

Is Germany's new offshore wind law fit for purpose?

Following the recent amendment of the German offshore wind law and a plethora of industry players expressing severe concerns, inspiratia looks back at the country's offshore wind history and gives a first preview of what can be expected next. Will it be zero-subsidy bids or nothing?

The German offshore wind market has been one of the foundations of the global offshore wind industry, and the second largest in Europe – after the UK – with a current installed capacity of 7.68GW.

In the beginning of June [2020], the German Ministry of Economic Affairs upscaled its long-term target to reach 40GW by 2040 – an increase from 35GW by the same timeline – and also set an interim target to reach 20GW by 2030. With the already auctioned capacity expected to be commissioned between 2022 and 2025 standing at 3.1GW, the country will need approximately an additional 10GW to reach the interim targets.

To this end, the ministry also published the long-awaited offshore wind law amendment to update the rules for the next auction set for 2021.

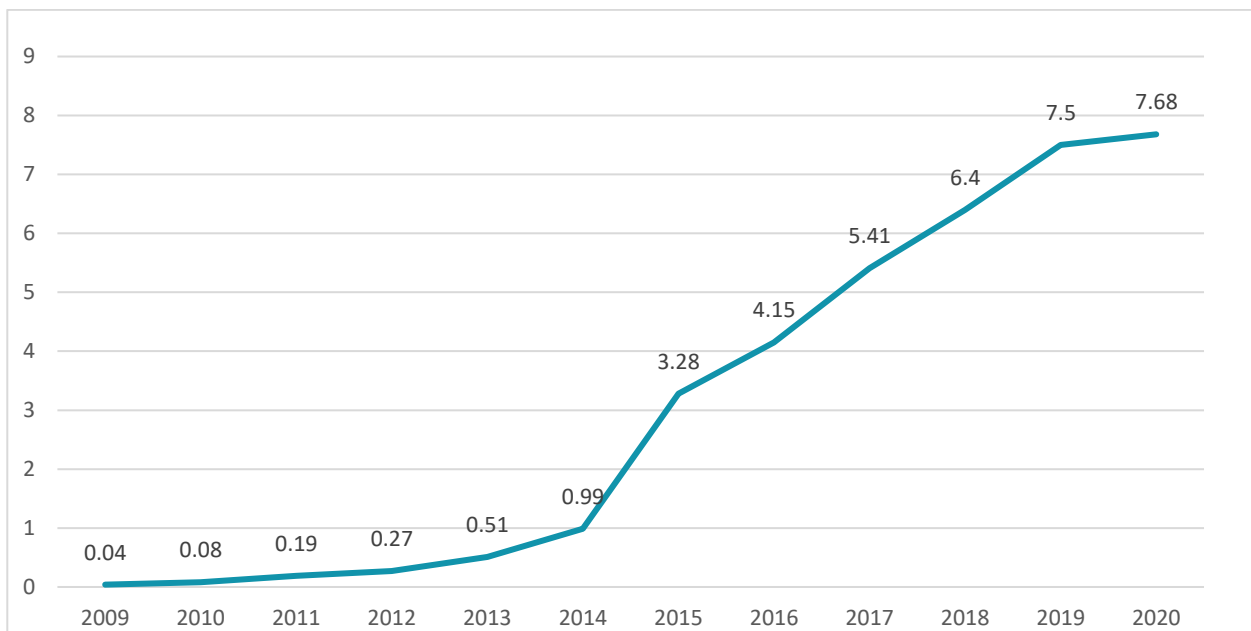
The details sparked reactions from industry bodies and local states, both arguing that the auction design would jeopardise the long-term viability of the German offshore wind sector, and the cost-effectiveness of national electricity prices.

Before we delve into the debate over the auction design, let us take stock of progress up to now.

How were zero-subsidy bids reached in 2017?

Germany's first offshore wind farm was installed back in 2009. Back then, the private sector had to secure project development rights, with the projects then accredited with feed-in tariffs (FITs).

German offshore wind installed capacity, 2009- June 2020



Source: Fraunhofer ISE, inspiratia

In 2017, the German government introduced the first dedicated offshore wind law, which brought with it the introduction of the competitive auction system. The auctions are structured in a pay-as-bid way, where bids incorporate a premium on top of the revenues from the wholesale market prices.

During the country's inaugural competitive auctions in 2017 and 2018, a total of 1.49GW and 1.61GW, respectively, was awarded contracts.

