



- Consultation Response –

## **Public Consultation for the Revision of the Guidelines on State aid for Environmental protection and Energy 2014-2020 (EEAG)**

Brussels, 7 January 2021 | Europex recognises the need to review the EEAG guidelines in the context of the European Green Deal initiatives and the objective of achieving climate neutrality by 2050. The revised guidelines should build on the clear market design framework as set out in the Clean Energy Package and take particular care to avoid undue distortions of competition in the Internal Energy Market. Despite the high fixed cost structure of renewables as well as the need for predictable revenue streams, market-based remuneration of renewables in the energy market offers the most cost-efficient way of achieving decarbonisation, especially as renewables are deployed at scale. Distortive aid, in particular operating aid, risks undermining the development of the energy market. Deviations from the 'energy-only' market should be seen as an exception and all types of aid should be minimised. Having a clear target model and a phase-out schedule for support is vital in order to minimise distortions of competition.

This also applies to the development of demand-side flexibility (demand-response, energy storage etc.): Regulation (EU) 2019/943 lays down key market design principles to reward flexibility and ensure the provision of adequate price signals. Recent market reforms, including the harnessing of demand-side flexibility and ensuring RES can achieve revenue streams from multiple markets, need to be fully implemented to allow markets to realise their full potential in a high renewables system.

Trading on power exchanges is facilitating the integration of renewable energy in the market. For example, trading is increasingly possible closer to real time, finer product granularities are available and automated trading solutions facilitate RES access to the market. Forward markets provide important tools to hedge and manage price risk.

### **Market integration of renewable energy**

The Electricity Regulation (EU) 2019/943 and the Renewable Energy Directive (EU) 2018/2001 have confirmed the market-based approach and the need for support schemes to avoid unnecessary distortions to the electricity market. Although the current EEAG refers to the principle of market integration of renewable energy, a clear definition is missing, as well as accompanying criteria. Therefore, a revised EEAG should include both a definition of market

integration and a legal requirement to avoid negatively impacting the functioning of the electricity markets as defined in Art. 2(9) of Directive (EU) 2019/944. Note that this also includes impacts on the forward market – a potential negative effect of some CfD designs.

We propose the following definition of market integration of renewable energies: *‘Full market integration means that renewables participate in the market under the same conditions as any other (conventional) generation assets. Market integration has the objective of ensuring that producers and consumers of power from renewable systems respond fully to the market price signal. Revenues from the energy market are maximised while government funding/aid is minimised, ensuring efficient allocation of resources and increasing overall welfare.’* These concepts are partially referred to in Article 4(3) of the Renewable Energy Directive.

### **Form of the aid: operating aid versus investment aid**

For renewable electricity and the energy market, all types of aid have distortive effects and should be minimised. Operating aid suppresses incentives to react to market price signals or to maximise the value of production, e.g. by the use of combined RES-production and storage, providing system services to TSOs (e.g. balancing and ancillary services) etc. This is a particular risk in some new scheme designs such as CfDs where guaranteed remuneration limits the incentive to generate alternative revenue streams or hedge in the energy forward markets. The current EEAG guidance to mitigate this impact (market premiums, balancing responsibility etc.), while important, are not sufficient and need to take into account these distortive effects. Remuneration from market revenues benefits the end consumer by avoiding costly support payments. RES generation remains responsive to market price signals, avoiding ‘produce- and-forget’ strategies and incentivising investment in flexibility.

### **Safeguards to avoid potential negative impacts**

The current rules are not adequate and additional safeguards are required. These include:

**a) A clear and reliable phase-out timeline for any support:** In line with the objective to reduce subsidies to a minimum in view of their complete phase out, the phase out of support should be linked to specific criteria e.g. thresholds for the share of renewables or cost competitiveness criteria such as the LCOE.

**b) A clear definition of market integration of renewable energy:** A clear definition is missing (please see our proposed definition above). A revised EEAG should include both a definition of market integration and a legal requirement to avoid distortion of electricity markets in all timeframes.

**c) Clear phase-out rules for exemptions from the condition to avoid support of renewable electricity during periods of negative prices.** The current guidelines allow for exemptions with no clear termination rules. In general, incentives to produce at negative prices should be eliminated.

## **Instruments to incentivise investments in renewable energy: fixed premiums, variable premiums, two-way contracts for difference (CfDs)**

None of these methods are a suitable future model for RES financing and will inherently introduce unacceptable market distortions. We consider that aid is no longer needed to incentivise investments in renewable energy. Two-way CfDs where the state becomes the counterparty of all transactions, replacing commercial contracts and hedging via the wholesale futures market, pose a particular danger to the current market model. The transfer of risk, via off-market interactions between RES operators and the state, effectively reduces the need for operators to hedge their risks on the derivatives market and risks reducing liquidity and consequently increasing the transaction costs of hedging. Insufficient liquidity on the futures market could in turn negatively impact the spot market if hedging needs cannot be met. Please see our paper '[Moving towards full market integration of renewables, November 2020](#)' for more detail.

## **Carbon contracts for difference (CCfDs)**

We are critical concerning the introduction of carbon contracts for difference (CCfD) to further incentivise the decarbonisation of the industry. We do not consider that this type of support should be allowed.

First and foremost, the EU ETS will be reviewed in the context of the new ambitious EU target for carbon reduction – at least 55% carbon reduction by 2030. The new 2030 target requires an adaption of the ETS cap and the linear reduction factor leading to different fundamentals for the price discovery compared to the status quo.

Secondly, CCfDs could lead to several negative impacts on the EU ETS, including:

- Risk of interfering with the EU ETS market dynamics – CCfDs would effectively remove exposure to the ETS price signal for parts of industry;
- Would require an adjustment of the ETS cap and linear reduction factor to avoid waterbed effects;
- Risks reducing the effectiveness of the price signal as a short and long term operational and investment decisions driver;
- Reduces the need for market participants to hedge the carbon price on the derivatives market;
- Publicly backed CCfDs draw funding from public budgets compared to the preferred solution of a strong ETS price.

If, from an industrial policy perspective, aid for industry is politically considered to be necessary, investment grants should be used to incentivise the decarbonisation of the industry while avoiding negative repercussions on the EU ETS.

Industry benefiting from CCfDs would not be subject to the EU ETS in the same manner as industry not benefiting from CCfDs. This could lead to a situation where non-beneficiaries of CCfDs have a dual competitive disadvantage by not benefiting from the CCfDs and, additionally, are financing the state funding of CCfDs via the EU ETS. Interaction with free allocation of allowances also risks creating competitive advantages for some industries/projects benefiting from multiple types of aid. Competitive tendering to access the contracts and determine support rates may not be able to overcome the risks of asymmetry of information and low levels of competition.

### **Broadening**

We do not consider a requirement for Member States to broaden their support schemes for decarbonisation to be beneficial. In general, state aid support should be an exemption and limited in scope to avoid interference with the lead policy instruments – such as the internal electricity market for RES development as well as the EU ETS for low carbon technologies. Expanding eligibility and opening up schemes, with the objective of decarbonisation, risks introducing ill-defined and unnecessary state aid for other sectors and technologies, leading to distortion of competition. The principle of technology neutrality, and the opening of support schemes to all producers of electricity from renewable sources, is already set out in RED II Article 4.5. The concept of broadening risks undermining the existing market framework and instruments (internal energy market, EU ETS) which rely on fair competition and price formation based on the free interplay of supply and demand.

### **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.

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