The opportunities of the Modernisation Fund for the energy transition in Central and Eastern Europe.

State of play and implementation issues

Bucharest Workshop on 23 January 2019

Summary and Conclusions

The Bucharest Workshop on the Modernisation Fund was organised on the 23rd of January by the Centre for European Policy Studies (CEPS), the Energy Policy Group (EPG) and the Romanian Energy Centre (CRE). The workshop was attended by 21 participants representing energy and industrial companies, national authorities and civil society organisations. The objective of the workshop was to discuss the opportunities that the new Modernisation Fund represents for the transition to low-carbon energy systems in Central and Eastern Europe.

Christian Egenhofer (CEPS), Radu Dudău (EPG) and Mihai Macarie (CRE) presented the introductory remarks on the general context of the European Union commitment to the decarbonisation of the economy and the transition to low-carbon energy systems.

A discussion paper by Mihnea Cătuţi and Milan Elkerbout focusing on the purpose and the *modus operandi* of the Modernisation Fund was presented.

The Modernisation Fund

What is it for and how is it financed?

The Modernisation Fund is a part of the post-2020 reform of the EU Emissions Trading System (ETS) for its fourth trading. It is an instrument for enabling investments in small-scale energy projects, improvements in energy efficiency, and the modernisation of energy systems in lower-income member states, with a GDP per capita of less than 60% of the EU average. The following countries will be beneficiaries: Poland, the Czech Republic, Hungary, Croatia, Slovakia, Estonia, Lithuania, Latvia, Bulgaria, Romania and Greece[1].

The fund will be financed through the auction of up to 2% of the total EU ETS allowances (EUAs) for the period 2021-2030 (approx. 310 million, estimated to be worth between €6.2 billion and €9.3 billion)[2]. Each individual member state will have a fixed allocated share from which projects can be financed (the share of Romania represents 11.98%[3] of the fund, i.e. €928.45 million)[4]. The fund can be used for coal power plants only in the case of refurbishments of existing coal power plants for district heating in countries with a GDP per capita lower than 30% of the EU average (i.e. Bulgaria and Romania).

How does it function?

Member states must send project proposals to the European Investment Bank (EIB) and to an investment committee made up of the ten eligible member states, the European Commission, the EIB and three representatives of the non-eligible countries.

Eligible projects can fall under two categories:

1. **Priority projects**, for which at least 70% of the fund will be allocated. These are investments in renewable energy, energy efficiency (including in transport, buildings, agriculture and waste), energy storage, interconnections and just transition in carbon-dependent regions (supporting redeployment, re-skilling and up-skilling of workers, education, job-seeking initiatives and start-ups). Can be financed up to 100%;
2. **Non-priority projects**, which must be in line with the EU 2030 Climate and Energy Policy Framework and with the long-term objectives as expressed in the Paris Agreement. In this case, there are two possible scenarios. Can be financed up to 70% of the project costs (provided that remaining costs are financed by private legal entities[5]).

Main discussion points and outcomes

- ❖ The Modernisation Fund offers a unique opportunity for Romania (i.e. government, industry and other stakeholders) to assist the modernisation of the Romania industry by improving carbon-efficiency and embarking on a general modernisation to gradually move towards a lower-carbon economy.

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[1] Greece, given these precise rules, would narrowly miss out on eligibility, as it only fulfilled the GDP per capita criterion from 2014 onwards. This has been addressed by conditionally making available another 25 million allowances, to be auctioned under the same rules as those for the Modernisation Fund.

[2] Estimation based on prices of €20/EUA and €30/EUA.

[3] The size of the allocated fund for Romania can be increased through transfers from the Solidarity Provision.

[4] Calculated at 25€/EUA, as it represents the upper bound of the recent trading range in late 2018 – early 2019.

[5] Further clarification on this are expected in the European Commission's implementation acts for the Modernisation Fund.

Thus, for example, the fund could well support the efforts of the Romanian power generation companies, which are mostly owned or controlled by the state and operate on mono-fuel structures, to diversify their generation portfolios with renewable or other low-emissions capacities. It could also finance energy efficiency projects, which currently lack a financing platform in Romania; thus, it could co-finance projects selected by a much asked-for National Energy Efficiency Fund. And it could certainly support energy infrastructure and storage projects that are crucial to the clean energy transition.

