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EFET recommendations for revision of RED II in the context of a Fit for 55 legislative package

Taking account of revision of the Energy and Environment State Aid Guidelines and related EU climate and energy measures

The European Federation of Energy Traders (EFET)¹ welcomes the review of the Directive 2018/2001/EU on the promotion of the use of energy from renewable sources (RED II), as part of the proposed EU Fit for 55 legislative package. We support the ambition of achieving net zero carbon by 2050 and targeting a 55% reduction in carbon emissions, compared to 1990, by 2030; we see the need for EU measures to underpin the ambition and achieve the target. Reaching carbon neutrality is critical for European citizens and society. It will require a radical overhaul of every aspect of Europe's economy, including fundamental changes to the energy sector.

Europe has the means to respond to these challenges, partly thanks to the development and evolution over the last twenty years of open, competitive, transparent and liquid markets in power and gas and the creation of the world's largest carbon market in carbon abatement instruments.

We firmly believe that a renewed focus on creating, improving and expanding markets should lie at the heart of Europe's approach to decarbonising the economy, should steer the EU Commission's Fit for 55 legislative initiative and should inform national energy policy choices at every turn.

We thus call for new EU climate and energy legislation to be underpinned by six policy priorities on the road to European carbon neutrality:

- 1. Observe the principles of **technology neutrality and cost efficiency** as far as practicable when promoting renewable energy consumption, so that the Fit for 55 package embraces low carbon energy sources while accelerating RES penetration.**
- 2. Establish a **comprehensive and robust certification, verification and registration system** (including what are currently called GoOs) covering all renewable and low carbon energy sources and carriers (either in the framework of RED III or another legislative proposal under the Fit for 55 package).**
- 3. Ensure that **any financial support schemes** still needed to stimulate investment in renewable and low carbon energy sources **are open to competition, of limited duration, and designed in a way which is least distortive of wholesale energy markets.****

¹ The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

4. Ensure **consistency among relevant legislative proposals under the Fit for 55 package**, including the review of RED II, the EU ETS Directive and EU Hydrogen and Gas Decarbonisation legislation, **recognising the central role of a robust EU-wide carbon price** in driving cost-effective decarbonisation of the European economy.
5. Recognise the role of **precise price signals** enabled by Europe's well-functioning wholesale energy markets in steering the deployment of the most efficient renewable energy and low carbon technologies in the most cost-effective locations.
6. Allow Europe's **well-functioning liquid and competitive wholesale energy markets** to enable the **integration of growing volumes of renewable and low carbon technologies** and to deliver **the right mix of flexible capacity**.

1. **Observe the principles of technology neutrality and cost efficiency as far as practicable when promoting renewable energy consumption, so that the Fit for 55 package embraces low carbon energy sources while accelerating RES penetration**

We note that the roadmap for RED II revision and certain questions set out in the corresponding Commission questionnaire (Qs 2.4-2.7 and section 3.2) suggest that the Commission is considering expanding the scope of RED II and potentially modifying the design of targets under the Directive to accommodate not only renewable but also low carbon energy carriers (in particular, in transport sector and heating and cooling). While we in EFET do not take a prescriptive approach to the function of RED III under the broader revised 2030 climate and energy framework, we believe that that suitable provisions related to low carbon energy carriers not qualifying as "renewable" should be included in the Fit for 55 package. Such provisions would complement the existing main EU RES consumption target and would introduce a possibility for Member States to combine renewable and non-renewable but low carbon sources in their national energy and climate plans, to help achieve overall EU decarbonisation goals.

We believe that the overall package, and the legislative proposal for RED II revision as part of it, should therefore as far as practicable be aligned with the approach set out in the EC Climate Law proposal, according to which "in taking the relevant measures at Union and national level to achieve the climate neutrality objective, Member States and the European Parliament, the Council and the Commission should take into account [...] cost-effectiveness and technological neutrality in achieving greenhouse gas emissions reductions and removals and increasing resilience."²

Ultimately, the Fit for 55 package and RED III should provide for a level-playing field for technology developers and a framework that recognises the environmental benefit of a wide range of available renewable and low carbon technologies and rewards carbon abatement at least cost in a market based, technology neutral way.

This is a crucial prerequisite for achieving the increased 2030 climate targets and the 2050 carbon neutrality objective cost-effectively, which is indeed the core policy priority in the framework of the European Green Deal.

