

EUROPEAN COMMISSION CONSULTATION PAPER ON STATE AID FOR ENVIRONMENTAL PROTECTION



EFET¹ RESPONSE

The responses set out below reflect a general overview of European support mechanisms for renewable energy. It is the view of the European Federation of Energy Traders (EFET) that significant improvement and harmonisation of these mechanisms is required. DG COMP should focus their attention on better integrating renewables into the internal market and to work towards the eventual phasing out of state aids and other support mechanisms. This is one of the objectives of the European Commission, as stated in the Communication COM (2012) 217 and the existing guidelines. In particular, the “balancing test” in the guidelines implies that as renewable penetration increases, the less that market distorting impacts from state aid should be tolerated. A gradual opening of current national support schemes using existing cooperation mechanisms, e.g. Joint Projects, would be a very important first step.

1. GENERAL QUESTIONS ON ENVIRONMENTAL PROTECTION MEASURES

- 1.1 **Have State aid instruments been adapted in your country since the introduction of the 2008 Environmental Aid Guidelines? For example, changes in types of aid instruments, in aid intensity, in selecting aid beneficiaries (e.g. via subsidy tenders or other selection processes)? Have State aid measures been phased out? Please explain.**
- 1.2 **Have any changes in environmental support policy been announced or envisaged for the near future such as phasing out existing measures and/or introducing new support measures? If so, what is the reason for making such changes?**

State aid instruments are constantly evolving in Member States, often in a conflicting and uncoordinated way. Member States largely use policy instruments centred on **operating aid** based on either Option 1 (feed-in-tariff type schemes) or Option 2 (certificate type schemes). However there is almost no coordination between Member States. And Member States are switching between these options, often in opposite directions, at the same time. For example, the Netherlands is going from option 1 to option 2, while the UK and Italy are going from option 2 to option 1.

¹ EFET is an industry association which was set up in order to improve the conditions of energy trading in Europe, mainly in electricity and gas markets. Established in 1999, EFET represents today over 100 companies in 27 European countries. EFET works to promote and facilitate European energy trading in an open, transparent market unhindered by national borders. More information at: www.efet.org.

Aid intensity has reduced with declining investment costs. However, the overall volume of state aid and related schemes continues to increase. As the extent of renewable support increases, DG COMP needs to pay increased attention on the impacts on competition and strengthen its role in oversight of such measures and narrow down the options available to Member States to more market-oriented support.

Most of the support systems are purely national; however, Sweden and Norway recently implemented an option 2 system which is valid in both countries, thus reducing market distortion by harmonisation.

1.3 In your experience, how do State aid measures contribute to an increase in environmental protection taking into account other already existing mechanisms to promote environmental protection, such as regulation, taxation, or market-based mechanisms (e.g. ETS)? Are such considerations taken into account by Member States when designing State aid measures?

State aid measures have certainly led to a significant increase in renewable generation. However there has also been considerable impact on the existing market based mechanisms, in particular the EU ETS. Member States have not taken into account these impacts in designing state aid and other mechanisms. DG COMP therefore needs to ensure that the new guidelines require this, including the interactions between state aid, taxation of carbon emissions and the EU ETS. The risk is that a high penetration of renewables, although reducing carbon emissions on an individual basis, has a minor effect on emissions overall in the end due to the erosion of signals coming from market based mechanisms like ETS.

Market-based mechanisms such as the ETS can contribute positively to the objectives of state aid measures. A well-functioning ETS would increase incentives for investments in RES if support schemes were designed so that the power price forms part of the income of RES producers (e.g. premium systems with a fixed premium and a certificate scheme).

1.4 Are in your experience certain aid measures more effective in targeting specific market failures? Please explain.

1.5 Based on your experience which aid instruments rank highest in terms of their overall effectiveness in terms of achieving the environmental objective and phasing out the need for State aid (e.g. resulting in competitive and integrated renewable energy)? Please explain.

EFET agrees with DG COMP that policy makers can best deal with market failures through the internalisation of environmental costs and the polluter pays principle. The EU ETS is the policy which is most in line with this since it directly targets the by-product with the environmental impact and gives it a price, thereby internalising the costs. State aid measures to promote renewables are inevitably a less direct policy and therefore will be less efficient.

However, given the renewable targets assigned to each Member State, individual countries are obliged to also support renewables directly. Again, the principle of 'internalisation of external costs' implies that an additional premium should be provided to renewable production, either in the form of a market based scheme (certificates) or an estimated premium value over and above the market price. Measures based on either ETS or a fixed renewable premium for RES in addition to the

wholesale electricity market price are more effective than feed-in tariffs in terms of overall effectiveness and working towards a situation of competitive and integrated renewable energy.

