THE EU RENEWABLE ENERGY FINANCING MECHANISM – WILL IT INCENTIVISE INVESTMENT?

In order to achieve the target of reducing emissions by 55% by 2030, the European Commission has proposed that the share of renewable energy in the power mix increases to 40% from 32%. Together with the EU's 2050 targets for the production of green hydrogen, an electricity-intensive process, this will require new sources of renewable energy. This briefing looks at the EU Renewable Energy Financing mechanism, which is designed to incentivise and support the development of renewable energy projects, reinforcing cooperation among EU Member States.

To support renewable energy projects and incentivise the uptake of renewable energy sources (**RES**) across Europe, the EU has established a novel RES financing mechanism (**REFM**), under which Member States will make voluntary financial contributions to support new renewable energy projects in EU countries interested in hosting such projects, through competitive tenders for investment or operating aid. Member States participating in the scheme will be able to include part of the statistics from the projects they are financing in their own national renewable energy targets. Host countries will retain the remaining statistics to help meet their targets.

The idea is that a Member State that struggles to reach its RES target, such as Luxembourg or the Netherlands (due to limited space and a high concentration of energy- and emission-intensive industries respectively), but at the same time is able to finance projects in Member States with high RES potential can cover this gap and receive RES statistics increasing its national RES share towards its target.

RES FINANCING MECHANISM – KEY ELEMENTS

Regulation 2018/1999 on the Governance of the Energy Union and Climate Action (**Governance Regulation**) provides that where the Commission finds that Member States fall below or struggle to meet their RES targets it will ensure that additional measures are implemented in order to cover the gap. Article 33 of the Governance Regulation sets out the framework for one of those measures: the REFM The recently adopted

Key issues

- The EU will introduce a novel renewable energy financing mechanism under which Member States will make voluntary financial contributions to support new RES projects in EU countries interested in hosting such projects.
- The Commission will organise competitive tenders for investment or operating aid if there is sufficient interest on the part of the contributing and host Member States.
- Member States struggling to reach their RES targets but that are able to finance projects in Member States with high RES potential can cover this gap and receive RES statistics increasing their national RES share.
- Member States decide whether they want to participate and under what conditions: contributor countries define volumes and maximum financial contributions, while host countries determine technologies, overall volumes and project sizes.
- The first tender is expected to take place by the end of Q1 2022.

Regulation 2020/1294 on the Union renewable energy financing mechanism (**REFM Regulation**) sets out the detailed rules for how the REFM will operate . This supports the European Green Deal objectives, the 55% target for cutting CO2 emissions by 2030 and the new proposed renewable energy target of 40% by 2030.

Currently, the REFM is in the implementation phase, and the Commission has a leading role. At the end of last year the Commission conducted an informal, non-public expression of interest (**EOI**), whereby Member States expressed their interest in participating in the mechanism to host projects (hosting Member States) or providing finance (contributing Member States) or both. Depending on Member States' willingness to finance and host RES projects, the Commission will organise competitive tenders with specified ceiling prices.

In January 2021, the Commission carried out a survey of private entities comprising a seven-point questionnaire to gather feedback on potential participants to the mechanism, in preparation for the first call for proposals.