We will need an evolutionary approach but, ultimately, we would like to see EU rules and standards applying to renewable and low carbon technologies evolving over time into a system

² European Commission proposal for a Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law), Recital (15), p.12

which can yield a comprehensive evaluation of a technology's carbon abatement contribution and sustainability characteristics. The vision is of a system of certification based on objective life cycle analyses of the carbon footprint of all types of energy carriers.

We therefore believe that, if RED III is to introduce a comprehensive certification system – in line with one of the objectives of the roadmap for RED II revision - it should lay out a set of EU rules and standards for certifying carbon content and sustainability characteristics of *all renewable and low carbon energy carriers* (see our recommendations in section 2 of the present paper).

In order to deliver on the cost-effectiveness imperative, set out in the Climate Law proposal, any targets set under RED III should be achieved primarily by way of harnessing marketplaces in wholesale energy and emission allowances (see section 3 and section 5).

Should national or EU wide financial support schemes continue to prove necessary to accelerate the uptake of renewable technologies/ energy carriers and thereby facilitate the decarbonisation of the energy system, such schemes should be designed in keeping with criteria we set out in section 3 below.

2. Establish a comprehensive and robust certification, verification and registration system (including what are currently called GoOs) covering all renewable and low carbon energy sources and carriers (either in the framework of RED III or another legislative proposal under the Fit for 55 package)

Either in the framework of RED III or another legislative proposal under the Fit for 55 package, we believe that the EU Commission should aim to establish a set of standards and rules to underpin a comprehensive certification system covering all renewable and low carbon energy carriers.

We think such a system would promote choice for consumers and further promote least cost decarbonisation, *as long as it is concentrated on verifying and validating RES and low carbon attributes, and does not purport to track transactions, molecules or electrons.*

Primary legislation creating such a comprehensive system would need to be complemented by Implementing Acts dedicated to certification, validation and registration, whereby the Commission could develop a set of EU standards and rules with industry consultation.

The primary legislation and Implementing Acts should mandate the following main features of a comprehensive certification system:

- A. EU-wide standardisation (at least per source or commodity and per quality, irrespective of end-use sector and purpose for which a certificate is to be used)**
- B. A combination of an underlying book and claim mechanism, with mass balancing or locational or temporal characteristics incorporated in certain narrower standards, depending on the sector and the purpose for which the certificate is needed**

The book and claim mechanism would be based on that currently used to validated classes of RES electricity GoOs when traded. A mass balancing mechanism (including time and geographical tracking elements) might need to be overlaid, for example in the gas sector, according to the wishes of consumers. It would still be underpinned by sustainability certificates, the value of which is separated from the value of the

commodity itself. The documentation for such a mass balancing system applied to different types of energy carriers - either injected in the grid or not – should be harmonised across Europe and provided by a central entity, to enable cross border trade in certificates. We believe it is preferable to avoid any compulsion to attach certificates to molecules and electrons or to traded volumes, since the tracking of physical commodities or of transactions (e.g through requiring proofs of purchase of energy) could rapidly become a bureaucratic nightmare and discourage liquidity (or even participation by some producers and suppliers). It should be feasible to prevent the double counting of sustainability attributes through other safeguards, including regulation and auditing of registries.

Unhindered cross-border trade between Member States both in sustainability attributes and in underlying energy commodities should indeed be a feature of any such certification mechanisms. Cross-border trade, combined with harmonised arrangements for cancellation of certificates (see E. below) should ultimately maximise the opportunity for market participants to participate in financial support schemes across borders.

C. Choice for producers, suppliers and consumers of energy about how they use certificates contractually

An overhauled legislative framework covering the issuance and use of certificates must enable producers, suppliers and consumers of energy to choose how they use certificates contractually. In particular, they should be free to determine whether or not they would like to link certificates evidencing sustainability attributes of a given energy carrier to the specification of that energy carrier as a commodity within their overall sale and purchase transactions.

D. Mandatory issuance of certificates by designated Member State authorities, upon request of producers or suppliers, and corresponding mandatory verification and registration processes

In principle, Article 19(2) of RED II does not prohibit issuing GoOs if a project receives state aid (as long as the value of the GoO is factored in when the project receives support):

Member States shall ensure that when a producer receives financial support from a support scheme, the market value of the guarantee of origin for the same production is taken into account appropriately in the relevant support scheme.

That said, currently the interpretation of Article 19(2) varies across Member States. For example, in France renewable energy plants receiving state aid are not entitled to have GoOs issued for the renewable electricity they produce. This, in turn, creates an obstacle for the uptake of PPAs in the country.

