

## **European Commission Green Paper consultation on a 2030 Framework for Climate and Energy Policies**



### **EFET response – 2 July 2013**

The European Federation of Energy Traders (EFET)<sup>1</sup> welcomes the EC Green Paper ‘A 2030 framework for climate and energy policies’. In particular, EFET appreciates the aspiration of the Commission to move towards an integrated market-oriented model for supporting low carbon generation and the intention to learn from the experience of the 20-20-20 strategy. We believe that the approach to decarbonisation and renewable energy support needs to be fundamental re-designed to provide for a Europe-wide market-based framework.

The current framework has promoted the rapid growth of power generation from renewable energy sources (RES-E). However, for the most part, this advancement has developed separately from the operation of the wholesale energy market and has undermined the efficiency of the European carbon market. Furthermore, the current framework detracts from, rather than contributes to the completion of a single European market in electricity. The severe deficiencies of the current methods of subsidised RES-E production involving the injection of physical volumes into the grid on a fragmented national basis is not a sustainable or efficient approach for the longer term. The serious negative impact of this process on the functioning of the European wholesale power markets in various timeframes, combined with the slow progress in international negotiations to reduce greenhouse gas emissions, indicate a fundamental need to re-think EU legislation.

An open debate on the appropriate mechanisms for meeting the EU policy goals of competitiveness, sustainability, and security of supply through the completion of the internal energy market in the run-up to 2030 is of paramount importance. That debate must be followed by credible and timely policy commitments made well before 2020. In helping to reduce uncertainty, such commitments would give new momentum to the internal market in electricity at the wholesale level and would ensure that strategic investment decisions are made in the next few years.

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<sup>1</sup> EFET promotes and facilitates European energy trading in open, transparent and liquid wholesale markets, unhindered by national borders or other undue obstacles. EFET currently represents more than 100 energy trading companies, active in over 27 European countries. For more information: [www.efet.org](http://www.efet.org).

## 1. General comments

### *1.1 Which lessons from the 2020 framework and the present state of the EU energy system are most important when designing policies for 2030?*

EFET shares the European Commission's satisfaction to see that the actual 2011 greenhouse gas (GHG) emissions were estimated to be 16% below 1990 levels. Although on this measure carbon reduction policies have enjoyed success, there are a number of lessons to be learnt from the experience of the implementation of RES consumption and CO<sub>2</sub> emissions reductions targets to date. In the absence of any significant low-carbon investment signals since 2010 through the EU Emissions Trading System (ETS), implementation has in reality largely relied on uncoordinated national schemes to support renewable generation. The operation of those schemes has had a number of negative effects on other policy objectives, especially the completion of the single electricity market in a cost-efficient way. Some of the negative side-effects include:

- An erosion of the energy and carbon markets caused by the current policy architecture, leading to unnecessary costs for the energy transition and negative effects on competitiveness and investments,
- High costs to consumers and distortion of the retail market through allocation of costs only to 'non-privileged customers,' e.g. the additional cost to these consumers in Germany has risen above EUR 50/MWh in 2013,
- Limited development of the cooperation mechanisms or joint schemes provided for in the Directive due to an excessive reliance on individual Member State initiatives and deficient development of a proper standard for the Guarantee of Origin (GOs), hindering the implementation of a proper voluntary market for renewable energy generation attributes,
- Reduced effectiveness of the emission allowances market, and, arguably, little additional savings in CO<sub>2</sub> emissions beyond what would have happened naturally with the phasing-out of coal-fired generating plants, the recession, and the reductions forced through 'command & control' instruments to support RES-E and energy efficiency, increasing the cost of decarbonising the EU compared to what an efficient EU ETS would have delivered,
- Inefficient dispatch of generation plants and excessively volatile prices with missed opportunities for RES-E producers to help develop flexibility,
- Decreasing liquidity of wholesale electricity markets through the exclusion of RES-E output from normal contracting processes in many countries,
- Unpredictable physical network flows leading to restrictions in the availability of cross-border transmission capacity, distortions in cross-border trade and restriction of cross-

border competition due to insufficient contribution of RES-E generators to the planning of network operations, insufficient information exchange between RES-E generators, DSOs and TSOs, and between TSOs themselves, as well as insufficient procedures for coordinated cross-border congestion management (redispatch).

In our view, the 2020 framework is, therefore, not a sustainable approach for the medium to long term. An important lesson from the 2020 framework and the present state of the EU energy system concerns the interactions among the different targets, policies and instruments. To yield the desired benefits, the 2030 framework should contribute to creating a secure, liquid and well-functioning energy market through the full harmonisation and integration of regulatory measures introduced in the past years. One of the highest priorities of the next EU climate and energy policy is to provide greater coherence between the EU ETS and other EU climate policies, such as energy efficiency and renewable energy promotion, and to ensure minimum distortion of the internal energy market. Particularly, the 2030 framework must fully integrate renewable energy producers into the market by requiring from them to comply with balancing obligations and must harmonise efficient support schemes for renewable energy across the EU. Likewise, any mechanisms to promote renewable generation (beyond the ETS) must be closely controlled to deliver a level-playing field for investment in renewable energy production, to deploy renewable energies in a cost-efficient manner, and to preserve the European internal electricity market and the EU ETS.

