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THE PORTUGUESE LV GRID TENDERS

CONTENTS

- 03 BACKGROUND
- 04 HOW MANY CONCESSIONS?
- 05 THE NEW TENDERS' TIMELINE
- 06 THE TENDER SCOPE
- 07 THE LV GRID OPERATOR PROFILE
- 08 QUALIFICATION REQUIREMENTS
- 09 BIDDING STAGE AND FINAL AWARD
- 10 ANTICIPATING WHO WILL BID

BACKGROUND

The Portuguese low-voltage grid ("LV Grid") is operated by private entities awarded with a concession provided by the municipalities (up to the maximum length of 20 years). It can also be operated directly by each municipality, but none of them is currently doing so.

E-Redes - Distribuição de Eletricidade, S.A. ("E-Redes") is the predominant force in the management of the LV Grid, supplying 99,5% of the Portuguese electricity consumers. There are other 10 small operators, small local communities organized as cooperatives operating exclusively within individual municipalities or autonomous regions (Azores and Madeira).

Most of the existing concession contracts were to expire between 2021 and 2022. The new tenders for awarding LV Grid concessions were initially planned for 2019 but only in the end of 2023, the former Portuguese Government finally published the tender documents. And shortly before leaving office it announced the timetable for the launching of the LV Grid concession tenders.

One of the reason for this delay can be found in the Portuguese Energy Supervision Authority ("ERSE") and the National Association of

Municipalities ("ANM") different views regarding the number of tenders to be launched, a key element in assessing the competitiveness of the procedures.

In case the new Government confirms this timetable, the map of the tenders will be decided until October 31st, 2024. The municipalities must decide by then whether to join or not in intermunicipal concessions tenders. If they do, they will have until March 31st, 2025, to make all resolutions needed to launch the public tenders and, finally, their representative has until June 30th, 2025, to launch the public tender procedure.

Unfortunately, some of the concession award criteria, such as the years of required experience, may compromise the small grid operators' ability to participate in the tender and may force them to participate in joint-ventures.

This paper provides an overview of the regulations and of program for the LV Grid tenders and other information that we trust may be relevant for market players interested in participating.

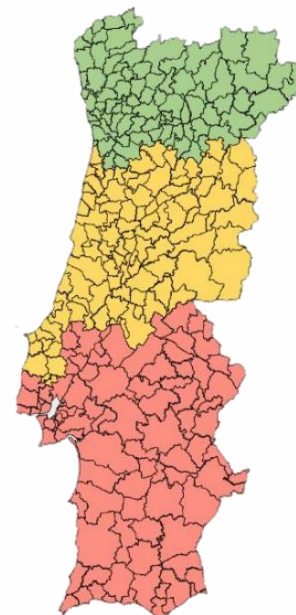
HOW MANY CONCESSIONS?

According to Law 31/2017 of May 31st (the “CIM Law”), the basis of the of the concession of energy distribution networks should be the inter-municipal communities (*comunidades intermunicipais*) known as “CIM”. However, ERSE considered that the 23 CIM in mainland Portugal cannot provide the similarity of the referred criteria, due to the significant differences within each of them.

After a public consultation, ERSE suggested in January 2019 the division of the Portuguese mainland into three different territories by grouping CIMs in three areas: north, center, and south. This territorial division determines the number of tenders which, according to ERSE's proposal, would be three.