RED III or parallel legislation within a Fit for 55 package should provide for mandatory issuance by Member State authorities of certificates upon request of producers, and corresponding mandatory verification and registration processes. At the same time, if a certificate is only used as evidence for contractual purposes under a PPA, a separate market value should not be attributed to it.

E. A harmonised set of criteria for cancellation of certificates when energy is consumed or when energy is converted from one carrier to another, together with a common methodology for determining the effect of such cancellation

The basis on which Member States may cancel or devalue such GoOs and/or certificates, in cases where related financial support is claimed by the recipient, must be the same across the EU, so that trade in such instruments across borders is not hindered. Naturally, EU mechanisms will also be required to ensure that, in the absence of cancellation, double counting is avoided.

F. Facilitation of Member States' use of the certificates to:

- Substantiate their attainment of RES and or low carbon energy consumption targets, in a manner more conducive to cross border trade, in cases where adjustments can only be made by means of statistical transfers between Member States
- Justify the content of their periodically submitted National Energy and Climate Plans
- Verify claims made by producers, suppliers and consumers for financial support under RES and/ or low carbon energy national promotion schemes or carbon pricing schemes
- Be redeemed against green or low carbon national sectoral supply quotas (if such are introduced).

G. Alignment of the EU-wide regime for certificates with the operation of the EU ETS

The revision of RED II coupled with the review of the Monitoring and Reporting Regulation under the EU ETS (MRR) should provide for the use of certificates (comprising what are currently designated as GoOs, but enhanced with sustainability information) as the only means of proving the renewable origin of gas (or, in future, other low carbon characteristics of gas) injected and withdrawn from the gas network.

The principles set out at A. through G. above might in the long term underpin a “common currency” for certifying the carbon abatement value and sustainability characteristics of different technologies, covering all renewable and low carbon energy carriers. Such a “common currency” would deliver on one of the Commission objectives of RED II revision, namely to facilitate energy system integration through the development of a comprehensive certification system.

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- 3. Ensure that any financial support schemes needed to stimulate investment in renewable and low carbon energy sources are of limited duration, open to competition, and designed in a way which is least distortive of wholesale energy markets.**

In order to support efficient uptake of nascent decarbonisation technologies and renewable and low carbon energy carriers, the Fit for 55 package should be complemented by an overhaul of the existing framework for financial support schemes. In particular, there is an opportunity to revise the relevant provisions in the IEM legislation and the Energy and Environment State Aid Guidelines (EEAG)³, so that:

- A. Any temporary financial support schemes for renewable and low carbon energy sources are open to competition, become technology-neutral to the greatest extent possible, as well as progressively open to participation across national borders within the EU.**

Conducting bidding procedures on a national basis and restricting them to specific technologies would lead to suboptimal outcomes for consumers and governments.

By maximising the number of potential bidders and ensuring a competitive process, incentives to reduce costs and to innovate will be greatest and the measure is likely to be more effective – with a lower overall cost.

It is therefore crucial to ensure that the criteria to be fulfilled in the framework of the tendering process are defined in a way that ultimately allows choosing the best suited and most optimal technology, whichever its location in Europe.

- B. Sunset clauses are put in place, ensuring that the respective support schemes end once investment expenditures are recovered.**

Allocation processes need to be designed in a way which minimises the cost over the life of the support. That may mean reducing the level if underlying costs fall or prices rise and having plan to phase out the support, for example when a technology has become cost competitive.

- C. Financial support for nascent technologies is granted upfront via R&D grants/ tax reliefs, considering their contribution to Europe's decarbonisation objectives.**

- D. The economic impact of any temporary financial support schemes is taken into account in the framework of the EU ETS, to the extent the carbon abatement they incentivise diminishes the need for generators and industrial emitters to purchase and use allowances.**

This measure is key to preserve the integrity of the EU ETS and any temporary sectoral EU emission trading scheme and progressively strengthen rather than weaken carbon price signals across the EU economy.

³ See EFET response to the Commission consultation on State aid for environmental protection and energy: https://efet.org/Files/Documents/Downloads/EFET_consult%20EC%20EEAG_07012021.pdf

Turning to mature RES-E technologies, we believe that policymakers must aim to realise their full integration in the wholesale electricity market as soon as possible. The cost burden stemming from the inefficiencies of some legacy national financial support schemes eventually fall on European electricity consumers, and such legacy support schemes have a negative impact on the European electricity market.

