Europex

- Position paper -

Net zero at least cost: energy and emissions markets at the core of cost-efficient decarbonisation

Brussels, 17 February 2020 | Achieving a climate neutral economy by 2050 presents a significant challenge that will require fundamental changes across many sectors. Open, competitive, transparent and liquid power, gas and emissions markets are among the core tools necessary to reach the EU's 2050 net zero target cost-efficiently.

Agreement on the 2050 neutrality objective itself represents an important milestone which we explicitly welcome. To help achieve this, close attention must be paid to the instruments and mechanisms required, including how to trigger the necessary innovation and investment and to achieve decarbonisation at the least cost to the consumer, the taxpayer and the energy system.

Reliable market mechanisms will underpin decarbonisation efforts by:

- Providing transparent price signals which incentivise the most efficient technologies to be deployed in the most effective locations, supporting further integration between sectors;
- Guaranteeing the achievement of emission reduction targets by putting a price on greenhouse gas emissions and setting a clear cap for total emissions;
- Integrating renewable generation into the energy market by ensuring that supply is matched with demand efficiently across regions;
- Stimulating the development of new technologies and services through fair and open competition, encouraging the entrance of new companies and solutions into the market;
- Ensuring that consumers as well as all types of decentralised generation and storage benefit from links to fully-integrated and liquid energy wholesale markets.

This said, it is important to note that the necessary market conditions do not develop automatically. Poor subsidy design, discriminatory rules or technology bias can put the efficient functioning of markets at risk. Energy and emissions markets must therefore be carefully designed and regulated to ensure fair competition while leaving enough room for entrepreneurship. Regulatory certainty and stability are also needed to encourage investment in innovation and infrastructure.

As the EU Climate Law is developed and as the policies and instruments that make up the European Green Deal are designed, we call on policymakers to explicitly recognise the enabling role that efficient, transparent and reliable energy and emissions markets play in delivering cost-efficient

decarbonisation. Strong market principles, further detailed below, should be reflected in the sector specific initiatives as part of the European Green Deal.

1) An efficient EU Internal Energy Market to facilitate the transition to a climate-neutral energy sector

The increased level of interconnection and improved liquidity of European energy markets has led to more efficient matching of demand and supply, resulting in lower energy wholesale prices at a greater level of security of supply. Vital market principles that must be maintained include undistorted and robust price signals, technology neutrality, fair and non-discriminatory access to the grid as well as a clear definition of individual roles and asset ownership, i.e. the unbundling of vertically integrated activities.

Building on these achievements, energy markets keep evolving continuously and provide new solutions to support decarbonisation. The possibility to hedge risk in the long-term and to trade ever closer to real-time across Europe allows increasing amounts of renewable energy to be deployed and efficiently integrated into the system. Moreover, the cost-efficiency of replacing renewable energy subsidies with market-based mechanisms, such as direct marketing and tendering, has been demonstrated in many circumstances.

Non-discrimination and effective competition will also underpin the shift towards more decentralised energy sources and more active consumers. Energy exchanges have pioneered new market-based solutions unlocking flexibility. This started initially on individual organised short-term wholesale markets which today are coupled at European level. More recently , this is also being gradually implemented at local level to relieve grid congestion and to make optimal use of valuable demand side resources. Maintaining links with liquid and transparent wholesale markets will help to incentivise more dynamic consumer participation in the market for those who want it.

2) A robust market design to support smart sector integration

The recently reformed electricity market design, introduced as part of the *Clean Energy for All Europeans* package, provides a strong foundation for the energy transition. Integration between sectors will, however, become increasingly important. Price signals from the respective well-functioning power and gas wholesale markets will help to drive investment and economic decisions that integrate sectors even further (e.g. where to locate and when to run conversion assets). Emissions trading provides a cross-sectorial price signal as the basis for the efficient attainment of greenhouse gas reduction targets at the lowest possible cost.

For the European gas market, it will be of crucial importance to integrate renewable and low-carbon gases into the existing gas grid and storage assets. This will require commonly agreed definitions and a suitable regulatory framework. Already today, renewable gases are traded together with conventional gas in one single traded gas market, building on the achievements of the wholesale market and providing further liquidity to the benefit of consumers. As renewable gases are produced, transported, stored and used on larger scales, they should continue to be integrated into the single traded gas market. The use of existing gas infrastructure to transport green gases, with technical upgrades as necessary, will support an efficient energy transition, both in terms of time and cost.

The 'green' characteristics of renewable and low-carbon gases will soon become tradable in the form of Guarantee of Origin (GOs) certificates, in a system that is distinct from the trading of the actual commodity. Inspiration can be drawn from the well-established GO scheme for (renewable) electricity, a proven market-based mechanism to track and incentivise the use of renewable energy. The scheme for renewable gases should ensure that the certificates are based on common standards, transferable from one energy carrier to another and tradable across borders.

3) A strong EU ETS as part of a move to global carbon pricing

The trading of emissions allowances, combined with a clearly defined emissions cap, provides the necessary flexibility for efficient and cost-effective decarbonisation. In the EU, a strong EU ETS guarantees the achievement of emission reduction targets, promotes investments and innovation in low-carbon technologies and constitutes the right tool to drive decarbonisation by putting a price on greenhouse gas emissions. Expanding the scope of the EU ETS to include further sectors, such as road and maritime transport, and ensuring coherence with other European and national policies will help to achieve this. Importantly, EU efforts to decarbonise must be part of a wider global shift to implement effective carbon pricing schemes. Europe should continue its efforts to reach agreement on the implementation of Article 6 of the Paris Agreement and to foster the establishment and linking of new emissions trading schemes around the world.

4) Extension of Guarantees of Origin (GOs) to reliably certify the origin of (renewable) energy

The recent review of the Renewable Energy Directive (RED II) has extended the scope of GOs to renewable gas as well as to heating and cooling. Improvements like full disclosure of all sources would increase the transparency in these markets and drive consumer demand for different types of energy across the EU. Continued efforts to standardise certificates is vital to promote transferability and (cross-border) trade. With growing demand, GOs can also provide important revenue streams for renewable installations. Similar efforts should be undertaken to further strengthen the market for energy efficiency certificates (i.e. White Certificates).

5) A global role for European energy and emissions markets

European energy and emissions markets cannot be considered in isolation, especially when it comes to decarbonisation. Europe is one of the world's largest energy net importers as well as an important centre of industrial production and final consumption. Europe's' action will have a significant impact on decarbonisation at the global stage.

The ambition of the EU ETS as the leading carbon abatement scheme should be matched with the further development of carbon pricing schemes in other countries and regions of the world. Establishing new emissions trading systems, fostering the existing ones and linking them where relevant, is the most effective way to move towards a global carbon price and a level playing field.

Finally, any proposal for an EU carbon border adjustment mechanism, were it to be introduced, should ensure that the scheme is market-based and that it minimises the distortion of trade.

About

Europex is a not-for-profit association of European energy exchanges with 29 members. It represents the interests of exchange-based wholesale electricity, gas and environmental markets, focuses on developments of the European regulatory framework for wholesale energy trading and provides a discussion platform at European level.

Contact

Europex – Association of European Energy Exchanges
Address: Rue Archimède 44, 1000 Brussels, Belgium
Phone: +32 2 512 34 10
Website: www.europex.org
Email: secretariat@europex.org
Twitter: @Europex_energy