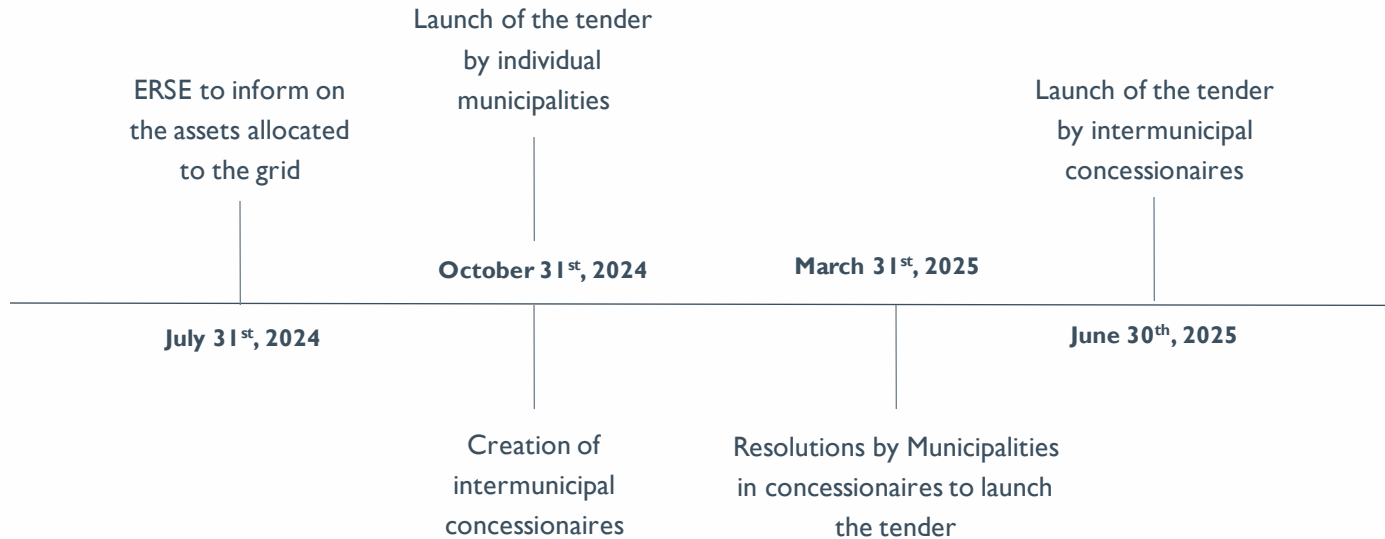
ANM suggested a single concession for the Portuguese mainland as it is the option that best guarantees territorial cohesion and the uniformity of prices. The municipalities can either: (i) confirm ERSE's solution by launching the three tenders or (ii) create a new division supported on technical studies that confirm the viability of their solution.

The municipalities have until 31st October 2024 to agree on the creation of intermunicipal concessions and, in that case, publish the technical studies on which this decision was based. Only at that point will we know the number of concessions that will be tendered.



Source: ERSE, January 2019

HOW MANY CONCESSIONS?



THE TENDER SCOPE

The tenders will end with the execution of a services agreement between the awarding entities and the concessionaries. The main purpose of such agreement is the rendering of the grid distribution services by the concessionaires.

The grid distribution services refers to the operation of the following assets:

- a. LV lines, cables and connection grids included in the public grid;
- b. Transformers and ancillary facilities; and
- c. Metering and measuring equipment;
- d. Real estate belonging to the Concessionaire on which the assets referred to above are installed, as well as any easements created;
- e. Other movable or immovable assets necessary for the performance of the activities covered by the concession;
- f. The Concessionaire's technical and human resources, including electronic platforms, allocated to carrying out the functions of

operator of the LV electricity distribution network included in the concession.

The awarding entities may exclude the public lighting (“**PL**”) grid in the scope of the tenders.

This provides, for the first time in Portugal, the opportunity to split the LV Grid operation of the PL grid operation (which is more common in other countries, such as Germany or Spain).

If the PL services are included in the scope of the tenders, the PL installations, luminaires, their supports, columns and any the measure and control systems will also be included in the concession.

The consideration for the operation of the PL grid will be a fee calculated based on the costs borne by operators, as set by ERSE.

The decision of the awarding entities to include or not the PL grid in the tenders' scope will be known until the date of the tenders launch: October 31st, 2024 for individual municipalities' concessions and June 30th, 2025 for intermunicipal concessions.

THE LV GRID OPERATOR PROFILE

The LV Grid operation activity must be carried out in exclusivity. The LV Grid operators are not allowed to:

- (a) Purchase electricity for supplying;
- (b) Own, develop, manage or operate storage facilities, except when such facilities are integrated on the public grid and subject to a favourable opinion from ERSE; and
- (c) Own, develop, manage or operate recharging point, except if for their own use or if an authorization is issued by ERSE.

In addition, the encumbering or the transfer of shares representing the awarded applicant require the grantor of the concession prior consent.

Other LV Grid operators' obligations include:

- (a) The design and preparation of the plans for the remodelling and expansion of the LV Grid;
- (b) Grant to the municipalities all the information related to the concession;

- (c) Subscribe a civil liability insurance covering the damages caused to third parties; and

- (d) Manage the public illumination (if applicable, see previous section).

After the approval of the projects related to the expansion of the LV Grid, the LV Grid operators are entitled to expropriate or create administrative easements. However, the LV Grid operators are responsible for the compensations to be paid to the expropriated owners.

The municipalities may take over the LV Grid if there are there are serious deficiencies in its organization and operation or if the facilities and equipment are likely to compromise the regularity or quality of the service.

