OFFSHORE WIND OFFERS A LEGAL PIPELINE

AS EUROPE PUSHES FOR MORE AMBITIOUS DECARBONISATION TARGETS, OFFSHORE WIND CONTINUES TO GROW AS AN ATTRACTIVE ASSET CLASS. AUCTIONS AND SUPPORT MECHANISMS THAT HAVE PROVEN SO SUCCESSFUL IN WESTERN EUROPE ARE NOW BEING ADOPTED IN NASCENT SECTORS FURTHER EAST, PROVIDING NEW OPPORTUNITIES FOR SEASONED LEGAL ADVISERS. BY PETER COLLINS AND JORDAN BINTCLIFFE.

For lawyers familiar with the offshore wind markets of Western Europe, their experience should prove to be a valuable asset to the East, as the Baltic States signal their strong intent to develop the wind potential of their northern coastlines.

Poland plans to support 5.9GW next year, Lithuania will auction 700MW in 2023 and another 700MW in 2025, and the governments of Estonia and Latvia have signed a memorandum of understanding (MoU) on the joint development of an up to 1GW wind farm. Though it is not all plain sailing for these new markets – an auction in Turkey for a 1.2GW scheme was recently scrapped and privately-procured projects in Estonia lay "dormant" – early excitement has been generated by the similarities of the support mechanisms to the tried-and-tested Western models.

A third and likely final version of Poland's offshore wind law is supposed to be passed before the end of the year, although it could slip to January. The law, described as comprehensive and timely by market actors, sets out an ambitious 10GW to be awarded under a contract for differences (CfD) structure.

"A CfD was always the main model from which Poland's framework was designed," said Piotr Ciolkowski, energy partner in CMS's Warsaw office. "The starting perception was that the UK system would be the most suitable for Poland."

Poland has run auctions successfully since 2017 – albeit with some minor technical hiccups to begin. The pace has picked up in the last two years, with a string of onshore wind and solar projects financed since May 2019. The 15-year tariff is structured essentially similar to a CfD, with guaranteed price floors providing certainty to sponsors and lenders.

An offshore wind "basket" has existed in past auctions, but for all intents and purposes its inclusion has been purely symbolic.

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"The existing auction system is not fully adjusted to the needs of offshore projects," said Ciolkowski, as the larger, more expensive offshore projects will typically require longer tenors and offtake agreements, which the offshore wind law provides with 25-year contracts.

Europe's commercial banks are comfortable with the market and ready to get involved. The long tariff period is encouraging, but some concerns do remain. Currency denomination is obviously a factor, as the bid bond and tariff will be denominated in zloty and the question will be whether banks have enough capacity to lend in local currency.

"Offshore wind developers are really looking at Poland seriously, not only investing but investing early," said Thomas Schubert, a partner at Dentons' Berlin office. Indeed, Orsted, Equinor, RWE Renewables, EDPR and E.ON – among others – have all struck partnerships with local utilities or begun developing their own projects and many will be among the first in line to secure a CfD. A revised draft of the law released this summer increased the maximum capacity from 4.6GW to 5.9GW in the first phase in response to the high levels of interest.

Eastern Europe's offshore wind market hasn't yet lived up to investors' ambitions however.

"Offshore wind in Eastern Europe has had a lot of attention in the past five years, although this does not in all instances seem reflective of the traction it has gotten in real life," said Malte Jordan, global energy sector co-head and a partner in Watson Farley & Williams' corporate and M&A group based in Hamburg. WFW has instructions from developers in both Poland and Estonia.

"We are involved in the Eastern European offshore wind marking by using correspondent local firms," Jordan said. WFW's strategy is to bring its in-sector experience to bear while teaming up with native firms that bring experience of local law.

Despite showing promise, the industry doesn't yet have the draw to bring international law firms in of their own accord – although they are following their key clients into the region, according to Christian Knuetel, partner in Hogan Lovells' Hamburg office says.

Hogan Lovells is working on an "opportunistic basis", Knuetel said, when it comes to entering Eastern Europe – as the team is already being kept busy on mandates in Taiwan, Germany, Vietnam and the US. He added that the firm's strategy is more about following existing clients into the markets where they want to be active.

"It's a question of who would be your clients if you enter a new market," Knuetel said. "If you enter a market and target local developers and make them your client, you'll typically see things will really speed up only when the international developers are moving in, buying stakes and partnering up with the local developers."

In Knuetel's view, the most efficient and promising strategy is to team up with large, international firms and to be on their radar when they do pull the trigger to enter a new geography, rather than having boots on the ground to build clients in a new country or region.

"In the end, the ones deciding which law firm to use tend to be the international developers, so typically the most efficient and promising strategy is to team up with them and to be on their radar when they need help on a project, rather than doing grassroots work in the country itself," he said.

Knuetel said Hogan Lovells is already active on a mandate in Poland with a large German company that has entered the market and partnered with a local developer, buying a stake in their developments. This is likely to be the primary route of entry for international firms – on a cooperative, rather than competitive basis.

This was the view of Sergej Butov, a partner at Sorainen, which advised Ignitis Grupe on the formation of its offshore wind partnership with industry heavyweights EDPR and Engie in Lithuania.

