

ERCST Feedback to the European Commission Delegated Regulation amending Delegated Regulation (EU) 2019/856 supplementing Directive 2003/87/EC of the European Parliament and of the Council with regard to the operation of the Innovation Fund

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ERCST welcomes the opportunity to participating in and contributing to the on-going consultation on the Innovation Fund, following the revision of the EU ETS Directive. The Innovation Fund (IF) is a key instrument to support the decarbonisation of EU economy. Providing the right incentives is key to deploying low carbon technologies required to achieve Net Zero.

As a member of the Innovation Fund Expert Group, the ERCST recognises the potential of this tool to trigger economic change among participants, setting the frontrunners for the deployment of key technologies supporting climate ambition goals.

Among the proposed Delegated Regulation's positives:

- **ERCST considers that re-defining small and large-scale projects' sizes and introducing a new category for medium sized projects is a welcomed experiential gain increasing efficiency.**

Currently, two types of projects are foreseen under the scope of the Innovation Fund: small scale projects (up to EUR 7.5 million) and large-scale projects (above 7.5 million).

The European Commission proposal introduces changes both in the threshold and in the categories in place. The new framework encompasses small-scale projects (up to EUR 20 m), medium-size projects (EUR 20 m to EUR 100 m), and large-scale projects (above EUR 100 m).

So far, small-scale projects have been undersubscribed compared to large-scale ones.¹ The introduction of a medium-sized category, coupled with an increased minimum threshold for classification as a large-scale project, holds promise as an effective approach to attract a larger pool of small scale-sized projects applicants and enhance representation between similar size brackets.

- **Participation in a two-stage application procedure can provide a higher degree of flexibility.**

A description of the application procedure, specifying whether a one-stage or two-stage procedure applies, is to be defined in the specific calls (Article 9(2) IF Draft Delegated Act).

A two-stage application procedure comprises of 1) expression of interest stage, and (2) full application stage. During the full application stage, the applicant shall submit the supporting documentation.

¹ As of April 2023, the total funding of small-scale projects amounted to EUR 109 million, compare to EUR 2.9 billion of large-scale projects. Source: Marcu, A., López Hernández J., Romeo, G., Alberola E., Faure, A., O. Chimdi., Qin B., O'Neill, M., Caneill J-Y., Schleicher S. "2023 State of the EU ETS Report." ERCST, BloombergNEF, Ecoact, and Wegener Center.

The two-stage application procedure provides a higher degree of flexibility to applicants and accelerate the awarding decisions for each call, as not all relevant documents will be required in the 1st stage of the application procedure. A two-stage procedure can also be perceived as a way to boost transparency and better inform applicants on how to improve the quality of future applications.

- **Upholding the integrity of the Single Market.**

Under the amendments set out in Article 19 (4), projects receiving Innovation Fund's support may receive contributions from any other EU programme, including funds under shared management, provided that those contributions do not cover the same costs. In addition, Article 13(e) states that for each competitive bidding procedure, the Commission *may* decide to restrict the possibility for a project proponent to cumulate the support awarded on the basis of a competitive bidding procedure with EU funding or national public support.

The use of *may* leave too much room for interpretation and may be counter intuitive. The criteria whereby a project will be denied funding under the Innovation Fund should be clearly defined. While it is important to preserve the integrity of the Single Market, excluding projects receiving state aid from the Innovation Fund may not be necessary. This is because such projects have already undergone scrutiny and checks by the state, indicating a higher probability of being lawful and trustworthy. Thus, providing support from the Innovation Fund to projects that receive state aid would enhance confidence in their legitimacy and discourage fraudulent applications.

Moreover, it will be important to clarify the possibility for cumulation of IF funding along the value chain - both through the IF, additional EU programmes, or state aid. This would strengthen the information availability for project developers considering investing in the EU market.

- **Extension and access of projects to benefit from the Project Development Assistance (PDA).**

Article 13 of the Draft proposes that the implementation of an open PDA for which all projects falling within the scope of the Innovation Fund can be eligible, regardless of whether they have previously applied for an Innovation Fund grant.

PDA is a key tool to allow unsuccessful projects to become successful in the future. Therefore, we positively see the expansion of the PDA's scope, as it allows a greater number of projects to enhance their quality, increasing their chances of success in future applications.

