– Consultation response –

Review of RED II on the promotion of the use of energy from renewable sources

Brussels, 9 February 2021 | Europex welcomes this opportunity to contribute to the Commission consultation of the Review of RED II on the promotion of the use of energy from renewable sources. In this paper we extract critical points raised in the consultation questionnaire that underpin the need to modify RED II and explain how such a review will support the integration of renewable energy sources while minimising unnecessary market distortions.

1) RED II needs to be modified to align it with the clear market-based approach taken by the Electricity Regulation and Directive and with the cost-efficient decarbonisation objectives of the Green Deal.

The EU has supported a market-based approach to achieve decarbonisation – for example, Recital 9 of Directive (EU) 2019/944 argues that 'A well-functioning electricity market design is the key factor enabling the uptake of renewable energy'. However, the current RED II text does not ensure consistency with this approach – support schemes, which fundamentally distort the functioning of electricity markets (forward markets as well as spot markets are being impacted) are permitted, with no legal safeguards in place and no phase-out requirements.

The deployment at significant scale of support schemes (without sufficient safeguards concerning their design) risk undermining the potential of the market framework to reward flexibility and innovation, which are vital aspects in high-renewable system, which also values demand-side flexibility. Poorly designed support schemes in place for long-term periods would lead to 2030 and 2050 renewable energy targets being achieved at far higher cost than necessary to the consumer and the energy system as a whole. Acknowledging the challenges around 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 renewable energy targets, especially as renewables are deployed at scale.

All support schemes have distortive impacts to some extent. If designed correctly, market-based support schemes encourage energy producers and consumers to participate in the market and to finding innovative solutions to optimizing market revenues instead of support payments. Through their activity, market participants support market price signals to reflect the entire physical reality of a market and to serve as trustworthy links between sectors. The use of market mechanisms avoids misallocations, which would otherwise be caused as a result of the assumption of risks by the state. Market-based support schemes should pave the way to full market integration of supported energy carriers and full exposure to market prices.

Electricity markets are successfully integrating increased amounts of renewable energy, and trading on power exchanges is allowing effective management of risk. More efficient direct marketing is also

playing an important role in integrating renewables into the market, while complementary tools such as guarantees of origin (GOs) can allow the green value of the energy to be traded independently of the commodity. Forward / futures markets provide important tools to hedge and manage price risk through the development of liquidity in contracts with increasingly long time horizons, which among other aspects also can help the development of market-based PPAs.

2) Include safeguards against distortion of electricity markets by support schemes

For renewable electricity and the energy market, all types of aid have distortive effects and should be minimised. While the current RED II text acknowledges that support should be as non-distortive as possible, a definition of 'electricity market integration' into electricity markets is still lacking.

We propose the following definition of market integration of renewable energies, which should be inserted into Article 4 of RED II: '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, including spot and futures markets as well as markets for ancillary services, are maximised while government funding/aid is minimised, ensuring efficient allocation of resources and increasing overall welfare.'

A legal requirement to avoid distortion of electricity markets as defined in Article 2(9) of Directive (EU) 2019 /944 should also be inserted. Importantly, this definition also includes forward markets, which can also be negatively impacted by more recent support scheme designs such as publicly backed contracts for difference (CfDs)

A clear phase-out timetable for support schemes should also be included in the RED. Distortive support schemes risk 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.

3) An upgraded framework for guarantees of origin to support decarbonisation

The GO framework has significant further potential. A scaled-up GO scheme covering all production sources (i.e. both renewable and non-renewable electricity, gas, heating and cooling) would allow key energy sources to be reliably certified and provide the means for consumers to make choices based on the contribution that the energy sources and technologies make to decarbonisation. This in turn would help to incentivise the take-up of renewable energy and would contribute towards achieving renewable energy targets at least cost. The scaled-up scheme would be based on European-wide standards, ensuring

that certificates can be transferred between Member States and traded on a European scale. A robust and comprehensive certification and verification system covering all renewable and low carbon fuels should be based on the following principles:

Full disclosure: A scaled-up GO scheme covering all production sources, both renewable and non-renewable, of all consumed electricity, gas, heating and cooling (i.e. full disclosure), would allow a more complete and reliable certification of energy sources. This in turn would provide a better view of the contribution that the energy sources and technologies make to decarbonisation, further incentivising the take- up of renewable energy and helping achieve the more ambitious 2030 targets at least cost.