"For some phases of the work, the presence of international practices will be very much needed to follow the good examples set by other countries," said Butov, who added that Engie and EDPR would be likely to bring in an international firm to partner with the local lawyers. "Since the first 700MW was announced, there has been lots of positive attention – we've received many calls and emails from European and UK firms. This is what's building the excitement for the sector," he said.

In terms of which market holds the most appeal, Poland appears to have the greatest draw. Although Latvia, Estonia and Lithuania are showing promise, "they don't have a comparable amount of funds and as much need to transition to green from brown like Poland does," according to Knuetel.

Poland has other elements in its favour too – including strong wind resources and good environmental and site conditions.

"Poland is also in a good position because its support industry is already very developed, with the exception of turbine manufacturing," said Ciolkowski, another area of advantage for the Polish market over its eastern neighbours.

Countries that are now beginning to pursue offshore wind could look at some of the historical events in the now more established markets. Offshore wind developers in Germany such as Siemens and RWE faced problems with their projects not being grid-connected in time to begin operations.

A lack of definition regarding grid operators' liabilities to connect the new offshore wind projects meant that in its early days Germany's offshore wind boom was close to finishing before it had even started. At the end of 2011, North Sea grid operator TenneT said it was becoming increasingly difficult to finance new grid connections and that it would not be able to connect new wind farms to the grid after 2015 under the then regulatory framework.

At one point, newly built offshore wind farms were consuming energy. Diesel generators powered some turbines to keep them moving and prevent corrosion in the salty sea air, local daily Der Spiegel reported in 2013. The turbines created more power than was needed to start them up, and with no grid connection it was not possible to dispose of the surplus.

Developing a stable regulatory framework is clearly needed in order to successfully foster a new industry. A clear pipeline of upcoming opportunities is also a help, Daisy East, a London-based partner in Watson Farley & Williams' energy group said:

"One of the hard-learnt lessons is that uncertainty around the regulatory environment makes it very difficult to build the volume of transactions that you need to bring costs down. That uncertainty can include changing regimes from one support system to another."

Auctions need to have low cost barriers to entry, to ensure enough companies take part and encourage competition – which in turn will reduce costs over the long-term.

"If the costs of getting to auction are prohibitive in the context of allocation risk, then there will be a reduced number of players taking part," East said. "So regulatory arrangements over how the grid connection, consenting, the mass spatial planning of wind, wake effects and so on will all work – these are all required in order to bring costs down and create a competitive market that isn't dominated by just four or five names."

Encouraging investment into local economies is a key consideration when developing a regulatory regime. In Germany's case, "there was an understanding right from the beginning that if you want to be seriously involved in offshore wind that means significantly upgrading local infrastructure such as factories, supply chains, and so on," said Jordan.

"In order to get the private sector to invest in these kinds of developments, there needs to be a reliable project pipeline and developers need to be sure of what kind of volumes are being tendered, for example. If you don't provide any certainty about tendered volumes, that's clearly a problem."

In some newer markets, such as Turkey, local lawyers feel they have the legal capabilities and experience to work on these projects – the missing link is technical expertise. Mustafa Durakoglu, partner at Turkish firm Cakmak, said the reasons a planned 1.2GW offshore wind auction was recently scrapped were the project's size and technical inexperience among local investors and advisers.

"The project was too big, and a lack of measurement and site data made it very difficult for potential bidders to identify the risks involved in a very limited period of time," he explained, adding that "any winning bidder would have to face a lot of 'firsts' from legal, regulatory and technical perspectives, which is a huge burden."

"Turkish lawyers have experience in designing successful frameworks, but the difficult part is to make thorough technical risk analysis."

On the legal side, there are plenty of international firms with a Turkish presence that will be both used to issues unique to offshore wind as well as to the Turkish YEKA and YEKDEM support systems – on which the planned offshore support is based. Indeed, some law firms are finding that much of their experience in existing markets is applicable to the newer Eastern European markets as they open up.

"How to do a turbine supply agreement or a balance of plant contract, or whatever the procurement strategy is, is about 90% the same across the world. And then the rest tends to be specialist, local stuff like earthquakes or typhoons in Taiwan, local content, fishing rights, or regulatory issues. So these are areas where you need to custom tailor rather than bluntly applying your experience earned in Western Europe," Knuetel said.

The contractors and suppliers involved tend to be the same all over the world, and they often have similar asks, concerns, and approaches as to how they do things – which add further familiarity to deals in new locales.

The auction procedures and CfD or CfD-adjacent structures add another level of confidence, with trends pointing towards the mechanism becoming widely regarded as the fairest and most reliable for offshore wind.

"Over time, even more established markets will move to a CfD," opined Dentons' Thomas Schubert.

There is some pressure on firms' rates, but the biggest pressure is on caps or lump sums for certain phases of work.

"Generally speaking, we see firms bidding extremely aggressive caps which they know won't work, but it's still attractive for the client because it looks as though its better value," Knuetel said. "So the question is do you under-price intentionally from the outset in order to get the job and then manage the problem when you get in, or do you pursue the more straightforward approach with a realistic cost projection?" ■

Aerial view Dutch landscape with offshore wind turbines along coast. © T.w. Van Urk | Dreamstime.com