The establishment of sustainable energy markets throughout Europe for the overall long-term benefit of the economy and of society must be retained as a key part of the EU energy policy and strategy. Well-functioning energy markets have the capacity to provide clear wholesale price signals which allows for optimising supply and demand and enhances security of supply. It is our strong belief that market fundamentals should continue to form the backbone of EU energy policy and that the 2030 framework should be designed with a view to ensuring the functioning of the internal market. This will provide for a cost-efficient realisation of the EU climate objectives, improve the security of European energy supply and offer an efficient model for others to follow.

## **2. Targets**

*2.1 Which targets for 2030 would be most effective in driving the objectives of climate and energy policy? At what level should they apply (EU, Member States, or sectoral), and to what extent should they be legally binding?*

The three EU 2020 targets, related to RES consumption, CO<sub>2</sub> emissions and energy efficiency, are interdependent. However, they have the common aim to reduce greenhouse gas emissions. Unfortunately, the circumstances during the 2010-2020 period, specifically the impact of the financial crisis and recession, have made these interactions unhelpful in that the central mechanisms to reduce GHG emissions — the EU ETS — has been degraded by the impact of the other two targets.

Such a situation needs to be prevented in the 2020-2030 framework. In the medium to long term, the ETS must prevail as the central measure for abating CO<sub>2</sub>, while promotion schemes for RES and energy efficiency should be gradually phased out.

As pointed out by the European Commission in its 2012 Communication on Renewable Energy and the Internal Market<sup>2</sup>, ideally, renewable energy should not require any subsidy at all, with projects being developed in response to the price of carbon. Support for nascent RES technologies would then be provided through research and development (R&D) funding, if necessary. This would promote CO<sub>2</sub> emissions reduction by the most efficient means. Therefore, we believe that the reduction of GHG emissions should be the overriding objective of the European Union, since it is the policy instrument having the most direct beneficial impact on climate change. Hence, the CO<sub>2</sub> emissions target should become the dominant target in the post-2020 EU climate policies.

### ***Carbon Target***

EFET believes that setting a greenhouse gas reduction target, combined with a well-functioning GHG emissions trading market (in its current guise, EU ETS), provides a non-discriminatory, cost-effective and market-oriented way to reach the EU objective of decarbonisation. EU-wide interim carbon reduction targets for the years between 2020 and 2050, in line with the agreed EU long-term objective of 80-95% reduction by 2050, should be adopted as soon as possible and should drive the future structural reform of the EU ETS. Such targets would provide a clear signal to investors that the ETS will continue to play a decisive role in the transition to a low-carbon economy by 2050 and would help re-establish the much needed trust that the ETS is here to stay.

Price signals in the CO<sub>2</sub> market are of particular importance in the power sector. As the CO<sub>2</sub> price signal has the essential beneficial effect of being technology neutral, it has the capacity to act as the key instrument to achieve many of the sector's structural evolutions not only the decarbonisation objective, but also energy efficiency, demand-side response (triggered by short-lived but high peak prices), the development of carbon capture and storage (CCS) technologies or alternative technologies to decrease CO<sub>2</sub> emissions.

Up until now, RES support mechanisms within the EU have had the effect of forcing exogenous emission reductions in the power sector, which has reduced significantly the demand for EU emission allowances (EUAs), thus depressing CO<sub>2</sub> prices<sup>3</sup>. In addition, important volumes of intermittent generation are being directly injected with

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<sup>2</sup> "Renewable energy should be gradually integrated into the market with reduced or no support", European Commission Communication COM (2012) 271 on renewable energy of 6 June 2012.

<sup>3</sup> Currently, the development of power generation capacity from renewable sources within the EU frees up EUAs for the rest of the power industry, thus having a diluting effect on the offer on the carbon market. We believe that the carbon market should be reformed so that the natural decrease in demand for EUAs linked to the development of subsidised renewable power technologies within the EU is not exacerbated by a market design flaw leading to an over-supply of EUAs. Such a reform should avoid that renewable power development abnormally depresses the CO<sub>2</sub> price.

priority dispatch in the system or being offered at negative marginal costs on the market. This double effect has had a particularly distortive impact on power prices.

Beyond the necessary short-term measures (such as the back-loading of EU ETS phase 3 supply), the priority for the 2020-2030 period should be to reform the carbon market in order to ensure that the pressure of the CO<sub>2</sub> market is maintained on a steady slope, thus ensuring that adequate price signals are maintained in the power industry. Any regulatory uncertainty with respect to the greenhouse gas reduction targets between 2020 and 2050 will affect negatively CO<sub>2</sub> prices and dilute signals for private investments in low-carbon technology. Therefore, policies and legislative measures setting firm interim targets for carbon reduction will be crucial for maintaining the CO<sub>2</sub> price signal. This is particularly important, considering that the expected reduction in energy intensity in the EU is likely to have a depressing effect on fossil fuel prices, most probably more significant than projected in the 2050 Energy Roadmap. Maintaining investment signals in low-carbon technology in that context will necessitate appropriate signals from the CO<sub>2</sub> market.