In this context, in parallel to RED II revision, we believe the Commission could use the opportunity to revisit the operational privileges granted for RES-E generators under the Electricity Regulation and the extent of state aid allowed under the EEAG.⁴ In particular, it should be ensured that:

- Priority dispatch for legacy RES plants is removed;
- Renewable energy generators have no incentive to generate energy in times of negative prices.

4. Ensure consistency among the revision of RED II, a Hydrogen and Gas Market Decarbonisation package, and the revision of the EU ETS Directive, recognising the central role of a robust EU-wide carbon price in driving cost-effective decarbonisation of the European economy

A credible, reinforced and expanded EU ETS is the best instrument through which to achieve the European 2030 climate targets and the 2050 climate neutrality objective in a cost-effective way. The revision of RED II and the development of a Hydrogen and Gas Market Decarbonisation package should be underpinned by this policy priority and should be mindful that policy overlap could prove detrimental to this objective.

We recall that the targets set in RED II and in the EED under the current climate and energy framework were agreed after the size and implementation of the ETS MSR had been agreed. As a consequence, proper alignment between the EU ETS and the two Directives could not be achieved. This had negative effects on the carbon emission allowances market supply and demand balance.

We support the Commission intention to set up proper greenhouse gas emissions monitoring, reporting and verification systems for the sectors currently not covered by the EU ETS as a first step to pave the way for their subsequent integration into the existing EU ETS. We agree that transitional arrangements or a pilot period will be therefore necessary, before these new sectors can be gradually integrated into the EU ETS. In our view, this means that

- A. In the short to medium term (over the next five years or so), a separate EU-wide emissions trading system for road transport and buildings or – preferably – for all non-ETS fossil fuel use should be put in place;
- B. There would be significant value in articulating a clear timeline for integrating a new ETS for all fossil fuel use into the existing EU ETS;
- C. A revision of the overall Union RE target or any RE target for transport should not undermine the effectiveness of a reinforced and gradually expanded EU ETS. The establishment of a separate ETS for transport and buildings and its gradual integration into the existing EU ETS should be recognised as a policy priority.

⁴ See EFET response to the Commission consultation on State aid for environmental protection and energy: https://efet.org/Files/Documents/Downloads/EFET_consult%20EC%20EEAG_07012021.pdf

5. Recognise the role of precise price signals enabled by Europe’s well-functioning wholesale energy markets in steering the deployment of the most efficient renewable energy and low carbon technologies in the most cost-effective locations

Precise price signals enabled by Europe’s well-functioning wholesale energy markets are key to ensure the most efficient renewable energy and low carbon technologies, as well as flexibility solutions, are deployed in the most cost-effective locations.

We recall that, in accordance with Article 3 of Regulation (EU) 2019/943 (the ‘Electricity Regulation’), Member States, national regulatory authorities (NRAs), transmission system operators (TSOs), distribution system operators (DSOs), market operators and delegated operators must ensure that electricity market rules encourage free formation of prices and avoid actions which prevent the formation of prices on the basis of demand and supply. Yet, barriers to efficient price formation remain across most of the Member States.⁵

With an increasing share of intermittent power generation in the European energy mix, precise price signals are needed more than ever to ensure the reactivity of market participants’ bidding and dispatch decisions to rapidly changing demand and supply conditions. Large-scale penetration of intermittent renewables will need to be accompanied by the development of extra peaking generation units, storage solutions, demand-side management, and other types of flexible assets and services, including power to x (PtX). Accurate price signals allow market participants to identify the nature and timing of investments in flexible capacity alongside generation and transmission capacity.

We therefore believe that the enabling policy and regulatory framework for achieving the EU 2030 and 2050 climate targets should recognise the need for ensuring that reliable, undistorted price signals in the wholesale energy markets are maintained to drive investment and divestment decisions in generation and transmission capacity, alongside flexibility and storage solutions and demand-side management.

6. Allow Europe’s well-functioning liquid and competitive wholesale energy markets to enable the integration of growing volumes of renewable and low carbon energy sources and to deliver the right mix of flexible capacity

One of the measures listed under question 3.3.6 of the Commission’s public consultation on RED II revision suggests that “better coordination ... [between] electricity and gas TSOs and DSOs to plan network investment” in order to “integrate flexibility” is key “to maximise renewable integration.” While we welcome greater cooperation between electricity and gas TSOs and DSOs, in order have flexibility solutions deployed in the most competitive and efficient way, it is crucial to ensure that system operators remain in their role of neutral market facilitators.

