In Prague, 30 May, 2014

Subject: Threat to stability of the EU investment environment due to retroactive changes to renewable energy project legislation in the Czech Republic

Dear Sirs,

Herewith we[1] would like to **express our deepest concerns about the foreseen retroactive changes in the legislation regulating support for renewable sources in the Czech Republic** and ask you to pay close attention to these efforts. As can be seen, inter alia from the documents from the notification process SA.35177 (2014/NN) Czech Republic, the Czech Ministry of Industry and Trade is preparing changes in legislation that – if adopted – would dramatically impact the faith of investors in the Czech Republic and also other EU countries, especially in **projects of public and EU interests**. This encroachment is about to change – retroactively and in a very significant way – the guaranteed terms and conditions through which the Czech government once encouraged private investments (both Czech and European) to fulfil its national obligations in the EU targets for renewable sources up to 2020.

The Czech Ministry of Industry and Trade plans to introduce a retroactive 10-year review mechanism for all renewable projects that would **adjust the guaranteed investment conditions individually** for each project**. This idea is, however, based on a wholly incorrect interpretation** of the 15-year payback period mentioned in the Act 165/2012 Coll. and we must express our serious concerns mainly for the following reasons:

1. **The review mechanism would be wholly in breach of both the previous and current Acts on support for renewable sources (180/2005 and 165/2012 Coll.)** according to which all renewable energy sources are guaranteed with a specific feed-in-tariff ("F-I-T") for a specific period of time (e.g. 20 years in case of solar plants), both given at the time of their commissioning and calculated for each year by the Energy Regulatory Office (ERO). **It is therefore a wholly incorrect claim by the Ministry of Industry and Trade that all individual renewable energy sources should attain a 15-year payback period**. The 15-year payback period is used by the ERO only for the calculation of the F-I-T, but once the F-I-T is set, it shall be valid for the project for the prescribed period.
2. The vast majority of renewable projects is financed by bank loans with average tenor of 15 years and with long-term interest rate swaps, where underlying economic assumptions were made by the banks based on a 20 years lifetime of the projects. The 10-year review mechanism would create such an **uncertainty for the banks that they would most likely restructure the financing from 15 to 10 years and as a result these projects would end up in an insolvency regime**.
3. It is obvious that with such a mechanism projects that are more expensive would get more subsidies for longer time. Therefore we have reason to believe that this mechanism might be tailored to support the most expensive solar projects in the Czech Republic that have been purchased by the state owned company CEZ (currently under investigation by Czech public authorities; projects more expensive than market average by 30%).
4. It is also necessary to point out that the 10-year review mechanism, most probably administered by the ERO, **would create huge potential for corruption.** Regarding the ERO, two complaints have

[1] The Alliance for Energy Self-Sufficiency (hereinafter „AliES") is Czech association of independent experts covering the entire sector of renewable sources and modern energy generation. Czech Photovoltaic Industry Association (hereinafter"CZEPHO") is professional association covering more than three thousand entities that deal with the solar power generation.

been already submitted concerning a breach of its independence, the last one on 10 October, 2013 under file number CHAP(2013)03504.

5. We understand concerns of the European Commission regarding overcompensation through the concurrent receipt of investment and operational support. However, it is obvious that the **Czech Ministry of Industry and Trade plans to abuse this pretext in order to change the support even for projects launched before 2013 that have received the operational support through F-I-T only**.

6. Besides the aforementioned this mechanism would be also in conflict with:

    a. the long-term position of the European Commission which emphasizes that the Member States should not interfere in the guaranteed terms and conditions for already existing projects – as can be seen in the MEMO/13/948 from 5 November 2013: *"Governments must avoid unannounced or retroactive scheme changes. Investors' legitimate expectations concerning the returns on existing investments must be respected"*;

    b. the targets of the European Union for renewable sources up to 2020, since it is more than obvious that the proposed retroactive change would cause a reduction in the share of renewable energy resources in the Czech Republic;

    c. the recent report and targets of the European Commission regarding the fight against corruption;

    d. terms and conditions guaranteed by the Czech legislation under which the investors and banks have invested more than 200 billion Czech crowns in the projects of renewable sources – as can be seen above.

Unfortunately, this is **not the first retroactive change of the corresponding legislation**. As it is not clear whether the European Commission has been properly informed about all measures that have already been implemented and retroactively affected the renewable projects, let us mention them here briefly:

1. 26% levy on income for solar power plants put into operation between 2009 and 2010, which was valid between 2011 and 2013;
2. 10% levy on income for solar power plants put into operation in 2010, which has been valid since 2014 without time limit;
3. cancellation of tax holidays for the first five years of project operation;
4. obligatory extended depreciations for solar power plants for 20 years;
5. obligatory investment in remote controlling of the PVPPs;
6. obligatory contributions on future solar modules recycling.

We estimate that the implementation of the 10-year review mechanism would force most projects with income exceeding 2 million Czech crowns / year, i.e. more than 1 000 projects in the Czech Republic, into insolvency. After previous retroactive changes that have put the projects into difficulties, they would not be able to confront the measure in any other manner than by declaring themselves bankrupt.

The bank sector would have to write off a significant part of their outstanding loans to these projects. This could cause an economic depression lasting several years in our environment. The heavy losses of banks would then be reflected in stricter terms and conditions for new credits and Czech firms would lose the financing opportunities for their investments.

It is necessary to understand that except for a possibility of international arbitration proceedings (which is limited), **the investors have no realistic opportunity for defence against malevolent retroactive changes within a Member State**. And it was mainly entrepreneurs from the Czech Republic who have invested their profits from other businesses (e.g. construction industry, furniture production, transportation etc.) into renewable sources, in good faith to help their country meet the EU targets.

<u>Finally, it should be noted that the Ministry of Industry and Trade has not communicated or consulted these proposed changes with any other stakeholders, e.g. the Ministry of Finance, the Ministry of Environment, banking sector, professional organizations etc, and we strongly believe that this shall not be the case when dealing with legislation of such importance and with the European Commission</u>.

Thank you for your time devoted to reading this letter and **thank you for your support if you decide to act upon it**. At the same time, we would like to offer you our participation in negotiations or further information regarding the situation of renewable sources in the Czech Republic.

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