The LV Grid operators shall bear the costs resulting for the municipalities of the exercise of LV Grid operators' obligations and other costs incurred to restore the normality.

The remuneration of the LV Grid operators is set yearly by ERSE, considering the costs involved with the management of the LV Grid.

QUALIFICATION REQUIREMENTS

There will be a qualification stage where all applicants must provide evidence that they meet the requirements of the tender documents. The date for submitting applications will be set by the municipalities.

The technical criteria require from the applicants (or from one of its shareholders with at least a third of the applicant's share capital) at least 5 years of experience in operating distribution grids (with a number of customers equivalent to at least 2/3 of the concession to be awarded), including:

- Planning, construction and technical management of the grid;
- The daily management and provision of data; and
- The operation and maintenance of the grid.

On the other hand, the applicants must have technical and human resources to perform the duties of a LV Grid operator, including in asset management systems; and the capacity to operate physical stores and online systems where new connections may be requested.

Regarding financial capacity requirements, at the time of their bid

submission, candidates must have proven financial resources equal to at least the last value certified by an independent entity of the concession's net assets considered for tariff purposes, plus the average annual value invested over the last three years in the concession area.

In addition, the applicants need to have a financial autonomy ratio over 20% [$\text{equity}/(\text{equity} + \text{debt}) > 0,2$] and a financial debt structure ratio over 50% ($\text{medium/long term debt}/\text{total debt} > 0,5$)

After analyzing the applications, the tender jury releases a preliminary report informing which applicants met the qualification criteria. The applicants will be granted with the opportunity to dispute this report to, eventually, revert a disadvantageous decision.

A final report is then released in which the jury analyses any comments and either maintains or amends the conclusions of the preliminary report.

BIDDING STAGE AND FINAL AWARD

The qualified candidates will receive an invitation to submit their bids, which must include:

- Amount of the additional to the rent destined to the municipalities;
- 10-year strategic plan that includes concrete targets;
- Strategic plan control mechanisms and penalties suggestions.

The tender jury will valueate each of the above from 0 to 100 points – from inadequate to excellent. Their specific weight in the over all rating will be determined in each tender.

With those results, the tender jury then will prepare a preliminary report with the ranking of the bidders. The bidders will be granted with a hearing period before a final award report is prepared and notified to all bidders.

If the final report changes the conclusions of the preliminary report, namely by ranking or excluding a bid previously excluded or ranked, the jury shall grant a new hearing period, followed by a new final report. The same occurs if the jury changes the order of the final order of the bids.

The awarded bidders will have 10 days to:

- Deliver a deposit (by depositing the funds in a bank account in name of the relevant municipalities, through bank guarantee or through a surety insurance), in an amount to be defined for each tender; and
- Submit the qualification documents, such as the beneficial owner's registration, proof of regularized situation regarding social security and tax contributions.

ANTICIPATING WHO WILL BID

Among the current Portuguese grid operators, only E-Redes meets the technical requirement of 5 years' experience with at least 2/3 of the clients of the area to be concessioned, as the other operate in small areas or individual municipalities and the new auctions will probably cover large areas with a big number of costumers.

To be able to participate alone, small-scale operators or any other newcomers would need a decentralized tender process which, at this point, seems unlikely to occur. The decision on the number and size of the concessions is therefore a key to assess the competitiveness of the tenders.

If it is confirmed that the concessions adopted by the municipalities are large in size and number of customers, the alternative for newcomers and small-scale operators is to group with international grid operators as, otherwise, they will not meet the technical criteria to qualify for the tenders.

The Spanish grid operators are a possible option, considering that many have shown interest in participating in the Portuguese tenders.

Within a bidding group, the technical capacity requirement is considered

met if any member satisfies it individually or if multiple members satisfy it collectively, which can be advantageous for small operators who can join.

Another uncertainty that remains is the extent to which each factor (additional income and strategic plan) will influence the adjudication process as the concrete weight of each criteria was not clarified.

The new operators will be asked to make substantial investments in the grid to modernize it and address the emerging challenges, such as the need to expand the grid capacity - which may give some advantage to bigger players.

There are also uncertainties arising from the concurrent existence of the strategic plan to be submitted in the application for the tender and the Development and Investment LV Electricity Distribution Grid Plan (PDIRD-BT) to be implemented after contract award.

Specifically, regarding the remuneration for investments, as those conducted outside the purview of the PDIRD-BT are not going to be remunerated.

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WHO WE ARE & WHAT WE DO

ABOUT US

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