESF will have the right to collect additional funds from: (i) the RES and CoGen producers  $\geq 4$ MW and (ii) all the end users of the national energy system (including from the TSO and EDCs for the consumed electricity for technological losses) in the form of mandatory payments of the obligation to society price. While this is estimated to bring additional revenues to the SESF (from 3,9 TWh annually from the TSO and EDCs alone), it can not remain unnoticed that the RES/ CoGen should also contribute and finance the premiums which they will claim from the SESF.

### ***Compensation of costs***

In addition to the contributions from market players, the SESF is proposed to have the right to claim compensation of its costs for (i) the purchase of electricity under the long term PPAs with the Maritsa East 1 and 3 TPPs, (ii) the purchase of electricity under FiTs for RES and CoGen  $< 4$ MW, and (iii) the provision of premiums to RES and CoGen  $\geq 4$ MW. The SESF is to apply before the EWRC and the EWRC will have the final call to determine the amount of compensation for the respective period. Based on the above, it seems that SESF will be compensated by EWRC for all premiums to RES/CoGen and payments under long term PPAs, and in addition it will receive contributions from the market.

### ***Bank guarantees including from RES and CoGens***

To secure the contributions from the electricity market stakeholders, including RES and CoGen  $\geq 4$ MW, the SESF will require the stakeholders to provide bank guarantees or cash deposit at 150 % of the highest amount for the last 12 months calculated as a the multiple of the fees under Art. 30 (1), it. 17 of EA (the price towards society) and the electricity sold by the respective undertaking for the preceding 12 months. Potential reductions of these amounts are possible if precise adjustment on monthly basis of the guarantee is ensured for 12 preceding months. SESF shall monitor on a monthly basis the securities and shall notify the stakeholders in case they should adjust the securities within 7 days. Otherwise, they will be excluded from the market by ESO.

The due contributions to SESF shall be qualified as public receivables subject to public enforcement under the Tax and Securities Procedural Code. However, the SESF's funds shall not be subject to assignment and/or sequestration. It is interesting that while RES/ CoGen will have increased liabilities and risks, they will also have less efficient recourse to collect the premiums they would qualify for. In addition, the Bill proposes no premiums to be paid if respective producer owes moneys to SESF and no interest is due for delayed payments. The SESF shall not be obliged to provide premiums if a RES or CoGen producer: (i) has failed to conclude contracts for (a) sale of electricity at IBEX at free negotiated prices; or (b) with a coordinator of a balancing group or (c) a balancing contract; or (ii) has not transferred the monthly guarantees (RES) or certificates (CoGen) for origin under Art 34 of AERS.

It is clear that, if adopted as is, the proposed Bill would introduce a completely new framework in the electricity market in Bulgaria affecting the existing investments by the RES/ CoGens.

#### OTHER AMENDMENTS

- **The TSO and EDCs have to purchase the electricity for technological losses from the IBEX at free negotiated prices.**

The Bill introduces the obligation of the TSO and EDCs to purchase the electricity necessary to cover their technological losses in the transportation of the electricity through the respective networks not as currently under regulated prices, but from the IBEX at a market price. Despite the fact that EWRC has to set a Forecasted Market Prices annually by 30 June it remains unclear how such FMP correlates to the free market prices and the costs of the TSO/EDC. As the TSO and EDCs will have to purchase the technological losses at free market prices they will be exposed and bare the market volatility risks. It also remains unclear how the end users' grid access and transmission/distribution prices regulated by EWRC will be impacted? One could assume that due to the market volatility the regulated prices will be increased, but if EWRC intervenes to avoid such increase then ESO and the EDCs will have to take the hit and reduce their profits.

- **EWRC with extended powers**

In addition to the above discussed new powers of the EWRC to determine the Forecast Market Prices, the technological costs for the TSO and the EDCs and the *premiums* to be paid by the SESF, EWRC will also have the right (i) to amend the Electricity Market Rules by its own discretion/ initiative, which was not possible currently, (ii) to adopt Ordinance for determination of annual premiums for the SESF to pay to RES and CoGen producers  $\geq 4\text{MW}$  and (iii) the Methodology for setting of Forecast Market Prices for RES and TSO and EDCs for the technological losses.

It is interesting that the Bill does not require anymore in the process of price forming EWRC to follow the principle to balance the interests of the stakeholders in the energy system. This along with the newly introduced obligation of TSO and EDCs to purchase electricity at market prices that is not typical for the electricity systems brings serious questions as to the possibility for them to reimburse their regulated costs which are indirectly linked to the security of supply

of the energy system.

Last but not least, under the REMIT (Regulation 1227/2011 on wholesale energy market integrity and transparency) EWRC will have amongst others (i) investigatory and enforcement powers in case of market manipulation and insider trading (ii) supervisory powers for abidance with Art. 4 (publication of inside information), 8 (data collection), 9 (registration) and 15 (obligation for notification in case of suspecting violation of art.3/5) of REMIT. Under its enforcement powers EWRC will be able to impose sanctions to legal entities too.

## COMMENTS

The proposed amendments, if adopted as they are, would represent the most significant regulatory change affecting the majority RES electricity producers and the entire electricity market in Bulgaria. The result will be a further decline of revenues of the RES and CoGen producers in Bulgaria following the previous measures introducing of 20 % fee on revenues (now repealed by the Constitutional Court), additional access to the grid prices, introduced balancing charges, etc.

The Bill also raises questions as to the legislative process followed and in particular as to the transparency, predictability and the credibility of the preliminary impact assessment of the state policy in the sector. The fact that the Bill is not supported by a detailed legislative impact assessment and formal public consultations as required under the legislation is a big question mark on the transparency of the process.

One can not exclude investment protection claims against Bulgaria in case such significant reshaping of the investment framework is introduced before the expiry of the existing PPAs for RES and CoGens.

## About WOLF THEISS

Wolf Theiss is one of the leading law firms in Central, Eastern and Southeastern Europe (CEE/SEE). We have built our reputation on a combination of unrivalled local knowledge and strong international capability. We opened our first office in Vienna over 60 years ago. Our team now brings together over 340 lawyers from a diverse range of backgrounds, working in offices in 13 countries throughout the CEE/SEE region.

For more information about our services, please contact:



**Anna Rizova**

Partner

[anna.rizova@wolftheiss.com](mailto:anna.rizova@wolftheiss.com)

T: +359 2 8613 700



**Radoslav Mikov**

Partner

[radoslav.mikov@wolftheiss.com](mailto:radoslav.mikov@wolftheiss.com)

T: +359 2 8619 700

This memorandum has been prepared solely for the purpose of general information and is not a substitute for legal advice.

Therefore, WOLF THEISS accepts no responsibility if – in reliance on the information contained in this memorandum – you act, or fail to act, in any particular way.

If you would like to know more about the topics covered in this memorandum or our services in general, please get in touch with your usual WOLF THEISS contact or with:

Wolf Theiss  
Atanas Dukov str. 29  
BG – 1407 Sofia

[www.wolftheiss.com](http://www.wolftheiss.com)