Germany’s Renewable Energy Sources Act (Erneuerbare-Energien-Gesetz, “EEG”) already provides that an auction system shall apply to renewable energy remuneration starting in 2017, although the switch to an auction system will require changes to the EEG. On 31 July 2015, the Federal Ministry for Economic Affairs and Energy published its long-awaited “key points” paper relating to the proposed reform. The key points paper mainly relates to the wind and photovoltaic sectors and roughly outlines the Ministry’s current thinking regarding the proposed reform.

Comments may be submitted until 1 October 2015. In fact, the key points paper raises a number of questions which the Ministry specifically asks the market participants to answer. Following the review of the input received in this consultation process, the Ministry will prepare a draft legislative proposal for the “EEG 2016”. The draft is planned to be available by January 2016, when the Federal States and industry associations will be given the opportunity to comment. On this basis, it is intended that a Government’s draft bill (Regierungsentwurf) of the EEG 2016 will be adopted by the cabinet in March 2016, to be passed as law by Parliament (Bundestag) and the Federal Council (Bundesrat) and to be approved by the EU Commission during summer 2016. The first auctions may even start in 2016, at least for some technologies.
OVERVIEW
Energy transition still ranks relatively high on the Government’s agenda. The intention is to increase the share of renewable energy from its current 27.8% to 40-45% by the year 2025, 55-60% by the year 2035 and at least 80% by the year 2050. Besides environmental aspects and security of supply, cost efficiency is an important aim of German and EU energy policy. With the EEG 2016, the Government intends to continue its way of integrating renewable energy into the market and fostering competition in the sector, in line with the EU Commission’s Environmental and Energy State Aid Guidelines.

The remuneration for renewable energy will remain subject to direct marketing, which means that the operator has to conclude a power purchase agreement with an off-taker in order to receive a market premium from the grid operator. Such market premium is the difference between the feed-in value (which currently is defined by the EEG) and the market price. Under the EEG 2016, only bidders that have received an award in an auction will be entitled to the market premium, and the feed-in value will no longer be determined by statute, but by the outcome of the auction proceedings.

The auction design will differ by renewable energy type, to take into account the differing basic parameters of each technology. For each technology, the auction design is meant to achieve three aims: ensuring that the envisaged amount of new capacity is actually built, keeping costs low by ensuring sufficient competition between bidders, and retaining the diversity of developers/operators currently seen in the German renewables sector.

PROPOSED AUCTION DESIGN
Onshore Wind
There will be three to four auctions per year, to allow for a continuous building of additional capacity. It is not intended to impose restrictions regarding the maximum size or permitted areas for eligible wind farms.

Bidders will have to submit sealed bids, i.e. there will be no open auction proceedings. A “pay as bid” mechanism will be used, i.e. the initial feed-in value for each successful bidder will correspond to the individual offer submitted by the relevant bidder. The law will provide for a maximum price, which will take into account the average development costs as well as costs and risks of the auction. The winners of the auction will only be determined by price, i.e. the bid amounts, not by any other factors.

The auction will determine the initial feed-in value. In the current EEG, the length of the period during which the initial (high) feed-in value applies as basis for the calculation of the market premium depends on the wind yield at the relevant site: The actual energy yield of any given turbine is related to a so-called “reference yield”, which is a reference energy yield calculated according to turbine type and hub height. The high value period will be longer for turbines at weaker sites. After the initial high-value period, a statutory base value applies. This reference yield model will in principle be retained, although the calculations will be amended. The suggestion now contained in the key points paper aims at achieving a similar IRR (internal rate of return) for all projects, largely eliminating the effect of the differing wind yields at the relevant site, so that competition between plants in different areas...
is possible. A comparison of the calculations of the Ministry’s advisors to the current reference yield model is set out in the following table:

<table>
<thead>
<tr>
<th>RELATION BETWEEN YIELD AND REFERENCE YIELD</th>
<th>HIGH INITIAL FEED-IN VALUE EEG 2014</th>
<th>HIGH INITIAL FEED-IN VALUE EEG 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>70%</td>
<td>20 years</td>
<td>20 years</td>
</tr>
<tr>
<td>80%</td>
<td>20 years</td>
<td>13.4 years</td>
</tr>
<tr>
<td>90%</td>
<td>16 years</td>
<td>10.6 years</td>
</tr>
<tr>
<td>100%</td>
<td>11.9 years</td>
<td>7.8 years</td>
</tr>
<tr>
<td>130%</td>
<td>5 years</td>
<td>3.9 years</td>
</tr>
<tr>
<td>140%</td>
<td>5 years</td>
<td>3 years</td>
</tr>
<tr>
<td>150%</td>
<td>5 years</td>
<td>2 years</td>
</tr>
</tbody>
</table>

However, other advisors of the Ministry were of the opinion that the current minimum high value period of five years should be retained, in order to ensure that the actual yield at the relevant site can be appropriately determined.

Only projects which already have obtained a permit for construction and operation will be eligible to participate in an auction, and the award will be granted for the specific project. Should the permit be amended or cease to exist later, this will leave the obligations of the bidder unaffected. Also, it will not be possible to transfer the award to another project, even if owned by the same bidder. Accordingly, bidders may prefer to wait until the objection periods applicable to their permit have expired before participating in an auction.

Bidders will have to provide a bid-bond in the amount of EUR 30/kW. The wind farm should be built within two years from the award. Otherwise, penalties will apply successively: For capacity not commissioned within 24 months, a penalty of EUR 10/kW will be payable. After 28 months, a further penalty of EUR 10/kW will be imposed. After 32 months, the remainder of the bid-bond will become due as penalty. If the wind farm is not built within three years, the award will be forfeited. In case the delay only concerns part of the capacity, the penalties and loss of award will apply pro-rata.

This auction design with high pre-qualification requirements but relatively low bid-bonds is intended to be suitable for smaller developers, and thus to comply with the aim of preserving diversity of market participants: The Ministry considers that smaller developers should be able to obtain bank financing and guarantees for their bid-bonds when their permit is already in place at the time when they participate in the auction. For the consultation, the Ministry inter alia asks the question whether or not it should be possible to participate in the auction before a permit was granted if a higher bid-bond is provided, e.g. EUR 100/kW.

It is still under discussion whether or not special rules are necessary for participants which only aim at developing one single project, e.g. in a specific municipality. For
such cases, the Ministry considers special rules within the auction process or an additional support programme.

Wind energy turbines with a capacity of less than 1 MW will not need to participate in auctions in order to receive a subsidy. The same applies for prototypes and test plants.

**Offshore Wind**

A fundamental change is envisaged, namely a switch to a centralised system, where the state pre-develops a project at a certain location, and developers then bid on that specific project – similarly to the system already used in Denmark and currently also being introduced in the Netherlands. The Ministry has considered two alternative models where projects at different locations would compete in the auctions. One of these models would retain the decentralised project development as well as the current planning mechanism for offshore grid connections, but the Ministry is of the opinion that such model would not create sufficient competition for effective auctions. In the other alternative, projects would compete regardless of grid connection planning, and the winning projects would obtain a grid connection. However, the development and construction of grid connections currently takes too long for such system to be effective, which is why the Ministry prefers the centralised system.

In the proposed centralised system, it is envisaged that two wind farms will be pre-developed annually, e.g. with a capacity of 400 MW each. Such pre-development shall comprise, *inter alia*, the strategic environmental assessment, the assessment of environmental and other effects at the specific project site, the initial soil investigation, an analysis of the collision risk for nautical traffic, and wind studies. The data obtained shall be sufficient to file an application for planning approval of the offshore wind farm. The successful bidder will have to bear the costs of the pre-development.