### ***Renewable Energy Target***

In relation to renewable energy, EFET would suggest that two possible options should be considered for the post-2020 framework.

- *Preferred solution: No target for RES beyond 2020*

With respect to RES output or consumption targets, it is the EFET view that, in order to optimise overall carbon reduction, a post-2020 strategy for encouraging carbon-free generation should focus on a well-functioning GHG emissions trading market. This market (in its current guise, EU ETS) would ideally be used alone to deliver the right investment signals for RES-E generation.

As mentioned above, CO<sub>2</sub> price signals are key to achieving many of the energy sector's structural evolutions, including the development of renewable energy production. The current combination of greenhouse gas reduction, renewable energy and energy efficiency targets have, in our view, failed to provide the right market-driven investment signals in low-carbon technologies beyond subsidised renewable power generation. Focusing the target on the carbon market would contribute to reaching the objective of decarbonisation in a cost-effective and market-oriented way by promoting low-carbon technologies (including renewables), energy efficiency, demand-side response, and other alternative technologies to decrease CO<sub>2</sub> emissions in a non-discriminatory way.

- *Alternative solution: an EU-wide target for RES beyond 2020*

As mentioned above, EFET believes that carbon reduction targets combined with a well-functioning GHG emissions trading market could deliver the objectives of the EU energy and climate policy on their own. The 20-20-20 targets have, in our view, failed to provide the right market-driven investment signals in low-carbon technologies

beyond subsidised renewable power generation. We urge the European Commission to conduct a thorough assessment of its multiple targets approach and its effects on the energy and climate objectives of the Union.

To the extent the political judgement may be that an EU ETS is considered insufficient on its own, we would favour binding targets on renewable energy consumption. However, unlike the current disaggregation into national targets, we suggest that a mandatory target for renewable energy sources at the EU level would be appropriate in the run-up to 2030, accompanied by reliance on harmonised EU-level market-based mechanisms, which facilitate both national and cross-border transfers of renewable electricity attributes.

An EU-wide renewable energy target would provide continuing certainty to investors and would stimulate investments in renewable energy projects and related infrastructure. Complemented by the potential for cross-border transfers of renewable electricity attributes, it would ensure coherence of renewable energy financial support schemes with the EU ETS and with EU-wide energy efficiency standards. Such an arrangement would also be in line with the internal market for energy, unlike the current arrangements. Alignment is crucial in order to avoid distortions, particularly in the single electricity market at the wholesale level.

Contrary to the current disaggregated target system, we are hopeful that the establishment of an EU-wide target would discourage Member States from setting up further individual RES-E output or consumption targets. This would encourage renewable energy producers to establish their production facilities according to the best geographical and demographic conditions, leading to more cost-efficient investments in renewable energies and facilitating the maturation of these technologies. If Member States were to establish such national targets, we would expect the European Commission to control very closely any support mechanisms to ensure that there are no distortive state aid or public service obligations. This is particularly important in light of the integration of national energy markets through the network code process. The situation is now substantially different to that prevailing in the 2000-2010 period where many schemes were accepted on the grounds that integrated energy markets had not yet been developed.

*2.2 Have there been inconsistencies in the current 2020 targets and if so how can the coherence of potential 2030 targets be better ensured?*

Any EU-level renewable target should be set at a level that avoids undermining the EU ETS as the core policy instrument supporting reductions in greenhouse gas emissions. An EU-wide targeted incremental increase in renewable energy consumption between 2020 and 2030 should, therefore, be more modest than the targeted incremental reduction in greenhouse gas emissions, i.e. there should be no repetition or imitation of the basic 20-20-20 formula. Without EU-wide policy measures, it would be better for renewable targets to be indicative and non-legally binding.

For additional information on the interaction between the different policy instruments, please refer to point 3.1.

*2.3 Are targets for sub-sectors such as transport, agriculture, industry appropriate and, if so, which ones? For example, is a renewables target necessary for transport, given the targets for CO2 reductions for passenger cars and light commercial vehicles?*

EFET believes that climate policies must eventually cover all sectors and uses. We oppose any sector-specific GHG reduction targets. In order to allocate the financial resources in an efficient manner, it is crucial to enlarge the market to all low-carbon applications and to avoid focussing on sectoral solutions.

A cross-sector fulfilment of targets is needed. In particular, including carbon-intensive sectors such as heat and transport would create a level-playing field allowing the most cost-effective investment decisions to reach the goal of decarbonisation. For example, low-carbon heat solutions in one country might be a cheaper substitute to the use of RES-electricity, which is preferred in another country. Likewise, although most scenarios anticipate wider use of electricity in both the heat and the transport sectors, specific sectoral targets undermine the search function of the market. Using different targets and policy instruments is likely to create perverse incentives and arbitrage opportunities that will make climate policies less efficient.

