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Mr. Claude Turmes
ITRE Rapporteur

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The risk of Internal Energy Market distortions arising from the Commission proposal for a RES Directive

Dear Mr. Turmes,

The draft RES Directive as published by the Commission on 23 January introduces an ambitious EU target for renewable energy consumption of 20% in 2020. We support this target and are committed to participate actively to help reach it.

In this context we appreciate the need to continue with separate incentives for investment in renewable energy production, until the carbon allowances market framework is more fully effective and new production technologies have reached a greater degree of maturity. Promotion of renewable energies should always contribute, nonetheless, to the overriding objective of reducing greenhouse gas emissions.

EFET, representing a large majority of those companies active in trading energy instruments in Europe, are interested in helping to provide solutions to the challenges of sustainable development. The majority of the investments needed will most likely come from our member companies and their affiliates. Yet we are not convinced that the Commission's draft Directive, as currently framed is an adequate measure, to ensure the required future investment across the whole EU.

In any efficient allocation of targets for renewable energy production or consumption between EU Member States, we believe the relative cost-effectiveness of potential projects must play a key role. The current burden-sharing proposal by the Commission is based, however, on a flat rate, GDP-linked approach.

We believe efficient target compliance can ultimately be achieved, only if geographical flexibility is mediated through market mechanisms. The obvious and robust system currently available in Europe would be trading of Guarantees of Origin ("GoO"). Thus it is a matter of regret to EFET that the Commission has stopped short of requiring Member States to reach at least a minimum level of opening of their national support systems to cross border trade in GoOs. In our view, this failure makes it unlikely that any real European market in GoOs will develop.

<u>We wish to draw your attention to four threats, posed to the EU twin policy goals of sustainability and openness in energy markets, if cross-border trade in GoOs will fail to evolve:</u>

**1. Distortion of the wholesale electricity market**

EFET supports the addition of new renewable power generation capacity across Europe. We are concerned, however, at the lack of harmonisation of national support mechanisms, to align them better with the operation of the wholesale power market. There is a danger of uncoordinated, nationally isolated subsidy schemes for renewable power output impairing trading liquidity, to the extent we have it today. We believe that facilitating some price signals between national schemes will diminish the risk of renewable power supply remaining divorced from liquidity in the wholesale power market. In the absence of such signals, we could end up with some 25% of continental electricity generation isolated from normal competitive processes.

In addition, absolute priority access to the grid is not necessarily compatible with the operation of market mechanisms determined by supply and demand, as required by EU competition law and by legislation creating the internal market in electricity. We suggest that RES generators, especially those claiming feed-in tariffs, should incur countervailing responsibilities not to cause avoidable network congestion, especially if it might have the effect of interrupting CB trade in electricity inside the internal market. They should therefore be required to schedule their forecast power production as accurately as possible. In the event of the forecast being wrong or interfering with the use of already allocated cross border transmission rights, or of the submitted schedule otherwise placing too heavy a burden on the interconnected network, TSOs must be given discretion occasionally to turn down output, even if payment obligations are not cancelled pursuant to the pertinent national support mechanism

**2. Impediments to internal trade in goods and services**

There are some articles in the proposed directive (e.g. 8.2, 9.2) which would overtly impede trade in instruments evidencing renewable energy production, possibly even trade in the energy itself, on a literal reading. The proposed Directive not only eliminates flexibility for project operators *ab initio*, but also allows Member States to introduce their own restrictions on trade in GoOs. In our view these articles will lead to a violation of Articles 28 and 31 of the Treaty, guaranteeing freedom of movement of goods and services inside the EU. At the point when Member States would come to transpose the proposed Directive into national law, we expect that it will run a real risk of being challenged legally in several European countries. This could delay the implementation of the Directive and cause Europe as a whole to lose momentum towards achievement of the ambitious 20% target. Much of the estimated € 8 billion saving through the efficiency of flexibility mechanisms might be lost. If several countries then failed to reach their targets, this could trigger Commission infringement procedures.

For further details concerning the legal aspects of the proposed Directive see the Annex to this letter, written by the legal firm DLA Piper.

3. **Opportunities for cost saving will be missed**

As mentioned above, it is our view, that the EU can only reach the overall target of 20 % energy consumption from renewable sources in a sustainable and efficient manner, if an internal trade mechanism for Guarantees of Origin forms an integral part of the legislative framework.

Costs of investing in renewable energy, which eventually have to be borne by consumers, could be reduced substantially, by ensuring that investments take place where local conditions are favourable to the technology involved. Subsidies amounting to an estimated Euro 200 billion over the period 2010 – 2020 are unlikely to result in efficient and sustainable investment incentives, if administered and governed on a purely national basis. For example, solar panels will tend not to be placed there were the sun shines, but where the highest national subsidy is offered. Some (sunny) countries are already complaining that solar panels become much more expensive or are not even available, because they are being installed in less sunny North West Europe.

The Commission itself has estimated the additional cost of reaching the target, without the flexibility of any trade mechanism, would amount to up to € 8 billion per annum by 2020.This number seems convincing, based on the assumption, that the overall 20% renewable energy consumption target by 2020 will entail approximately 35% of installed production power generation capacity being renewable, requiring in turn several hundred billions of Euros of new investments over the next 10 to 12 years.

4. **Distortion of retail energy markets**

The Commission insists that GoOs must in future unite in one instrument the functions of target counting, evidencing an application for financial support and informing customers about the fuel mix (Art. 8.1 paragraphs (a) to (c)). But the automatic cancellation of a GoO for customer information purposes, upon an application for financial support, and *vice versa*, will reduce liquidity in the market for the supply of renewable energy to customers.

Many suppliers will not be able to meet the future demand of their customers, if they are precluded from labelling supplies as renewable, just because they have received some subsidy along the supply chain, no matter how insignificant. Likely export or import restrictions on "foreign" GoOs will further diminish liquidity.

As a result of the disclosure provision in the Electricity Directive 2003/54/EC (Article 3.6), customers have become more aware of the fuel mix behind their power purchases. In certain countries this has led to customers massively switching to suppliers with more renewable energy in their mix. In total 130 TWh of renewable energy is sold from producer to retail supplier, evidenced by “voluntary” GoOs. Many retail suppliers can only meet the demand by “importing” certificates. We do not believe this “voluntary trade”, relying on disclosure also of sourcing from existing renewable generation units, should be precluded by a new Directive.

In conclusion, we are seriously concerned that the draft Directive in its present form will lead to an obstruction rather than a development of a European market in renewable energy. As the proposed Directive will have a fundamental impact on investment decisions and on the exercise of rights normally guaranteed by the European Union, we are reluctant to support the current political consensus, to shorten the co-decision process to only one reading by each of the European Parliament and the Council.

We realise there is a strong political will and pressure to push forward the implementation of a RES Directive. In order to minimise market distortions and the legal risks we have highlighted, we believe several basic amendments to the text will be necessary, however. In order better to explain our concerns and our suggestions for amendments, we would welcome a meeting with you, as an EFET delegation, possibly combined with other associations as well.

Sincerely yours,

EFET

J.N.H. van Aken
Secretary General

Cc.
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Annex 1