

Common principles for renewable energy remuneration mechanisms

Introduction

Today, renewable energy accounts for 16% of gross final energy consumption in Europe, an increase of 7.5% from 2004¹. This impressive growth can be predominantly attributed to a stable and clear policy framework, which has ensured certainty for investors and has lowered financing costs.

The centrepiece of this regulatory framework remains the Renewable Energy Directive (RED), the provisions of which have facilitated renewable energy policy in a number of Member States. The key elements of the directive that explain the successful deployment of renewables in Europe are the binding European and national goals for renewable energy, support of national remuneration mechanisms, as well as priority access and dispatch of renewables.

In particular the national remuneration mechanisms have been the driver of RE investment and the key to achieving European and national long-term decarbonisation goals. Over the years, national remuneration mechanisms have developed and converged, accounting for the maturity of both the technologies and the markets.

In view of 2030, and of our increased ambition in Paris, national remuneration mechanisms will continue to play a vital role and should remain a substantial part of the revised Renewable Energy Directive. Fair remuneration will continue to be necessary for driving investment in renewables after 2020: the internalisation of external costs alone will not allow a sufficient drive in development of RE, and the market will still be in a process of transition toward a fully flexible market without conventional overcapacity.

Remuneration mechanisms' adaptation to changing circumstances has been a continuous process since their inception. Well-designed and adaptive remuneration mechanisms, such as those in place in Germany, have proven invaluable in driving down costs and driving forward investment. On the contrary, sudden or retroactive changes in support have led to a complete halt in development and have destroyed industries and jobs in the Member States concerned.

The lesson to be drawn from experiences made with the current directive should be that the design of remuneration mechanisms must provide a strong foundation that attracts private investment and ensures stable development of RE. To this end, defining these common principles within a European directive might be useful.

Based on this idea and with sights set towards 2030, the German Renewable Federation has gathered several common principles, which could be anchored in the revised RED and could ensure predictability and security for investors in terms of fair remuneration.

¹ <http://ec.europa.eu/eurostat/documents/2995521/7155577/8-10022016-AP-EN.pdf/38bf822f-8adf-4e54-b9c6-87b342ead339>

Design of remuneration mechanisms

- **Free choice of market-compatible support and allocation instruments:** The Renewable Energy Directive has encouraged Member States to design their price-finding and remuneration mechanisms in a flexible way, heeding to their energy policy choices. The revised directive should continue to allow for differences, and not enforce a one-size-fits-all approach as are tendering systems. Tendering systems are flawed, as has been revealed by international and European experience.
- As regards support, market-based instruments, such as the ex-post market premium, have proven to be efficient in terms of cost and integration of RE. Ex-ante premiums would massively increase risks for renewable energy producers, as well as having no visible benefits, as they would do nothing to change the curtailment behaviour of market players. The sliding market premium combines the highest investment certainty possible with an increased market integration of renewables.
- **Technology specific remuneration mechanisms:** The concept of technology neutrality ignores the need for replacing conventional power plants with a broad array of renewable technologies and ensuring security of supply. Favouring the cheapest technology over others at a particular point in time can lead to an “energy monoculture” and eventually to an inefficient energy system. An “energy monoculture” is more difficult to fit into the overall system than a balanced energy mix, as it requires the development of more grids and storage, as well as other flexibility options. These additional requirements will also lead to increased costs.
- Technology neutrality is a static approach to cost-efficiency: it solely concentrates on the status quo of costs and ignores differences between the learning curves of different technologies. A technology can become cheaper only if deployed, thus rendering the concept of technology neutrality inefficient in terms of dynamic cost-efficiency.
- A qualitative approach is better suited to realizing cost-efficiency potentials, for example tendering a technology mix which would be required to fulfil systemic minimum requirements (still to be defined). The minimum requirements could be gradually increased in order to ensure a steady adaptation of new technologies to the overall system.
- We would therefore recommend that the European Commission enshrine technology specificity as one of the guiding principles of designing remuneration mechanisms.
- **Criteria for decentralised and community power projects:** Future remuneration mechanisms should allow for many stakeholders to participate and compete within the market – however, this is at odds with the introduction of tenders across Europe. If tenders are the instruments of choice, the exemptions allowed for by the State Aid Guidelines should be fully utilised (i.e. including 18 MW for wind power)². This would also require, as a guiding principle of the revised directive, establishing criteria for defining

² Letter Margrethe Vestager, Commissioner for Competition, to Hermann Albers, BWE President, from 06.01.2016.

decentralised and community power projects, which ensures their treatment is equal in every Member State.

- **Innovation factor:** Remuneration mechanisms should incentivise the deployment of a broad array of technologies and foster innovation. If tender systems are the choice of Member States, the directive should allow for innovative technological options to be incentivised either via a special tender or by quantifying their innovative value as part of the technology-specific tender (qualitative criteria).
- **Incentives for flexibility:** An energy system with high shares of variable renewable energy at its core will require much more flexibility than our current system allows for. This, in turn, will lead to the need for innovative solutions on both the demand and generation side, or via sectoral coupling at the crossing of sectors. Storage should also be included as an additional flexibility option. The design of national remuneration mechanisms should reflect this need and offer incentives for employing these innovative solutions.
- **Periodic monitoring and correction:** A monitoring mechanism, as well as clear and fair correction measures, should lie at the core of every well-designed remuneration mechanism. This would discourage Member States from introducing sudden or retroactive measures, which should, based on this principle, be forbidden by the revised directive. In particular, tenders should be carefully monitored, as this instrument cannot sufficiently serve to attain the goals of cost-efficiency, effectiveness and broad public participation in the energy transformation. If tenders do not deliver, they should be halted and replaced by a better functioning price-finding mechanism.

Administrative barriers

- **“Clearingstelle EEG”:** In some Member States, there is still a significant problem regarding grid regulation, specifically in that small project developers are facing difficulties when reviewing possible reasons for the lengthy wait in being granted grid connection, or the reasons why grid connection may be refused. In Germany, the “Clearingstelle EEG” can act as a mediator, a clearing panel that deals with disputes regarding the Renewable Energy Sources Act. Other Member States’ introduction of similar institutions might be a solution to improve grid regulation.
- **Removal of administrative barriers:** As the share of renewable energy increases in the system, so too does the relevance of administrative barriers blocking RE deployment. In this respect, the directive has neither done enough to help reduce the duration of permit issuing and connection procedures, nor simplify them. A common agreement on the removal of administrative barriers - either via a one stop shop or by exempting power plants below a certain size threshold from a permit to connect - could have a very positive impact and complement national remuneration mechanisms.

Financing rules and trade

- **Criteria for bankable community power projects/training for financing institutions:** As is emphasised by the results of the DIA-CORE project, capital costs in the European Union vary from 3.5-4.5% WACC in Germany to 12% WACC in Greece³. They are a function of different risk assessments in Member States and most certainly reflect the size and ownership structure of projects. In Germany, community power projects, supported by the stable regulatory framework, have taken off and have led to a democratisation of the energy transition. Replicating this development in other Member States could entail the definition of criteria for bankable community power projects, and training local financiers to familiarise them with these projects, thus reducing their risk profile and the overall costs of capital.

³ <http://diacore.eu/>