In this section we discuss the role of Europe’s wholesale energy markets in delivering on both of the abovementioned objectives - maximising integration of renewable energy sources into the energy system and delivering the right mix of flexible capacity.

⁵ See EFET response to ACER consultation on barriers to efficient price formation and easy participation in European electricity markets here:
<https://efet.org/Files/Documents/Downloads/EFET%20response%20to%20ACER%20consultation%20on%20barriers%20to%20price%20formation%20and%20participation.pdf>

6.1. Europe's wholesale energy markets are the enablers for integration of growing volumes of renewable and low carbon energy sources

Full integration of mature RES-E in the wholesale power market will enable increased efficiency in RES production and supply and ultimately help reducing costs to consumers. We therefore believe that it should be recognised as a policy priority.

The growth of intermittent RES electricity generation and the development of demand response and storage, increase the need and opportunities for adjustments closer to real time. This suggests a growing role and importance for the intraday (ID) market.⁶ At the same time, competitive and liquid forward electricity markets remain essential for market participants, as well as for producers and consumers alike, to hedge their short-term (e.g. day-ahead) price risks and uncertainties.

We note that there is still much to be done when it comes to the balancing timeframe. The current balancing framework often prevents the exposure of RES-E projects to market and operational risks, granting them the privilege to be exempted from balance responsibility and normal dispatch rules. These privileges should be removed as soon as possible, and RES-E units should be granted the right to participate in the balancing market and offer ancillary services.

Turning to renewable and low carbon gases, in order to contribute to overall efficiency and flexibility of Europe's energy system, they should become an integral part of the Internal Energy market. We therefore support the recommendation made in the latest ACER/ CEER market monitoring report that "any upgrade of the internal gas market rules, targeting an increasingly decarbonised sector, [should] be built on the foundations of the current market framework."⁷ Indeed, this approach will ensure that we "avoid the transition leading to new national market fragmentations, whilst at the same time retaining the significant benefits for consumers already in place."⁸

6.2. Relying on the market to deliver the right mix of flexible capacity

In order to deliver optimisation of the overall system cost and maximise social welfare, flexibility services provided by all types of energy carriers and technologies, should be procured via the market and delivered by market participants following a competitive, open, fair, and transparent tendering process.

When it comes to flexible power assets, the Clean Energy Package (Electricity Market Directive (EU) 2019/944 and Electricity Market Regulation (EU) 2019/943) already provide a comprehensive framework for their successful development and their participation in the wholesale electricity market.

At the same time, in order to ensure that the owners, operators or developers of flexible assets aimed at providing services to foster links between the power and gas sectors (e.g. PtX installations), face the right whole-system price signals (i.e. in the form of connection charges,

⁶ For further information on how the intraday market design can be further improved to facilitate RES integration, please see EFET position paper "Towards an efficient intraday market design in electricity" available at https://efet.org/Files/Documents/Electricity%20Market/Spot%20and%20short-term%20markets/EFET_ID_MarketDesign_06052020.pdf

⁷ ACER/ CEER Annual Report on the Results of Monitoring the Internal Electricity and Natural Gas Markets in 2019, Energy Retail and Consumer Protection Volume, October 2020, p.6

⁸ Ibid.

grid tariffs, congestion pricing, ancillary service revenues and/ or imbalance charges), there is an opportunity to introduce policy measures and further reforms both at EU and national level, in particular:

- A. Ensure the value of all types of flexible assets used for the purpose of congestion management and system balancing by TSOs and DSOs is signalled correctly;
- B. Ensure that asset owners or operators in the electricity system, which are subject to curtailment or redispatch measures, are remunerated at the market price in case of a congestion management market, or compensated in such a way that the financial impact is neutral, taking account the opportunity costs as well as actually incurred costs in case of a cost-based congestion management system;
- C. Implement changes to grid tariffs across electricity and gas to better ensure they reflect the costs imposed by participants on a forward looking basis;
- D. Avoid the adverse consequences of recovering sunk network costs and renewable and low carbon energy support costs - cost recovery should not lead to inefficiencies in the energy system and market distortions (e.g. through creating incentives for charge avoidance, or through disincentivising uptake of renewable or decarbonised technologies requiring them to bear the legacy costs of past investment in the grid);
- E. Ensure that the determination by regulators of permitted cost recovery by TSOs and DSOs is clearly separated from the internalisation of environmental externalities (which is done through the EU ETS) and from support schemes, in order to avoid distorting the price signals.