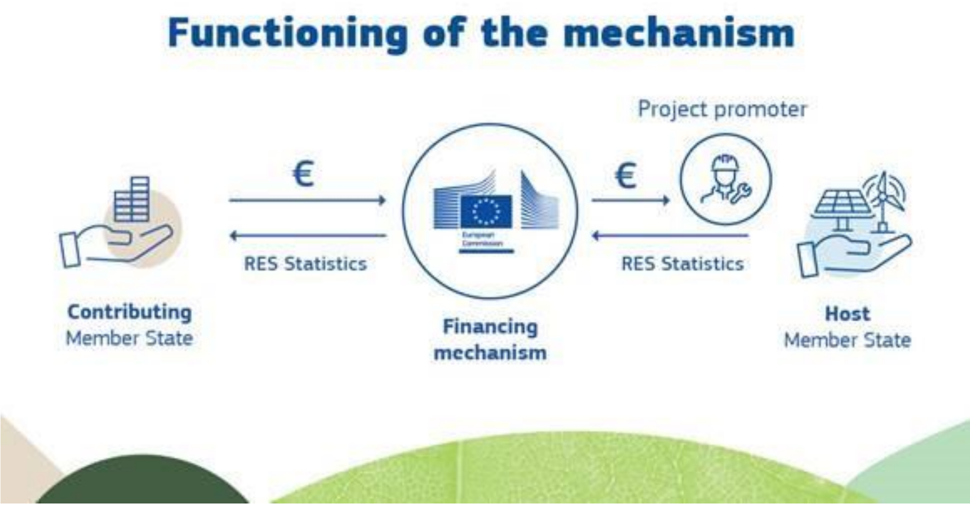

Figure 1 – Overview of the mechanism (Source: European Commission, https://ec.europa.eu/energy/topics/renewable-energy/eu-renewable-energy-financing-mechanism_en)

Calls for Expression of Interest

Under Article 7 of the REFM Regulation, the Commission will call on Member States annually to express their interest in participating as contributing Member States and/or hosting Member States in grant award procedures. The Commission will share an indicative timeframe covering the procedural steps from the expression of interest to the calls for proposal, as well as an indication of when the Commission intends to organise the next call for EOI.

At that stage, Member States interested in hosting the RES projects must provide the Commission with certain minimum information such as the preferred technologies, the minimum share of statistical benefits they are seeking and the maximum capacity of renewable energy available for projects on their territory.

In parallel, Member States interested in contributing financially to the development of RES projects must provide the Commission with some preliminary information including the maximum intended financial contribution, the maximum budget per kWh/kW that they are willing to disburse for their statistical benefit and the preferred technologies.

The Climate, Infrastructure and Environment Executive Agency (**CINEA**) will be in charge of carrying out the call for proposals and the tender process on behalf of the Commission. CINEA will have to take into consideration several factors such as the form of grants (*i.e.,* investment or operating aid, the ceiling price and the eligible technologies).

With respect to the eligible technologies, based on publicly available information, it appears that priority may be given to solar and wind power. However, the definition of energy from renewable sources derives from the Renewable Energy Directive 2018/2001 (**RED II**) and includes all renewable non-fossil sources, namely wind, solar (solar thermal and solar photovoltaic) and geothermal energy, ambient energy, tide, wave and other ocean energy, hydropower, biomass, landfill gas, sewage treatment plant gas, and biogas.

One of the most complex and controversial parts of the process will be the calculation of the ceiling price by the Commission. The Commission has stated that it will take into account the information provided by Member States, relevant comparators such as results of past calls, cost studies, as well as results from modelling exercises where appropriate.

The ceiling price should ensure that the actual support payments from the tender are equal to or lower than the maximum price, providing, therefore, a conservative estimate for the actual support costs that contributing Member States will ultimately have to cover. Only in the worst case scenario where, for example, there is minimal competition, could the award price in the tender equal the ceiling price.

Call for proposals and grant of awards

Based on the binding commitments of the contributing Member States and hosting Member States the Commission will launch a call (with several grant award procedures) or several concurrent calls for proposals. However, if the interest expressed by Member States is limited or the related transaction costs would be excessive, the Commission may decide to not launch a call for proposals.

The draft calls for proposals will include inter alia the ceiling price, the technology, the volume to be tendered and the type of aid (e.g., investment or operating aid). At that stage, Member States which have expressed an interest are consulted on the draft call for proposals, while private stakeholders, such as project promoters, may also be invited to provide feedback on the proposed tender design.

Funding Sources

Under the Governance Regulation, funding can come from payments by Member States, Union funds or private sector contributions.

Member States

Member States are not obliged to participate in the REFM, they will do so on a voluntary basis. Each year the Commission will have to ask Member States whether they are interested in providing voluntary payments. It should be noted that Member States must have committed to the transfer of sufficient financial contributions from their own national budget ensuring that they will be able to cover the full amount of the aid to be provided, as the Commission cannot pre-finance their contributions.

