

Changes In The Portuguese Energy Sector

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Among the large number of measures that the Government is taking within the financial assistance plan – some structural, some merely palliative – we are assisting to some important changes in the energy sector as part of the conditions imposed by the Troika (IMF, ECB, EC) of the Portuguese bailout package.



The first one was the completion of REN (the Portuguese TSO) and EDP, (the biggest Portuguese company in generation distribution and trading of power) privatisations within a short timeline which is not usual in Portugal. Both processes started in September, 2011. The EDP process was completed in May 11, with the Portuguese State taking the receipt of €2.1bn from China Three Gorges, winner of the tender for a 21.35% stake. REN's contract was signed in February 22, being REN's share capital sold to China's main electricity distributor State Grid Corporation (25%) and Oman Oil (15%) by €592 million.

These privatisation processes are in line with the European Law which indicates that the role of the State in the Energy sector has to be increasingly the role of a mere regulator of the activity of the market agents, leaving to them the direct participation in that market. Nevertheless and contrary to what one could think, the change of the role of the State (from manager to regulator) does not mean the absence of the State, on the contrary: the State must intervene in the market, by regulating it, meaning creating obligations which operators are obliged to respect, and simultaneously, guarantying the consumer rights.

The involvement of new foreign strategic shareholders and the implementation of strategic agreements on both companies will enable them not only to expand their business but also to achieve a higher degree of de-linkage from the sovereign's country risk and mitigate refinancing and liquidity risks.

Finally, the acquisition of these stakes in EDP and REN by companies of emerging countries has to be seen as a natural consequence of the new dynamic in the global macro-economic context in which Energy plays a vital role. In the past western companies acquired stakes in companies based in the emerging countries but now we are assisting to the acquisition of significant positions in western companies by companies of emerging countries all around the world (recently, PTT, a state-backed energy firm in Thailand, tendered a bid of 1.9 billion of dollars for Cove Energy which holds an 8.5% stake in a huge natural-gas field in Mozambican waters).

The second measure follows the IMF/ECB/EC recommendation of taking *"measures in order to limit the additional cost associated with the production of electricity under the ordinary regime, in particular through renegotiation or downward revision of the guaranteed compensation mechanism (CMEC) paid to producers under the ordinary regime and the remaining long-term power-purchase agreements"* (5.6. of the MoU executed between Portugal and IMF/ECB/EC).

It is important to understand that the "cost of maintenance of the contractual balance", the so called capacity system mechanism (CMEC's) has an historical reason. Back in the 90's it was necessary to invest in EDP's distribution network but due to its difficult financial situation it was convenient to minimise its investments in production. This was the reason for the implementation of the Contracts for the Acquisition of Energy (CAE's). Pursuant to the CAE's private companies invested in new power plants through a concession to sell the electricity produced to the public grid and received as consideration a tariff with two terms (a fixed term that assured the investment costs in the installed capacity and a variable term that remunerated the supply of energy). With the liberalisation of the electricity market the new power plants would bear the market risks (they would not have CAE's) but the ones that had been implemented under the CAE's could maintain such regime or go to the CMEC's in which they would be supported by a compensation mechanism that allowed recuperation of the investments made in case the operation in the free market provided lower cash-flows than the ones obtained through CAE's. The fact was that the high installed capacity of Wind Power Plants took space from the thermal power plants that started to work only as a back-up when there is no wind. It is easy to understand that afterwards the fixed costs of the thermal power plants, the so called capacity payments, began to have a disproportional weight in relation to the costs of the electricity produced.

Now the Government has reduced 120 million of Euros in the NPV of CMEC's fixed component (through a reduction of the interest rate) which means a reduction of around 13.1 million Euros/year from January 2013.

On the other hand, capacity payments for all the existing thermal power plants without CMEC's were abolished until the end of 2013, materialising the measures presented in Chapter 5 (Energy) of the MoU on Specific Economic Policy Conditionality - Third Update, March 15, 2012. However, such incentive will be € 6.000/MW per year, with no time limitation, after such date. Also, for hydro power plants capacity payments to new and repowering projects will be paid during the first ten years according to the methodology currently applicable with the reserve margin referring to the date when the production license is issued. New hydro power plants will receive 100% of this value while repowering projects will receive 50% of it.

Yet, the IMF, ECB and EC were not satisfied with these measures on the last evaluation made on the Portuguese financial assistance plan.

The third measure that has been taken concerns the revision of support schemes for co-generation with a downward adjustment of the feed-in tariff through a Ministerial Order recently approved that regulates a Decree-law from 2010 (which already determined the end of the former remuneration regime). Still, there are a number of issues that both diplomas do not solve and operators will still have to go through an adaption procedure.

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