It is intended that the grid connection will be developed in parallel, so that the grid operator can start EU tender proceedings for the components of the grid connection already during the pre-development phase. The Ministry hopes that this should reduce the time lag between an award in an EEG auction and start of construction of the offshore wind farm to approximately three years. The Ministry intends to investigate further possibilities to speed up the construction of offshore grid connections.

Because of the time required for the pre-development, the key points paper provides that the new system shall first apply to offshore wind farms in the North Sea to be commissioned in 2024, and in the Baltic Sea possibly already for wind farms to be commissioned in 2021. Wind farms under development which will be commissioned before 1 January 2021 may be protected by a transitory provision (see below).

For wind farms in an advanced stage of project development which are planned to enter into operation in the years 2021 to 2023, a special solution is suggested: A one-off auction with special conditions is intended for such wind farms. Such one-off auction will be open to projects with a final permit or in an advanced stage of the permitting procedure for project sites in the North Sea in zones one and two (i.e. relatively near the shore), and which are positioned in the reach of a grid connection which has either been ordered by the grid operator or is at least
confirmed in the offshore grid development plan. In the Baltic Sea, the requirement regarding the grid connection can be disregarded.

Start-of-construction deadlines in the permits which end before the auction date will be extended so that the permit will not expire before the auction. However, projects with start-of-construction deadlines expiring after the auction date will not be extended in advance of the auction. After the auction, only projects which have obtained an award may benefit from an extension of the deadline. In this way, project sites may become available for the centralised system, or in other words: operators may lose their permit which expires if start of construction does not occur by the deadline date. This would be contrary to previous practice, where extensions for start-of-construction deadlines were usually granted, provided that the project progressed and the revised date stayed in line with applicable deadlines under the grid connection regime.

The Ministry estimates that projects with a total capacity of approximately 5.5 GW will be eligible for the one-off auction, whereas only a capacity of less than 2.4 GW will be available in the auction. Eligible projects which are not successful in the one-off auction may receive compensation. The amount will be determined by statute and shall take into account the average costs of project development. To receive the compensation, the developers must renounce to their rights under the permit and must provide the data obtained during the project development to the State, so that the relevant site can then be used in the centralised system.

It is currently envisaged that the outcome of the auctions in the centralised system (and likely the one-off auction, although this is not expressly mentioned) will be determined by the bidding price only, although the key points paper mentions that the Ministry is still evaluating alternatives. The key points paper does not yet contain further detail on the auction process for offshore wind. As a first step, the fundamental change towards a centralised system and the one-off auction for projects in an advanced stage of development are now presented for consultation, with detailed suggestions regarding the auction design only to follow at a later stage.

**Photovoltaics**

For open-space PV plants, an auction procedure is already in place. It is intended that PV plants with a capacity of more than 1 MW which are placed on physical structures other than buildings (e.g. on waste disposal sites) will in the future participate in the same auctions as open-space PV plants.

For PV plants with a capacity of more than 1 MW on buildings, separate auctions will take place. PV plants which obtain an award in the auction process will have to feed their entire production into the grid, i.e. self-consumption will not be allowed. This is because the Ministry suspects that otherwise the plants with the best self-consumption rate would win in the auction, instead of the most cost-effective plants. The Ministry argues that the prohibition of self-consumption which already applies in open-space PV plant auctions needs to be transferred to PV plants on buildings, to obtain a level playing field. However, as the intention is to have separate auctions for PV plants on buildings, this argument does not seem convincing.

To be eligible for the auction for PV plants on buildings, the bidder will have to specify the location of the PV plant and has to submit bid-bonds (in the same
amounts that currently apply for open-space PV plants, namely EUR 4/kW when submitting the bid, and EUR 50/kW if the bid is successful). For open-space PV plants, an additional pre-qualification requirement exists regarding the status of the land development plan. Such requirement would not make sense for PV plants on buildings, which usually are not the subject of a land development plan. Similarly to the existing rules for open-space PV plants, construction deadlines will apply, the breach of which will lead to a penalty and ultimately to the loss of the award.