Meanwhile, support measures which provide a variable level of support or guarantee a specific “feed-in tariff” are less effective from a long term perspective. Such measures are less likely to lead to a situation where renewable technologies are competitive and integrated in the market. This is particularly true where renewable generators do not have to sell their own output into the market, and they do not have the balancing responsibilities of other generators.

1.6 Are in your experience certain aid measures more efficient for keeping budgets under control? Is the amount of public spending needed to incentivise private investment in order to achieve a higher degree of environmental protection considered/measured? Please substantiate your answer.

The provision of a guaranteed return at a particular capital costs reduces the incentives on developers and equipment providers to reduce costs. Although equipment prices have come down, there is evidence that equipment costs for e.g. solar PV cells and wind turbines are higher in the EU than in other global markets.

Often renewable support schemes do not draw directly on government spending. Although resources often pass through a state owned counterparty, the ultimate costs are usually borne by energy consumers. There is therefore limited impact on government budgets. However the overall effect on individuals is effectively identical since all electricity consumers will also be either taxpayers and/or recipients of government spending. There is also an indirect impact on government budgets since higher energy prices reduce the political scope for raising taxes or reducing government spending. For example, in Germany, it is expected that renewable support will add about €52,7/MWh to the bills of “non-privileged consumers” in 2013. This is for a share of RES penetration of 25-30% of electricity consumption.

On the other hand, government budgets often profit considerably from feed-in-tariffs if they are subject to VAT, as this is the case in Germany.

1.8 What are the main potential negative effects of State aid for environmental protection in the context of distortions of competition and effects on trade? Is there a difference between operating and investment aid (e.g. in distortive access or allowing market access)? How are or can these effects taken into account? Please substantiate and give concrete examples.

Currently, the prevalence of renewable support mechanisms based on feed-in-tariffs, without requiring producers to sell into the market or schedule\balance (due to a strict priority feed-in rule), is causing a number of undesirable side effects:

- Increased loop flows and reductions in cross border capacity,
- Reduced available transmission capacity distorting market coupling outcomes,
- Switch in liquidity from forward markets to shorter term markets, thus reducing longer-term investment signals
- Inefficient dispatch of generation plant.

Schemes based on operating aid are likely to have a more distortionary impact on competition and trade. This is particularly the case if support schemes are different in each Member State and if trade or exchange between the national support schemes is excluded. While differences in

investment aid will affect the location of generating plants, differences in operating aid will also affect the dispatch of different generation plants.

Schemes combining FIT and priority dispatch also annihilate renewable producers' incentive to moderate their output. This boils down to transferring their scheduling and balancing burden to other generators, which are required to modulate their output, either through market incentives or on the instruction of the TSO (i.e. redispatch). This may be more expensive if, for example, a conventional plant has to perform a stop-start operation.

1.9 Have assessments been made of the effectiveness of State aid to support environmental protection compared to other measures? If so, could you elaborate on the results? Please make available any relevant studies or reports that describe the effectiveness of EAG State aid in your country.

1.10 Have evaluations been carried out of State aid, with respect to both compliance with the State aid conditions by the beneficiaries and the effectiveness of State aid in achieving the policy objective? If so, did it lead to changes/improvements in the design of aid measures? Please provide copies of any documents or studies which may be relevant.

Here is a selection of studies recommended by EFET:

- [ewi Cologne: European RES-E Policy Analysis - A model-based analysis of RES-E deployment and its impact on the conventional power market](#), April 2010
The study shows the benefits of market harmonisation and estimates the costs of national policies vs. a European approach.
- [IEA/OECD: Projected Costs of Generating Electricity](#), 2010
The study compares the costs of electricity from various generation types worldwide, showing that RES-E investment costs are higher in Europe in comparison to other regions.
- [Copenhagen Economics: Support Mechanisms for Wind Energy](#), April 2012
The study shows that depending on the maturity of a technology, different promotion schemes should be chosen.
- [CERA: The Sum of the Green Parts](#), June 2010
The study discusses how Europe can improve its performance by using cooperation mechanisms and not rely only on national policies.

2. GENERAL EXPERIENCE WITH THE ENVIRONMENTAL AID GUIDELINES

2.1 What is your general assessment of the current Environmental Aid Guidelines on State aid for Environmental Protection: what has worked well, and what has worked not so well? Have they given appropriate guidance for Member States to design well targeted environmental aid measures. Please substantiate your answer.