The EU ETS is already an excellent basis for market instruments to be designed in order to look for an economy-wide solution. Its extension to other sectors (e.g. users of heat and transport fuels) is justified on the basis of the principle of non-discrimination, and considering its cost-effectiveness and ability to cause minimum market distortion. Moreover, exemptions should be made only when there is actual evidence that there are anti-competitive effects for the EU industry.

*2.4 How can targets reflect better the economic viability and the changing degree of maturity of technologies in the 2030 framework?*

As mentioned previously (see point 2.2 and Annex 1), EFET believes that if the EU Commission considers that renewable energy consumption needs to be supported by a target, it should be a mandatory target set at the European level. We believe that the financial support for RES-E production on the basis of ongoing operating aid should be gradually phased out. However, we realise that such an approach may result in investors' preference for low-cost solutions. Hence, mature and competitive technologies would be the clear winners of such a system.

EFET agrees that support for nascent or immature RES technologies may still be needed until they become competitive. We therefore believe that, like in other industrial sectors, more generous support for nascent or immature RES technologies should be provided through research and development (R&D) funding based on

streamlined and simplified state aid guidelines<sup>4</sup>, if and only up to the point when it is necessary. Research grants or tenders limited either by a financial cap, or by total promoted capacity in MW could help immature technologies becoming more competitive.

A clear separation of R&D promotion schemes with respect to the different degrees of technological and economic maturity of technologies will help avoid a large scale roll-out of high cost generation assets at a too early stage, leading to either stranded assets or high follow-up costs. Only a neutral framework can maximise market competition and innovation while keeping costs at a minimum level

### *2.5 How should progress be assessed for other aspects of EU energy policy, such as security of supply, which may not be captured by the headline targets?*

The attempts of the EU Energy Council and the European Commission to judge the overall energy security needs of Europe, in advance of market signals and geo-political developments, have, on a number of occasions, proved somewhat misguided. Global developments related to the availability, accessibility and pricing of natural gas in recent years, combined with the European recession, have had, in reality, a greater impact on European security of supply than, for instance, EU external energy policy initiatives or the growth of RES-E generation.

EFET considers that security of supply can be most effectively assured by giving market participants the right incentives to balance their portfolios and fulfil their contractual obligations (whether this is electricity, gas or other fuels). For both gas and electricity, the ongoing work on the Electricity Balancing Network Codes (currently being drafted by ENTSO-E and ENTSO-G) will be key to ensuring coherence between the EU energy and climate policies on the one hand, and imperatives in terms of security of supply.

Effective national balancing mechanisms and cross-border balancing schemes are important as they can help support the cost-effective integration of renewable energy. Alongside other improvements in the market, including proper competition among producers and suppliers, elimination of illicit state aid to the energy sector, full unbundling of TSOs, well-functioning and liquid wholesale markets in all timeframes and completion of the single markets in power and gas, they should suffice to safeguard energy security of supply.

EFET believes that the improvement of market arrangements should be the primary task of regulators, in order to sharpen price signals in wholesale markets (and improving the ability of market participants to respond to such signals). The European Commission and ACER should oversee these efforts.

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<sup>4</sup> See the *EFET response to the EEAG consultation of the European Commission*, 30 April 2013, available at: [http://www.efet.org/Cms\\_Data/Contents/EFET/Folders/Documents/EnergyMarkets/RE/~contents/8AZJMNVVGNRDBCEW/30042013\\_EFET-response-EC-consult-EEAG.pdf](http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/RE/~contents/8AZJMNVVGNRDBCEW/30042013_EFET-response-EC-consult-EEAG.pdf)

### 3. Instruments

#### *3.1 Are changes necessary to other policy instruments and how they interact with one another, including between the EU and national levels?*

As mentioned in our General Comments (see point 1 and 2.1), the achievement of environmental goals needs to be consistent with other objectives. In particular, if a RES target were to be set, it should be pursued in a manner which is compatible with the vision of a common European energy market, operating without distortions. A level-playing field can only be reached if RES are integrated economically into the current European energy market design. Therefore, the market integration of RES-E should be the cornerstone underpinning the common market in the future. The EU ETS, for instance, is a successful example of how environmental policy can be pursued according to a market-based design, harmonised and internationally compatible across Europe from the start. Some of the inconsistencies raised by current support mechanisms aimed at achieving the current 2020 targets are discussed below.

We believe that the European Commission needs to take a stronger role in coordinating and supervising the compatibility and side effects of climate policies in Member States. It can achieve this through stronger scrutiny of Public Service Obligations imposed by Member States under Article 3 of the Directive 2009/72, through the state aid guidelines for environmental protection, and by ensuring that support schemes do not infringe the Treaty by restricting trade between Member States.