However, the Ministry is considering shorter construction periods of only 9-12 months for PV plants on buildings, based on the consideration that the construction of PV plants on buildings in most cases does not require a construction permit. The Ministry also considers to restrict the possibility to use the award for another project of the same bidder, or to return an award within nine months at a reduced penalty, because in the case of PV plants on buildings, less obstacles to construction should arise than in the case of open-space PV plants.

For PV plants on buildings as well as for open-space PV plants, the awards will be granted on a pay-as-bid basis, with participants to submit sealed bids. A maximum price will be set for the auctions. To ensure a continuous project development, three to four auctions per year will take place.

It is intended that PV plants with a capacity of less than 1 MW will not be subject to the auction process, i.e. the rules of the current EEG 2014 regarding the statutory feed-in value as well as the rules on self-consumption will continue to apply for such smaller plants. Such exception is permitted by the EU Commission’s Environmental and Energy State Aid Guidelines.

Other renewable energy sources
It is currently not intended to include other types of renewable energy into the auctions. This is because few new projects can be expected in the future for hydropower, geothermal and mine gas, landfill gas and gas from purification plants, so that there would not be sufficient competition for successful auctions. Such plants will therefore continue to benefit from the current rules.

For biomass, the same applies regarding new plants. Given that biomass in principle is an expensive technology, the existing EEG no longer incentivises the construction of large-scale biomass plants. However, the Ministry will investigate further whether or not auctions including existing plants may make sense. The subsidised period will end in the foreseeable future for a considerable number of biomass plants. It may turn out to be efficient to continue to use or even to enlarge existing plants for the production of electricity, instead of constructing new plants of cheaper technologies. The preparation of such decision will require further studies and the matter will therefore likely not be decided in time for the upcoming reform. Possibly the revised EEG will allow the Government to introduce biomass auctions by way of an ordinance, so that the introduction of auction proceedings for biomass would not require the full legislative procedure.

SUPPORT FOR FOREIGN PLANTS
The EEG 2014 already provides that at least 5% of the annual auctioned capacity shall be open to bidders from other EU countries. As a test, the pilot auction proceedings for open-space PV capacity shall be opened to foreign bidders, provided that certain conditions are met: There must be an agreement in place between Germany and the relevant other EU country, the electricity must be...
physically imported (or have a comparable effect on the German electricity market) and the cooperation must be mutual. The Federal Ministry for Economic Affairs and Energy currently works on a draft ordinance to regulate the details. Following the outcome of the test, which is intended to take place during 2016, the partial opening of auctions to foreign bidders from 2017 onwards shall then be included in the revised EEG.

TRANSITIONAL PROVISIONS
The EEG 2014 already contains transitory provisions for the switch to the auction system. The following plants shall not be affected by the introduction of an auction model:

- Offshore wind turbines that have received an unconditional grid connection confirmation or an allocation of connection capacity before 1 January 2017 and have been first commissioned before 1 January 2021; and
- All other plants (except open space PV plants) that have received a required permit under federal law before 1 January 2017 and have been first commissioned before 1 January 2019.

OUTLOOK
The key points paper is a first step in the proceedings towards a revised EEG 2016 which will continue the efforts to make the support mechanisms for renewable energy more cost-efficient and market-oriented, at the cost of increased complexity.

The suggestions set out in the key points paper are not yet carved in stone. While a number of experts and industry players have already been heard during workshops held by the Ministry, the suggested key points will still be subject to political discussion. In its paper, the Ministry asks a number of questions and will evaluate the answers after the public consultation period. The Federal States may then also have a view on a number of details which may affect their interests, as was the case for previous amendments of the EEG.

Many aspects, especially regarding the future regime for offshore wind, will only become clearer during the further reform process. These details, especially regarding the compensation for developers that lose their projects due to the change to a central system, will also largely determine whether or not the proposal will be acceptable to the industry. Otherwise, litigation under German law as well as under international investment rules such as the Energy Charter Treaty may be expected.
FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.

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