2.2 Have the Environmental Aid Guidelines in your experience achieved the goal as stated in paragraph 4 of contributing to implement the environmental aspects of the energy- and climate change related targets? Please explain.

As renewable penetration has increased, the current state aid guidelines are now too loose. As discussed above, different levels and methods of renewable support are now threatening the objective of the EU internal market.

2.3 Are the Environmental Aid Guidelines still addressing the most important market failures hindering environmental production and in particular the achievement of EU 2020 objectives?

The guidelines do not always seem to address the main market failures. They should concentrate on the market failure relating to the non-pricing of carbon emissions. The state aid guidelines should not try to address other perceived capital market failures (which if they exist, exist in all sectors, and can be dealt with through non-selective policies).

3. QUESTIONS ON SCOPE AND DEFINITIONS (SECTION 2 OF THE ENVIRONMENTAL AID GUIDELINES)

3.3 Based on your experience with designing environmental aid measures, do you consider the current scope of measures covered by the Environmental Aid Guidelines to have been appropriately framed? If not, please explain what difficulties you have encountered.

The framing of aid measures into the traditional categories of “investment” and “operating” aid is not particularly appropriate. The main support mechanisms are “feed-in-tariffs” and “certificates”. They both correspond to operating aid under Options 1 and 2.

Meanwhile the most popular design of feed in tariff, which is neither operating nor investment aid and instead provides for an alternative revenue stream outside of the market, is not covered.

It would be helpful for the guidelines to refer to feed-in-tariffs, fixed premium and certificate schemes directly and further develop guidelines about how these should be designed.

4. QUESTIONS ON AID MEASURES SUBJECT TO A "STANDARD ASSESSMENT" (SECTION 3.1 OF THE ENVIRONMENTAL AID GUIDELINES)

4.4 In your experience, is renewable energy more supported by way of investment or operating aid? As regards operating aid, which of the three possibilities to grant operating aid is most used in your experience? In your view, are there any specific reasons?

RES is largely supported by operating aid. The main options used are Option 1 and Option 2, with feed in tariffs being the most popular. However, as discussed, feed in tariffs, in fact, normally provides for an alternative revenue stream. The main reasons put forward for doing this is that it reduces the risk for investors, which in turn reduces the cost of support. But as discussed in 1.6 above, this often merely transfers costs and risks to other market participants, consumers, or taxpayers.

4.6 Do certain aid measures or aid instrument to support renewable energy sources on the basis of the Guidelines, provide in better results in terms of renewable energy becoming competitive and being integrated in the energy market? Please explain.

As the European Commission generally takes a very negative view of operating aid in other sectors of the economy as being the most distortive, EFET recommends that the European Commission works towards removing all operational aid for renewable electricity production. In a long term

perspective, a functioning ETS should be the driver for investments in RES. It should therefore add a paragraph 111 (bis) to the guidelines, as follows:

§ 111 bis Member States may not grant operating aid to generators after the date specified.

In the meantime the European Commission should require that all supported renewable investment are obliged to sell into wholesale markets and to schedule and balance as for other market participants. This would imply the following changes to paragraph 109 of the guidelines:

§109

Add (d) Where aid is granted in accordance with point (a), the undertaking in question must itself be responsible for selling generated electricity into wholesale markets and the operating aid must constitute an additional amount rather than an alternative revenue stream. In addition, the undertaking must be subject to the same transmission requirements as other generators, including compliance with any European network codes adopted under Regulation 714/2009.

In addition, the guidelines should specify requirements about the cross border exchange of renewable energy and ensure that:

any renewable electricity, generated in the European Union, and delivered to consumers in the Member State in question should be eligible for aid.

11. MISCELLANEOUS

11.1 Do you have any other comments on the application of the Environmental Aid Guidelines and the GBER (environmental aid measures) on issues other than those covered in the previous questions?

EFET is conscious that some support schemes for renewable energy have been judged by the European Court of Justice not to be state aids. Specifically, this applies to feed in tariff schemes based on an obligation on privately owned system operators to purchase and dispatch renewable energy. We believe that, if such schemes continue to be considered as non state-aid, the Commission should launch a project to assess the compatibility of such schemes with the Third Package and with Articles 28 and 87 of the EU Treaty.

This process could turn into a set of guidelines which run parallel to the state aid guidelines and seek to ensure that distortions resulting from the support of renewables (both through state aid and through that based on obligations) is minimised, and that integration of renewables into the internal electricity market is encouraged.

11.3 Please indicate whether the Commission services may contact you for further details on the information submitted, if required.

Yes