#### ***Uncoordinated RES-E Support Schemes***

EU Member States have had too much room for manoeuvre in relation to the implementation of EU legislation for renewable energy, which has had detrimental effects on the functioning of the internal electricity market. The absence of coordination between national renewable energy support schemes leads to a degree of variety and incompatibility, which is certainly not in the spirit of an EU-wide internal market. Increasing the share of renewable energy in the consumption mix without at the same time ensuring the harmonisation and tradability of renewable attributes makes the integration of large volumes of electricity from renewable sources into the wholesale market impossible, which is in clear contradiction with the goal of a competitive internal energy market.

Furthermore, renewable electricity is not necessarily produced at sites with the best natural conditions or the most optimal customer base. In contrast, sites which offer the best economic or commercial conditions the investor (e.g. by reference to high tariffs) are preferred, this leading to unnecessarily elevated socialised costs.

Finally, there is also no distinction with respect to the different degree of maturity of technology. In many areas, it is common understanding that mature technologies are ready for large-scale deployment, whereas immature technologies still need R&D support.

### ***Priority Dispatch and Access for RES-E***

In order for the energy market to contribute to a least-cost solution for RES-E deployment it is crucial that that all generation (RES and non-RES) is competing on a level-playing field. This entails, for example, equal treatment in grid access and grid charging.

Priority dispatch of renewable production, often combined with fixed feed-in tariffs, means that RES-E producers always produce to the highest possible capacity with a right to full remuneration, even when the produced power is not needed due to low demand and overcapacity of other renewable sources. Therefore, priority dispatch does not incentivise RES-E producers to moderate their own output efficiently. This leads conventional generation operators to perform multiple stop-start operations which, in addition to being unnecessary costly, makes the overall environmental benefit in terms of GHG suspicious. Besides, such operations may artificially lead to negative prices (in Germany or Italy for instance), which further erode the overall income from the market leading to further intervention. Alternatively, such operations are often carried out at the direction of the system operator without proper remuneration.

Although RES-E producers are currently assured of either priority or guaranteed access and priority dispatch according to the Renewables Directive, this should not prevent the provision of market-based or TSO-designed incentives to RES-E producers to moderate their own output in response to price signals or to contribute to the management of network congestion and system imbalances. Future versions of the Renewables Directive should clarify this in more detail and should be consistent with European market design whereby generators of all types are largely responsible for their own dispatch decisions. Likewise, in the future subsidy regimes should rather be based on incentives that do not distort dispatch decisions and do not involve the TSO in buying and selling electricity, which is contrary to the unbundling requirements in the Electricity Directive.

Particular attention must be given to small-scale generation currently connected at the consumers' sites behind the connection point. At present, approaches with respect to network charges and taxation rules allow for uneconomic decision, based on avoiding different charges or taxes that are to the detriment of total system costs.

### ***RES-E financial support schemes***

Most existing support schemes have explicit or implicit trade barriers which distort the internal market. The direct effect on competition depends on the design of the support scheme, e.g. arrangements for grid access or dispatch. Generally, feed-in tariffs are more distorting because they exclude RES-E from the power market and therefore, limit liquidity and competition in power markets and are usually, by definition, exclusively national with a ban on import and export of the renewable production or

the renewable element of supported production. These are, arguably, quantitative restrictions on cross-border trade.

At present, we see various structures, e.g. in funding schemes for financial support systems, ranging from tax-funded systems to tax relieves and to levies on fossil fuels or power. Inevitably, such variation will create distortions, impede competition between renewable energies and between producers, and create barriers for cross-border trade and competition.

In our view, the 2030 framework should contain provisions for a reform allowing the EU as a whole to reach renewable energy consumption goals in a sustainable manner at an acceptable cost for society. Such a reform should include:

- Improving cross border congestion management operationally,
- Addressing the question of dispatch in a way consistent with the EU target model,
- Market based RES support schemes where support schemes do not constitute a barrier to cross border exchanges.

### ***EU ETS design***

As previously stated, the central role of the EU ETS needs to be restored to incentivise cost-efficient emission reductions and place the EU on the least-cost decarbonisation path, in particular for its power system. Recent experience shows that the scheme has only poorly coped with shocks and other distorting events. The EU ETS design, in particular its fixed supply, may have proved to be its main weakness. With no 'embedded' possibility for the instrument to adjust to significant changes in circumstances, policy makers were left with the unappealing choice to intervene to restore the relevance of the EU ETS signal.

Whilst we call for a general move to market-based, EU wide support schemes for renewables and energy efficiency, we appreciate that the transition away from national, command & control measures will not take place overnight. In our view, an urgent design reform of the EU ETS is needed to make it resilient to unanticipated distorting effects of RES-E and energy efficiency subsidies, as well as to major economic shifts.