- The participants agreed that the Modernisation Fund must be well aligned with the NECPs, in terms of policy priorities and measures. NECPs are energy and climate strategies that delineate the path a member state takes and set the speed it want to move to achieve its goals. As such, NECPs will reveal potential inconsistencies and incompatibilities between short- and medium-term energy and climate policies and long-term objectives.

  Meanwhile, the fund ought to support projects that can bring substantive contributions to EU's long-term decarbonization objectives, i.e. for 2050. The latter, as well as the steps to achieve them are currently under discussion. The European Commission has kicked-off the debate with the its November 2018 publication of communication *A Clean Planet for All.* A European strategic long-term vision for a prosperous, modern, competitive, and climate neutral economy[6]. This strategic vision sets out different pathways for the EU's long-term climate policy, i.e. with a view to 2050 and beyond. It can be seen as an update of the 2011 roadmap for a low-carbon economy, which established a 2050 target of 80-95% GHG reductions.

  The 2018 long-term vision suggests that this target should be strengthened to one of net-zero emissions by 2050. This would require a combination of technological pathways, including electrification, hydrogen, power-to-gas/liquids, energy efficiency, circular economy and negative emissions technology including carbon capture and storage. While not legally binding, the strategy indicates a long-term direction to which binding climate and energy measures with shorter time horizons would ideally be compatible.

- Another topic for discussion was the entirety of EU ETS funding instruments, first those related to EU ETS instruments that Romania has at its disposal: Modernisation Fund, Solidarity Provision, Article 10c derogation (transitional free allocation to the power sector). Coherence needs to also be ensured with other general EU instruments (i.e. European Structural and Investment Funds, Connecting Europe Facility , SET-plan, Horizon 2020, LIFE, COSME, the European Fund for Strategic Investments), but also with national investment plans.

  The way the Solidarity Provision will be used by Romania has direct implications for both the Art. 10c derogation and for the Modernisation Fund. Therefore, it should be used as part of a wider strategy for maximising the utility of the EU ETS instruments. Eligible member states can transfer their allocated allowances form the Solidarity Provision to the Art. 10c derogation and to the Modernisation Fund, provided that the transfers to the former cannot be higher than to the latter. Through this provision, Romania could increase the amount of allowances used for Art. 10c derogation to a maximum of 60% of its total allocated amount of allowances.

[6] COM(2018) 773 final, Brussels, 28.11.2018

Moreover, beneficiary member states have the option of transferring any amount of allowances form the Solidarity Provision and Art. 10c derogation to the Modernisation Fund. Consequently, an early and coherent strategy needs to be developed, based on Romania's intended use of the Art 10c derogation and on a potentially larger Modernisation Fund. Such a strategy should aim to use the Art10c derogation for short and medium term goals, while the Modernisation Fund should finance the long-term objectives of Romania.

Romania's Governmental Decision 1096/2013 established a mechanism of free allocation of ETS allowances for power generators in the 2013-2020 timeframe, according to the exemption granted by Article 10c of the ETS Directive 2003/87/CE, as well as the National Investments Plan, meant to support investment in modernisation of electricity production assets. So far, the construction of two gas-fueled power plants and the refurbishment of two lignite-fired ones have been approved from payments from the National Investments Plan.

Way forward

One important conclusion has been that there is a need for a dialogue between the Ministry of Energy and private and public stakeholders to discuss objectives and priorities in line with the long-term objectives of Romania and the EU.

The participants proposed establishing an informal group on the Modernisation Fund with the purpose of engaging in constructive dialogue with the Ministry of Energy and other relevant authorities. The group, which would function in a transparent and inclusive manner, has the purpose of supporting the Energy Ministry in the elaboration of a national Roadmap on the Modernisation Fund's use and operation.

Thus, the informal group will be instrumental in ensuring an active coordination between the public and private stakeholders, through working sessions and public communications – position and policy papers, green and white papers, etc. Ultimately, the process is meant to facilitate the optimal legal transposition of the Modernisation Fund's mechanisms.