April 2017				
Company	Project name	Capacity	Location	Awarding bid
DONG Energy (Ørsted)	OWP West	240MW	North Sea	€0 per MWh
DONG Energy (Ørsted)	Borkum Riffgrund West 2	240MW	North Sea	€0 per MWh
DONG Energy (Ørsted)	Gode Wind 3	110MW	North Sea	€60 per MWh
EnBW	He Dreiht	900MW	North Sea	€0 per MWh
April 2018				
Company	Project name	Capacity	Location	Awarding bid
Iberdrola	Baltic Eagle	476MW	Baltic Sea	€64 per MWh
Iberdrola	Wikinger Süd	10MW	Baltic Sea	€0 per MWh
Ørsted	Gode Wind 4	131.75MW	North Sea	€98.3 per MWh
Ørsted	Borkum Riffgrund West I	420MW	North Sea	€0 per MWh
Innogy	Kaskasi	325MW	North Sea	Above €46.6 per MWh
KNK Wind (Parkwind)	Arcadis Ost 1	247.25MW	Baltic Sea	Undisclosed

To the surprise of the industry and policymakers, zero-subsidy bids made their appearances in both auctions, meaning that project sponsors asked for no premium on top of the wholesale price. Although this was celebrated by the industry as a great success story for the cost competitiveness of renewables, many industry bodies, think tanks and research institutes expressed their concerns over the long-term viability of zero-subsidy bids for the sector.

German vs British auction design

Zero bids in the inaugural auctions meant that the offshore wind law was due for an amendment since the lowest bid of the previous round becomes the maximum bid in the next one – meaning that the following auctions were doomed to start on a negative bidding basis.

At the time, the industry had already started advocating for a change in the auction design to avoid negative bidding, claiming that this would be catastrophic for the offshore wind industry. Specifically, many voices started pressing for an auction design similar to the British one – that is, a two-side contract-for-difference (CfD) with both a floor and a ceiling element, in lieu of merely a floor price.

According to the German design, when wholesale electricity prices are above the strike price, the project sponsor doesn't get paid the upside – which possibly is part of the reasons why some bidders pursued zero-bid strategies.

It is worth mentioning here that there are a few reasons zero-bids made their appearance in Germany. In the UK, connection and transmission costs are initially assumed by the bidder, contrary to Germany where these are paid by local grid operators. Therefore, zero-bids are very unlikely in the UK anytime soon.

Besides, long lead times for delivery and low penalties for non-realisation in the German model make the adoption of a "wait and see" strategy a bit more feasible. Also, strike prices in Germany are not inflation-linked, contrary to the UK system.

The amendment and market reactions

Despite the arguments, in order to manage the anticipation of further zero bids, the German government came up with a second bid component and continued with the floor price system.

Under the new rules, in case of multiple zero bids, a second bidding round would follow where bidders may be required to submit additional payments.

"With this new design, it's quite obvious that the government's primary objective is to exploit the industry players' willingness to pay," says Simon Matthiessen from renewables financial advisory Green Giraffe.

This revenue is expected to be used for the country's much-needed grid expansion. However, it would also serve a higher purpose, that of the German government trying to alleviate public sentiment of electricity costs being too high due to subsidies for the first wave of renewables being paid by consumers as part of the EEG renewable energy surcharge.

Straight after the announcement of the amended law, industry associations BWO and WAB issued a joint statement reminding the dangers of projects eventually not progressing and not reaching FID.

"The government didn't really want to hear this. They had already decided the second-bid component, and I believe this is due to the short-term orientation of politics. They are not thinking what will be beneficial in the long-term from a policy perspective," says Matthiessen.

On 19 June [2020], energy ministers and senators of the five northern states issued a joint letter addressed to the federal minister of energy, Peter Altmaier, to change the tendering process over fears of increase in electricity prices, and delays in offshore wind deployment in the country. The letter characterises the new amendments more as a threat than an opportunity for project sponsors.

"We have taken important steps when it comes to expanding and planning projects, but we also need those who realise the projects," the letter reads.

Matthiessen argues that a fixed CfD similar to the UK would have been a better solution for both project developers and policymakers.

"The main argument is around cashflow certainty, which would in turn lower financing costs, driving down LCOE for offshore wind," he states. "From a policy perspective, the government had the opportunity to lock long-term competitive electricity prices.

"Rather than offshore wind being a price taker, it could have an impact on the price making, instead of the country relying on imported gas to set the wholesale price," he adds.

Highway to zero-bids?

As mentioned, the pressure to the government for design amendments is not new, and the government has resisted so far.

However, the latest pressure from local governments seems a surprise move that could eventually have an impact, so it remains to be seen whether the federal government would agree to reconsider.

Nonetheless, even in a non-amendment scenario, it is not very obvious that the majority of the sites would attract zero-bids.

"Given the current market environment, and also looking at the three sites that are being tendered in 2021, it's not certain that all sites will attract zero bids," says Matthiessen.

"It's fair to assume that that zero-bids may be the case particularly for some sites in the North Sea, but given the current market price environment, and a fairly challenging private offtake environment, it's not per se given," he adds.

What is more likely, though, is that the auction is expected to attract large players and utilities that would be able to finance the projects on a balance sheet basis, or at least with a need for less leverage. This has been a pivotal argument for the sector and had been stated multiple times from industry players.

"The new system is bringing up an important issue in German renewables, that of the diversity of players," comments Matthiessen.

"Smaller players that would need bank financing may find it challenging to participate," he concludes.

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