This could take the form of a transparent and predictable mechanism to introduce a supply response to well-defined parameters. In other words, the EU ETS supply function should become part of the fundamentals of the carbon market, as in any other market. In the specific case of RES-E, that mechanism should correct emission allowance supply for the unanticipated emission reduction impact of renewable electricity forced into the power system. The intention behind would be to maintain a

consistent level of scarcity in the carbon market, thereby maintaining the robustness of the EU ETS signal for both short-term optimisation and longer-term investment.

### *3.2 How should specific measures at the EU and national level best be defined to optimise cost-efficiency of meeting climate and energy objectives?*

In view of achieving future harmonisation and greater efficiency of resource allocation for energy and climate policies, EFET believes that the European energy and climate policy developed by the European Commission should follow the principles listed below:

- Centre the climate policies around greenhouse gas reduction targets (2030, 2040, 2050), to be delivered by a well-functioning carbon market (reformed EU ETS),
- Include all sectors in the carbon market to allow the most cost-effective investment decisions for decarbonisation in a non-discriminatory manner,
- If needed, set up RES targets through an EU wide scheme,
- Move away from operating aid for RES-E towards investment aid through European tenders or “take or pay” support arrangements,
- Progressively remove financial support for mature or maturing RES-E technologies, and channel support for nascent technologies through R&D funding,
- Revise priority access and dispatch rules for RES-E and require RES-E producers to the same balancing rules as other generators.

### *3.3 How can fragmentation of the internal energy market best be avoided particularly in relation to the need to encourage and mobilise investment?*

As mentioned above, the current fragmentation of energy and climate policies has proved detrimental to the objective of completing the internal energy market. In addition, we believe that a more harmonised, European, and market-oriented approach would deliver greater environmental benefits, while rationalising the socialised costs of decarbonisation.

For additional information, please refer to points 1, 2.1 to 2.5, 3.1, and 3.2.

*3.4 Which measures could be envisaged to make further energy savings most cost effectively?*

Please refer to points 1, 2.1 to 2.5, and 3.1 to 3.3.

*3.5 How can EU research and innovation policies best support the achievement of the 2030 framework?*

Please refer to point 2.4.

#### **4. Competitiveness and security of supply**

*4.1 Which elements of the framework for climate and energy policies could be strengthened to better promote job creation, growth and competitiveness?*

It needs to be recognised that achieving the European target of reducing greenhouse gas emissions will have a profound impact on the European economy and will require the diversion of economic resources away from other parts of the economy. Climate policies will better support job creation and growth if they ensure that targets are achieved in the most efficient way and at lowest costs. Climate and energy policies, therefore, need to be strengthened to place cost efficiency and market integration at the centre of policy design, and to avoid perverse incentives.

*4.2 What evidence is there for carbon leakage under the current framework and can this be quantified? How could this problem be addressed in the 2030 framework?*

As a federation of energy traders, EFET does not have a position on this point.

*4.3 What are the specific drivers in observed trends in energy costs and to what extent can the EU influence them? How should uncertainty about efforts and the level of commitments that other developed countries and economically important developing nations will make in the on-going international negotiations be taken into account?*

The international context is a key factor when making policy decisions that will trigger structural investments to shift the EU economy to a lower carbon development path. We believe, however, that uncertainty with regard to the outcome of international climate negotiations is not a reason for indecisiveness. Learning from the slow pace of those negotiations, a mistake would be to wait and make decisions solely on the basis of the outcome of the current negotiation cycle expected to end in 2015. We believe that 2015 will only be a step – albeit an important one – in the process of building an international policy framework based on meaningful pledges by all parties involved.

Consequently, uncertainty related to the international negotiations should not prevent the EU from adopting a reasonably ambitious position going into the 2015

negotiations. Similarly, a mixed outcome in 2015 should not necessarily trigger an automatic scaling down of the EU ambition.

*4.4 How to increase regulatory certainty for business while building in flexibility to adapt to changing circumstances (e.g. progress in international climate negotiations and changes in energy markets)?*

Climate policies during the 2010-2020 period have tended to concentrate on protecting investors from market risks while, at the same time exposing them to additional regulatory uncertainty. This has been counter-productive for a number of reasons. Most economic risks can be managed effectively in commodity and financial markets while regulatory uncertainty cannot be mitigated. Indeed transferring economic risks on to potentially unwilling consumers or taxpayers, or to other market participants, helps create political uncertainty. Regulatory uncertainty then has a detrimental impact on market participants' perception, within and outside of the EU, of the EU's commitment to the instruments and targets of its climate policy. The whole effect of this approach is to drive up costs unnecessarily since investors argue that they require significantly more compensation for taking on such uncertainties.

One particular long terms issue is the conditional evolution of GHG emissions reduction targets to international negotiation on climate change. This brings particular instability, both in terms of quantity signals and regulatory uncertainty. As mentioned in 4.3, the EU climate policies, in GHG emissions reduction framework, should be made more resilient to the progress in international climate negotiations. This should ensure regulatory certainty for market participants.