At the same time, Member States should take into consideration that the bid level and therefore the final level of support would only be known once the tender is completed. Against this background, the bid level would largely depend on the level of participation of Member States in the roles of host and contributors as this would determine the supply and demand side in the tender respectively. This could create some uncertainty in the initial steps of the process, and Member States may hesitate to participate in the mechanism.

Union Funds

Union funds include any form of EU financial support, including investment support instruments and funds, or programmes providing for financial instruments, whether or not part of the budget of the European Union.

Private sector contributions

The private sector can participate either as an investor, by making a financial contribution to the mechanism in order to support the deployment for renewables, or as a project developer by participating in a tender for support for renewable projects.

The REFM Regulation recognises the important role that contributions from the private sector can play in funding the mechanism and fostering the uptake of renewable energy projects.

Private investors will have an opportunity to contribute to the mechanism and they will receive guarantees of origin under Article 19 of RED II for the energy production corresponding to their contributions.

It should be noted that RES projects under the REFM are equally subject to national legal and regulatory frameworks including planning and permitting processes, site restrictions and grid connection regimes.

Additionality and State aid

The REFM clarifies that the relevant projects may be financed through combined funding from the mechanism and from other Union or national, public or private, programmes and/or instruments insofar as those national public mechanisms are in compliance with State Aid legislation, and the same costs are not financed twice by the Union budget. The Commission intends that contributions from the private sector should provide RES capacity beyond the EU's current target under RED II (for at least 32% renewable energy by 2030). To ensure that this capacity is genuinely 'additional', the Commission may decide to subject renewable energy generated by relevant projects to certification under a new EU-wide green label.

Distribution of RES statistics

Under Article 27 of the REFM Regulation, 80% of renewable energy generated by installations supported by the mechanism will be statistically allocated and distributed to contributing Member States and 20% to hosting Member States. The REFM pools all RES statistics transferred to it and redistributes them to the contributing countries in accordance with financial contribution to the mechanism.

The calculation of the share of energy from renewable sources and the statistical transfers between Member States is already provided for and described in Articles 7 and 8 of the RED II respectively.

Auction process – Key considerations

According to a case study[1] commissioned by the European Commission the more hosting Member States participate and the greater the volume they accept on their territory compared to the contributions, the higher the efficiency gains. The various hypothetical scenarios examined in the report revealed the importance of competition within hosting countries, in particular those offering to the auctions a big share of the total capacity.

The case study examined various tender scenarios applying different pricing methods (i.e., pay-as-bid, uniform pricing and pay-as-clear).. It was found that if a tender involves several hosting Member States each of which offers a maximum capacity lower than the total tender volume, pay-as-bid would be the preferred pricing rule in order to avoid excessive surpluses for the producers in countries where less support is required.

At the same time, it appears that uniform pricing across all hosting Member States inevitably would lead to a much higher average support level compared to pay-as-bid and could complicate the selection of the least-cost projects.

As with national support schemes, the REFM with upfront investment aid does not provide certainty as to the volume (kWh) that hosting Member States will receive in return for the financing offered due to the uncertainty around the full-load hours of the awarded projects.

Judging from the progress made thus far, it seems that the success of this initiative depends to a large extent – if not exclusively – on cooperation among Member States and their willingness to recognise the added value and contribution of the REFM to the achievement of the 2030 EU RES target. Private investors and project promoters could be play an important

[1] The new renewable energy financing mechanism of the EU in practice, available at: http://aures2project.eu/wp-content/uploads/2020/11/AURES_II_D6_3_EU.pdf

role in mobilising hosting Member States to participate more actively and understand the technical and financial aspects of the process.

Next Steps

Based on the binding commitments by hosting Member States and the binding commitments by contributing Member States, the Commission will launch the call or calls for proposals. The first call for proposal was expected to take place in the course of the first half of 2021; however, it appears that Member States are still reviewing the contributions and projects that they would be willing to fund and host respectively. Therefore, the first call for proposals is now expected to take place towards the end of 2021 or early 2022.

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