Among the proposed Delegated Regulation's areas for improvement:

- **ERCST questions the fitness of the competitive bidding mechanism in the context of the nascent hydrogen market.**

Following the call for proposals (Art 13b) and upon satisfying the qualification requirements in accordance with the competitive bidding procedure design (13c), project proposals are ranked from the lowest offered price to the highest (13d). Non-price criteria may account for up to 30% of the ranking weighting.

When implemented as part of a comprehensive policy support framework, competitive bidding fosters market competition, leading to reduced prices and accelerated deployment of green technologies. While these effects are commonly observed in mature commodity markets, they may diminish in an emerging market like hydrogen.

The hydrogen market exhibits both costs and regulatory asymmetries that are not conducive to an efficient allocation of scarce resources. On the cost side, hydrogen projects are highly heterogeneous in terms of applications, making a pure cost comparison inappropriate. Regulation sets industry-specific targets for hydrogen uptake. These targets put some sectors, such as mobility, in a more competitive position compared to others, like industry, under competitive bidding. Moreover, cost-efficient uses may not necessarily align with the ones offering the highest decarbonisation potential.

Kick-starting an environmentally efficient European hydrogen market through competitive bidding would require restricting the auctions' scope to specific end-uses or increasing the 30% non-price criteria threshold. The Commission could evaluate including a proof of existence of a PPA agreement for the project's application as part of the non-price criteria. Regarding the non-price criteria, the emission abatement potential is a factor that cannot be overlooked, and it should be given relevant weight inside the ranking criteria. The IF Regulation shall set a minimum weight of the latter component from the beginning.

- **The capacity of the European Commission to determine (with Member States only) additional criteria for the ranking of proposals gives room to discretion, potentially hindering transparency.**

Article 13(d) of the draft proposal provides that for competitive bidding the Commission may use additional criteria for the ranking of proposals, provided that the bid price accounts for at least 70% of the ranking criteria's weighting.

According to the draft regulation, if additional criteria are to be used, they must be clearly specified in the call for proposals and their relevance shall be justified by the nature of the auctioned product. The responsibility for defining these additional ranking criteria is delegated exclusively to the call for proposals instead of being included in the IF regulation.

To enhance transparency, any additional ranking criteria to the bid price, if applicable, should be included in the Delegated Act to the maximum extent possible. Relying too much on requirements specified in each call for proposals and not in the Innovation Fund regulation can hinder transparency and will give the appearance of an ad hoc and subjective approach.

- **The technical assistance criteria for Member States with a low level of participation can be improved to further reflect reality.**

The EU ETS Directive (EU) 2023/959, Art 10a (8), sets that the Innovation Fund should increase effective geographical participation in the calls. The IF Delegated Act provides the parameters for the calculation of the effective participation of Member States with calls in its territory.

The draft Delegated Act (Article 13h) mentions that Member States with low participation are those with the lowest ratio compared with their share of EU ETS verified emissions in 2013-2020. The list of Member States should be updated at least once every two years.

ERCST finds no justification for using data from 2013-2020 to determine the lowest ratio. The most up-to-date data should be utilised instead. This updated information would provide a more accurate representation of which Member States have the lowest participation in the Innovation Fund and should be periodically updated based on the latest available emission data.

- **The Innovation Fund should disburse funds earlier in the projects' development process for successful applicants.**

Article 6 of the IF draft mentions that grants shall be disbursed only when the pre-determined milestones are reached. Up to 40% of the total amount of the grant shall be disbursed to a specific project upon financial closure or upon reaching a specific milestone.

We should not forget the potential impact this could have, notably on small-scale projects, which may lack the required liquidity or financial capacity to start the development of an awarded project. For this size group, financial resources should be granted on a much more flexible basis, for instance by frontloading the funding to earlier stages of the project. The European Commission should nevertheless ensure the appropriate guarantees are in place before any disbursement takes place.

- **Incorporating additional factors to be taken into account during the assessment of the Innovation Fund's functioning would be important.**

In 2025 and every 5 years thereafter, the Commission shall carry out an evaluation of the operation of the Innovation Fund (Article 24.1).

In addition to the assessment of the synergies of the Innovation Fund with additional EU programmes (Horizon Europe), and the disbursement procedure, the IF shall also evaluate additional parameters, notably the IF's contribution to emission reduction in EU ETS sectors.

Prioritising projects with the highest decarbonisation potential is important, and an overarching objective of the public funding given to the projects. The Innovation Fund support mechanism should also assess the profitability of the project over time to ensure that funding is provided until projects reach maturity.