As mentioned in point 2.1, regulatory certainty would also be facilitated if the post-2020 policy framework avoids the current disaggregated target system. It would hopefully discourage Member States from setting up individual targets that would be detrimental to the overall investment climate in low carbon technologies in the EU.

*4.5 How can the EU increase the innovation capacity of manufacturing industry? Is there a role for the revenues from the auctioning of allowances?*

As a federation of energy traders, EFET does not have a position on this point.

*4.6 How can the EU best exploit the development of indigenous conventional and unconventional energy sources within the EU to contribute to reduced energy prices and import dependency?*

As a federation of energy traders with a neutral approach to technologies and fuels, EFET does not have a position on this point.

*4.7 How can the EU best improve security of energy supply internally by ensuring the full and effective functioning of the internal energy market (e.g. through the development of necessary interconnections), and externally by diversifying energy supply routes?*

### **Market fundamentals**

In addition to the discussion of the balancing network code in response to question 2.5, EFET believes that there are fundamental improvements that the European Union and national Member States need to focus on to enhance the functioning of the internal electricity market:

- Integrate renewable energy into the power market design (wholesale market and network infrastructures)
- Develop and improve intraday markets by moving gate closure to H-1 and facilitating cross border exchanges to make the maximum use of interconnector capacity
- Develop and improve balancing mechanisms, also on a cross border basis,
- Allow free price formation in wholesale markets and remove explicit and implicit caps/floors
- Extend real-time metering to enable demand response.
- Remove unnecessary operational requirements and restrictions on generation companies.
- Improve the functioning of the gas market, avoiding run-or-pay obligations and other restrictions on gas fired power plants and ensuring that power plants have flexible access to transmission networks and wholesale gas markets.
- Ensure a stable and consistent energy policy framework for decarbonisation based on ETS.

These recommendations to improve the energy (MWh) market will already strongly promote an ongoing match between supply and demand and encourage the efficient use of all assets (generation and demand-response). Flexibility and reliability are essential to back up the increasing share of intermittent generation.

### ***Infrastructure improvements***

Fundamentally, EFET believes that infrastructure improvement has a greater meaning than solely building more infrastructure. Congestion needs to be addressed by TSOs by making sure that enough existing transmission capacity is made available to the market in the first place. The lowest cost option to do so is to make sure that existing transmission assets have been used to their maximum extent. Most particularly, the development of capacity calculation and allocation rules thanks to the Capacity Allocation and Congestion Management (CACM) and Forward Capacity Allocation (FCA) network codes – a common grid model for flow based calculations in day ahead and intraday and intra-zonal ATC calculations for forward capacity allocation – should be used to maximise available capacity on existing assets. The allocation of the maximum possible of anticipated available capacity through PTRs or FTRs in forward timeframes is also key to improving infrastructure use, as well as the utilisation of coordinated redispatch and countertrading tools to guarantee allocated capacity when necessary.

The expansion of the transmission grid with the objective to avoid structural congestions is nonetheless important for a well-functioning market, and therefore for the efficient integration of renewables. For instance, increasing interconnection capacity between markets with large amounts of base load capacity and markets with significant peak load capacity offers clear benefits and would be used by market participants. Following a careful analysis of structural congestions which cannot be solved by improving the use of currently existing infrastructure, TSOs should propose new infrastructure projects to relieve structural congestions, ideally using accumulated congestion revenues to finance those projects. Regulators should ensure that an appropriate framework is established to incentivise the use of congestion revenue for the new investments.

### ***Capacity Mechanisms***

To counteract some of the shortcomings of the internal energy market in its current design, including the impact of RES-E penetration on the internal market, some Member States have implemented or are implementing capacity mechanisms. The preferred approach of EFET is, initially, for regulators to improve market arrangements to mitigate these issues by sharpening price signals in wholesale markets (and improving the ability of market participants to respond to such signals). Such measures will also encourage better liquidity and greater competition in order to deal with both risk and market power issues. Furthermore, the development of new products in both wholesale and retail markets have the potential to reward capacity without necessarily requiring regulatory intervention.

In addition, with the continuing integration of EU wholesale markets there is now a strong need, as discussed in the Commission's recent report on the internal market (EU Commission, 2012), for generation adequacy to be considered as a European issue and that "[Member States] should seek cross-border solutions to any problems they find before planning to intervene."

EFET believes that policy makers should avoid disturbing price signals in the energy (MWh) market if and when designing capacity mechanisms. The integration of EU electricity markets through the market coupling process relies on well-functioning day-ahead spot prices. Likewise, effective competition in the retail sector relies on efficient and liquid forward markets. Therefore, where capacity mechanisms affect these, they are also likely to have an impact on the EU internal market. Dilution of MWh price signals could also damage incentives to invest in reliable and flexible power generation. These characteristics are increasingly important as the European market moves towards decarbonisation with larger proportions of renewable capacity. Therefore, the EFET believes that capacity mechanisms should ideally:

- Demonstrably enhance adequacy and reliability;
- Avoid distortion or dilution of price signals from energy (MWh) markets;
- Be transitory in nature, with a natural dynamic and process towards phase-out of their price signals as generation adequacy improves;
- Focus on time periods far enough ahead to limit overlap and interference with forward and future markets in electricity;
- Facilitate an active demand side and promote wide consumer engagement through willingness to pay for reliability and/or price stability;
- Be non-discriminatory, by taking into account the contribution of non-national generation through interconnection which may decrease local needs;
- Be non-discriminatory between new and existing facilities and between different technologies
- Minimise centralised management processes and maximise the scope for independent decisions by market participants about their off-take and delivery obligations, so that market dynamics have a chance to function;
- Minimise risk of regulatory failure and of need for redesign (e.g. by avoiding overly complicated mechanisms)
- Use market-based remuneration mechanisms (e.g. by means of auctions, tenders, or subscription obligations);
- Be suitable for EU wide / harmonised application<sup>5</sup>.

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<sup>5</sup> For additional information, please refer to Design Principles for Capacity Mechanisms, an EFET Discussion Paper, February 2013, available at : [http://www.efet.org/Cms\\_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/Z5Z2WKTWJ8DB8F3A/EFET-discussion-paper-Capacity-Remuneration-Mechanisms\\_February-2013.pdf](http://www.efet.org/Cms_Data/Contents/EFET/Folders/Documents/EnergyMarkets/ElectPosPapers/~contents/Z5Z2WKTWJ8DB8F3A/EFET-discussion-paper-Capacity-Remuneration-Mechanisms_February-2013.pdf)

## **5. Capacity and distributional aspects**

*5.1 How should the new framework ensure an equitable distribution of effort among Member States? What concrete steps can be taken to reflect their different abilities to implement climate and energy measures?*

Targets must be set at EU level only from 2020 and no national targets should be applied. Efficient pricing of GHG emissions will naturally lead to an equitable distribution of costs and effort among Member States.

*5.2 What mechanisms can be envisaged to promote cooperation and a fair effort sharing between Member States whilst seeking the most cost-effective delivery of new climate and energy objectives?*

As mentioned previously (points 1, 2.1 to 2.5, and 3.1), an EU-wide target for the reduction of GHG emission, the harmonisation of RES-E support schemes to facilitate future cross-border trading mechanisms and the tradability of RES-E production attributes are cornerstones of a cost-efficient climate and energy policy for Europe.

Exploiting the potential for cooperation mechanisms which currently exist under the Directive, including statistical trading, financing of joint projects and joint support schemes would allow Member States to share the burden of the EU decarbonisation objective in the most cost-efficient and environmentally effective manner in the short term.

Post 2020, EFET advocates for an overall review of the energy and climate policies whereby the decarbonisation objective of the EU would be driven by greenhouse gas reduction targets and a well-functioning carbon market extended to all sectors. RES-E targets should ideally be abandoned or set up at an EU level to ensure coherence between climate action policies and the development of the internal energy market. Financial incentives for renewable energy should be fully harmonised at a European level, subject to mutual recognition of renewable attributes, and gradually phased-out for mature technologies. For additional information on all these elements, please refer to points 1, 2.1 to 2.5, 3.1, and 4.7.

*5.3 Are new financing instruments or arrangements required to support the new 2030 framework?*

As mentioned in point 3.1, EU Member States have had too much room for manoeuvre in relation to the implementation of EU legislation for renewable energy, which has had detrimental effects on the functioning of the internal electricity market. The absence of coordination between national renewable energy support schemes leads to a degree of variety and incompatibility, which is certainly not in the spirit of an EU-wide internal market. Increasing the share of renewable energy in the consumption mix without at the same time ensuring the harmonisation and tradability of renewable attributes makes the integration of large volumes of electricity from renewable

sources into the wholesale market impossible, which is in clear contradiction with the goal of a competitive internal energy market.

Furthermore, renewable electricity is not necessarily produced at sites with the best natural conditions or the most optimal customer base. In contrast, sites which offer the best economic or commercial conditions the investor (e.g. by reference to high tariffs) are preferred, this leading to unnecessarily elevated socialised costs. Currently, there is also no distinction with respect to the different degree of maturity of technology.

Going further, EFET believes that financial support for RES-E should move away from operating aid for towards investment aid through European tenders or “take or pay” support arrangements. European-wide trading of green certificates, valued in the internal market according to harmonised renewable source quota obligations for each power supplier could also reduce the overall social cost of existing support schemes. Using a certificate approach means that for newly built renewable plants, sites and technology will be chosen in the most cost-efficient way in consideration of several factors (e.g. site, proximity to grid connections).

Expensive technologies will therefore not be supported and incentives will point in the direction of lowering costs and offering competitive solutions. This can be seen, for example, in the very successful Swedish quota system, where the investors focus on hydro, wind and biomass. This leads, in the end, to lower costs for society, and makes potential windfall profits (due to minor differences between sites and technology) acceptable for society as well. Immature technologies could still receive financial aid through targeted R&D funding.