European standards: Ensuring full harmonisation of rules is vital to enable unhampered trading of GOs in efficient, transparent and liquid markets. These standards should be developed in close cooperation with the relevant issuing bodies and stakeholders with the overall objective to make GOs easily tradeable. Importantly, it must be ensured that common deadlines for cancellation and expiry are homogenously applied throughout Europe.

Apply the same level of VAT fraud protection to GOs as there is for emission, power and gas markets: The domestic reverse charge mechanism (DRCM) is a vital tool to help prevent missing trader intra-community (MTIC) VAT fraud in highly liquid energy and emissions markets in Europe. Council Directive (EU) 2018 /1695 actively extended earlier amendments to Article 199a of the VAT Directive, enabling Member States to apply the DRCM to specific transactions, including for electricity, gas and emission allowances. GOs, which are very similar in nature to European Union Allowances (EUAs), should be explicitly mentioned in the derogation of Article 199a which is currently not the case (although some Member States already apply the DRCM to GO transactions).

Ensure RES can fully participate in all electricity market timeframes to allow revenue generation from different markets: RES installations must be able to access multiple revenue streams ('revenue-stack') from different markets. In addition to the wholesale market, the ability for RES to participate in upwards and downwards balancing, provision of ancillary services and market-based redispatch is therefore important. The Clean Energy Package provisions provide the basis for this, and any remaining grid-related and regulatory barriers need to be removed.

Upgrade the Guarantees of Origin (GOs) framework to allow consumer preferences to incentivise further RES: Guarantees of Origin (GOs) effectively allow the green value of the energy to be recognised and traded across Europe in the form of certificates. GOs have the potential to provide a new source of revenue for post-subsidy plants, especially as an organised market for GO trading develops, together with a reference price. GOs play an important role in PPAs to ensure the traceability of green power, and their value can even be factored into developers' bids.

4) Principles for building a more integrated energy system.

Maintaining efficient, transparent and liquid gas and electricity wholesale markets, as they gradually integrate more renewables from distributed resources, will be vital to provide the foundation for further integration of (renewable) electricity and gas with other energy carriers and with other end-use sectors. Efficient gas and electricity markets provide flexibility and resilience in a high-renewables system and contribute to the energy transition. There are already significant links between the gas and electricity markets at trading level (i.e. traders continuously use well-established products to value and hedge multiple combinations of fuel/energy conversions) and in the form of gas-to-power assets (e.g. CCGT). These forms of integration should be maintained and enhanced where possible, as they will support further efforts to integrate with other sectors.

Reliable, separate price signals coming from the wholesale gas and electricity markets will allow owners and operators of flexibility assets (such as large industrial consumers, storage, distributed assets, electric vehicles, etc.) as well as conversion assets (such as P2G, P2X) to make efficient economic decisions of how to best operate assets and to decide where to invest. In the future integrated energy system, clear, undistorted market price signals will be key to provide incentives for market participants to interact and ensure that the flexibility potential from assets is both incentivised and activated.

The development of local flexibility markets will also play an important complementary role to organised markets, allowing the harnessing renewable energy and load flexibility at local level. For

example, surplus renewable energy can be converted into hydrogen via electrolysis, with clear price signals providing the incentives. Power and gas exchanges will continue to play a key role by providing clear and trusted market price signals to stakeholders, allowing for informed decisions and optimisation of activities.

Consistent carbon pricing via the EU ETS: Emissions cap and trading by means of a strong EU ETS should be the principle mechanism to drive emissions reductions in Europe and provide overarching incentives for innovation and investments. Economy-wide carbon pricing across sectors will be key to encouraging investment in cost-effective abatement technologies and driving further integration between sectors where it is most efficient.

The different types of hydrogen will need to be able to compete on a level playing field, also with alternative energy carriers. While hydrogen markets may well develop on a regional basis, or in clusters, it is important to already put in place a number of market principles which will allow fair competition in emerging hydrogen markets and further encourage it's use in different sectors.

In line with the development of the common Internal Energy Market, the objective should be the creation of an open, liquid, transparent and competitive EU hydrogen market with unhindered cross-border trade. This will require close alignment with some key principles underpinning the natural gas market, including unbundling and non-discriminatory third-party access to hydrogen infrastructure. Traded hydrogen markets, supported by certificates for hydrogen (based on GOs, which will reflect the carbon content of the alternative energy carriers/fuels), have the potential to play a key role in the decarbonisation of the EU energy system.

For further context, we encourage you to read our position papers: 'Moving towards full market integration of renewables – the most cost- efficient way to decarbonise the energy sector' and 'Six recommendations for a scaled-up Guarantees of Origin (GO) scheme to support decarbonisation'.

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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