

# ***THE ROLE OF LAW IN FINANCING OFFSHORE WIND: GOING AGAINST THE TIDE OR FEEDING THE STORM?***

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## **Overview**

The International Energy Agency has calculated that in order to meet future energy demand by low-carbon supply worldwide investments are required of \$3,5 trillion annually. The states bordering the North Sea have established that further development of energy projects at sea is essential for security of supply and to reach climate change goals, reducing CO<sub>2</sub>-emissions and increasing renewable energy production. The North Sea area will play a vital role because of the potential to produce electricity from especially wind, but also the tides and waves, to store CO<sub>2</sub> in depleted hydrocarbon fields and to construct trans-European transmission infrastructure. Considering the costs of offshore projects, wind farms usually exceed €1 billion and electricity interconnectors €500 million, any reduction in the cost of capital results in a significant reduction of overall project costs which can be invested in other renewable energy projects.

Law and policy should stimulate investments in such projects. In addition, governments should financially support the road to economic viability of promising technologies where possible. This contribution will address in which ways the law can either support or hinder investments in renewable energy sources and legal rules which influence the cost of capital. The law plays a crucial role in the both attracting investors and cost of capital in general as investors most prominently require legal certainty and because the law can be an important tool to allow for the hedging of different risks the project encounters during its lifetime. The result is the identification of a number of legal instruments which can be used by legislators in both developed and developing countries to attract investors and potentially lower the cost of capital. The legal issues touched upon range from international investment law to European law and national property law.

## **Methods**

In order to establish the issues which are encountered in practice, informal interviews have been held with bankers and lawyers active in (project) finance in different jurisdictions. To establish the legal issues envisaged in academia a literature review has been carried out. The Dutch offshore wind sector has been taken as an example and is compared to other jurisdictions to establish strong points, weak areas and possible alternatives for regulation. The resulting knowledge of the practical legal issues and strong suits of energy finance in different jurisdictions allowed for the identification of best practices which can be applied in other jurisdictions. The lessons drawn are relevant for any state which wishes to attract foreign direct investment in the renewable energy sector, of which some apply specifically to offshore wind.

## **Results**

The interviews, literature and comparative legal research resulted in the following. Firstly, policy uncertainty is the primary reason for institutional investors to decide against investing. Secondly, there is a range of legal matters which influence investment decisions and the cost of capital. Thirdly, in some cases essential financial matters are not provided for by law while the necessary legal changes could adopted be without having detrimental side-effects.

An overview of different legal barriers to investments has been made on the basis of this research. Where required, further legal research has been carried out to find legal solutions for the problems encountered. The issues include the opening of markets and investment protection through international investment law, the costs of local content requirements, the benefits of guaranteed market access and priority dispatch, different manners in which subsidies can be provided by government, the benefits of long term, clear agreements between government and industry and the protection of subsidy streams from influence of a change in government.

An important issue raised specifically concerning offshore wind is the impossibility to establish security rights, such as a mortgage, against the installations at sea. The main reason for this issue is the rule of private international

law *lex rei sitae*, which provides that the law of the state where property is located applies to that property. This is an issue when installations at sea are located beyond the territorial sea, which is limited to 12nm or 22.2 km from the coast. The reason therefore is that beyond the territorial sea, international law provides that the coastal state has an exclusive economic zone (broadly limited to 360 km off the coast) in which does enjoy jurisdiction to regulate the construction of offshore wind farms while the sea bed is not part of the territory of the coastal state. The result is that many wind farms are located in this area between 22 and 360 km off the coast where the sea bed has no owner. In combination with the aforementioned *lex rei sitae*, which applies in roughly 150 states, this means that there are no property laws which apply to these installations. Thus, no property laws apply and security interests such as mortgage cannot be established. These security interests are of foremost importance to investors to be ensured of repayment of their loans in case of insolvency. The reason why wind farms are still financed in practice is that all other assets of the companies holding the wind farm license, including the shares of the company where it concerns a special purpose vehicle, are included in the security package granted to the lenders. The validity of a number of the security rights usually established in such deals, however, is uncertain and thus may not hold up when challenged in court. Moreover, these alternatives do not provide the lenders with an as strong and certain rights as a mortgage would. Therefore, all barriers to establish mortgage against offshore installations have been researched and three alternatives for legislators to close this gap have been formulated.

## Conclusions

For large scale energy projects, legal and policy certainty are paramount to attract investors. There is a range of legal instruments which can either hinder investors and increase the cost of capital and on the other hand there are others which could increase investor appetite and decrease the cost of capital as they decrease the risks involved for investors. The overview of legal issues which this research includes is particularly relevant for developing countries who wish to attract (foreign) investors, while a number of the points on the list are also of significant importance for developed countries. The main reason therefore is that the total investments which have to be made in developed countries to transition towards a low carbon energy system are astronomical while the available budget and burden which the tax payer can handle are limited. Any reduction in costs can thus result in billions of euros of savings, allowing for additional projects to be realized. Moreover, a reduction in the cost of capital results in a larger reduction in a larger reduction of the LCOE and thus reduces costs on both sides.

Specifically as regards the offshore energy sector, there are issues with establishing a mortgage against installations at sea. The basic rule of private international law, the *lex rei sitae*, applies in 150 states. The result is that these states have to adopt specific legislation dealing with property laws beyond their territorial sea. I have formulated three proposals in order to allow for the establishment of security rights against installations at sea. The results are not only useful for the offshore wind sector, but for any activity at sea such as electricity production from the waves, interconnection, CO<sub>2</sub>-storage or other re-use of existing oil and gas platforms, pipelines and fields. Especially as regards CO<sub>2</sub>-storage and interconnection the governments controlling the natural resources of the North Sea have significant plans which include large scale storage and building an island on the Doggersbank. Also in these cases, any decrease in the cost of capital resulting from laws which can be adopted without having a negative impact should be adopted as soon as possible.

## References

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