Renzi Tilts at the Windmills

BY MICHAEL BONTE-FRIEDHEIM

Apparently the Italian government has an uneasy relationship with private capital. Piazza Colonna recently announced the government's first privatizations in six years, to sell off up to €12 billion in assets, in order to pay down part of the public debt. So far, so good. Yet little more than one month ago, the government of new Prime Minister Matteo Renzi also tabled a proposal effectively targeting institutional equity investors to finance electricity-price cuts.

The proposal would retroactively cut feed-in tariffs for renewable energy plants by up to 20%. These government-set tariffs function as fixed-price contracts for renewable-energy producers. In Italy, the owners of renewable-energy plants are a diverse mix: international and domestic pension funds, private equity funds, global energy investment firms—many backed by sovereign wealth funds and other institutional investors.

Renewable power is not driving Italian energy costs, so why attack its investors?

The proposal to retroactively cut their returns comes on top of previous governments' efforts to penalize owners of renewable energy plants, via a raft of new taxes and charges that have reduced investors' returns roughly by half since 2011. Now the Renzi government is doubling down.

Though the feed-in tariffs are a popular punching-bag, average wholesale power prices in Italy have already declined to €48 per megawatt-hour in 2014, from €76 in 2008. That reduction has been driven in part by the construction of new renewable-energy power plants. But for some reason these reductions have not been passed on to consumers.

Over the past five years, investors have poured more than €50 billion into Italian renewable energy, building some 17 gigawatts of solar-power capacity and six gigawatts of wind capacity. Renewables accounted for 34% of Italian power generation in 2012, up from 20% in 2008—the biggest jump among the major European economies over that time. As with all long-term investments, a clear legal framework was key to attracting the funds for Italian renewables. Now that the money is spent and the plants operating, Mr. Renzi wants to tear up the contracts and selectively wipe out equity investors, though renewable costs are only a small part of Italy's energy bill.

Pointedly, the Italian government is not targeting inefficient and costly services provided by large energy companies, such as electricity conglomerate Enel. Recently, Enel presented a strategic plan to invest more than €9 billion in emerging markets—financed in large part by revenues generated from Italian consumers. Piazza Colonna's proposal is also not addressing local distribution and supply companies controlled by Italian municipalities.

Finally, the feed-in tariff proposal is tailored not to affect Italian banks that made loans for the construction of the renewable plants. (Any write-down of loan portfolios by banks would only lead to for further capital increases by Italian banks, which the Italian government wishes to avoid.) With typical debt-to-equity financing ranging from 80-20 to 70-30, a 20% cut in feed-in tariffs neatly allows many if not most bank loans to be repaid, while equity investors bear the brunt of the retroactive haircut.

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Legally, the Italian government may not have a leg to stand on: Retroactive regulatory changes and rewriting previously contracted tariffs could contravene the EU's Energy Charter Treaty. The Spanish government attempted a similar move with its feed-in tariffs last year. Investors promptly sued, and the case is now before the European Court of Justice. If Madrid loses, the ruling could trigger multi-billion euro compensation payments.

Such a capricious move by the Italian government would be a negative portent for further investment in renewable infrastructure, or indeed in any sector in Italy. As it happens, the new Italian privatization agenda includes businesses subject to government regulatory power, such as the national post office, grid-operator Terna and utility giant Eni.

Mr. Renzi may believe that the markets have short memories, and that this route is easier than reforming the blatant inefficiencies in the Italian energy sector or cutting horrendously high taxes on energy users. Maybe he's right, but good luck in attracting foreign investors in the future. Don't come knocking on my door.

Mr. Bonte-Friedheim is the CEO of NextEnergy Capital Group.

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