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The Hidden Risks of Romania's Supercharged CfD Cost Reduction

Nadia Maki

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The second CfD auction clears at record low solar prices, but fails to meet quota for wind

The second Contracts for Difference (CfD) auction has cleared at record low solar prices, but has failed to meet quota for wind. For wind power, the total tendered capacity was 2 GW, with a maximum strike price of €80/MWh. The concluded contracts, though, cover 60% of the intended capacity, with the lowest strike price going down to €65.17/MWh (a 211 MW project in the Constanța county). The full intended capacity for solar was procured with 1.49 GW of capacity awarded contracts. The lowest strike price is €35.77/MWh, which was part of a project broken up into smaller bids. The previous auction procured the full 1.5 GW intended capacity with strike prices of €51/MWh for solar and €65/MWh for wind.

The scheme was modified for the second auction with the removal of the maximum capacity allowed per bidder, a more flexible increase in the total procurement cap and the establishment of a Do No Significant Harm principle.

Are clearing prices this low sustainable?

Many developers who were not awarded contracts in the first round declined to submit bids in the second auction, likely anticipating they would not be competitive with the eventual low clearing prices.

There is a sense of desperation in the solar market. The abundance of PV projects creates a rush to ‘secure something’. A possible reason for these low strike prices could be this market pressure -- likely in combination with underestimations of the number of hours with negative prices and penalties for imbalances -- have resulted in bids that risk delivering without even marginal profits. Furthermore, low strike prices from €35-45/MWh send a signal to future potential off-takers who may believe these prices are reasonable to expect in a PPA and, when confronted with a significantly higher offer, may be pushed further into a ‘wait and see’ mode, waiting for a better deal which the market cannot actually provide.

Low clearing prices are exacerbated when considering that inflation may outstrip the strike price as indexation only occurs every three years and is only adjusted if inflation exceeds 10%. However, inflation, measured through the Harmonised Index of Consumer prices, mostly remains in the single digits and the likely result is developers coping with several years of a much lower strike price than is appropriate. This is a high residual risk for developers to shoulder, especially on top of the existing development and CAPEX risks. It is unclear how developers could balance with such low revenue – even with a PPA. Besides, there is a risk that bond penalties may soon begin to look more appetising. Based on results for wind, it is clear that many developers are not willing to accept the risk as the CfD was not able to secure more than 60% of its intended procurement.

CfDs should be designed to enhance market participation

Developers bid into the wholesale market based on the lowest price they can afford that still offers them enough profit to run. CfD generators, who receive a top up payment regardless of spot market bid price, are incentivised to sell as much electricity as possible on the spot market at once. This gaming behaviour discourages participation of players who are not able to bid at artificially low prices and is forbidden under other CfD schemes such as in the UK, where regulatory scrutiny can minimise this behaviour, with the risk of voiding contracts. A possible solution to such a behaviour would be to amend the profit-sharing mechanism so CfD generators are allowed to make enough profit to encourage real bids and increase participation in other markets – like balancing or ancillary services which could help balance the grid.

Another related element which is incentivising CfD generators to operate in ways that hinder grid balancing is the discouragement of energy storage. This is because electricity generated from solar or wind, stored, discharged and fed into the grid cannot be considered for CfD payments. Introducing storage colocation would allow generators to self-curtail during periods of negative pricing and opt-in when profit could be made. This would favour the inclusion of larger, more experienced players, who may be able to reduce their bids (which are currently too high to participate).

The state would still benefit financially, though from a smaller margin – but the real benefit would be to the grid. Separating out storage changes the way a company optimises its projects, likely downsizing the amount of storage attached to a project. This kind of interference in project design optimisation increases likelihood of an unbalanced project and, eventually, an unbalanced grid. Despite ambiguity in the EU legislation, Romania should push for this allowance in the national CfD scheme as it has been successfully implemented in other countries. Ireland's comparable Renewable Energy Support Scheme allows for the inclusion of co-located storage, subject to stringent requirements such as metering behind the project and the demonstration that the asset only stores electricity generated by the supported project.

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Where do we go from here?

Rightly or wrongly, the CfD is viewed as a proxy for price signalling to consumers and developers alike. With so much of the market trapped in an inert ‘wait and see’ mode, unsustainably low prices can create more uncertainty and keep future actors inert, waiting for stability. Given Romania’s target of delivering at least 10 GW of new solar and wind capacity by 2030, there should be focus on projects which are financially stable and they should be incentivised to act in a way that reduces pressure on the grid.