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European Commission
Directorate General Competition

**ANNEX: Additional information to the public consultation for the
Revision of the Guidelines on State aid for Environmental
protection and Energy 2014-2020 (EEAG)**

This document provides additional information and background to the responses by the Regulatory Assistance Project via the online form.

Q63 - Supplementary comment on “deep pocket distortions”:

There is still merit in allowing Member States that *are* able to provide seed finance for nascent low-carbon technologies to do so. All Member States will ultimately benefit from the efficiency savings and environmental benefits that are created by innovative solutions, especially as technology costs reduce over time.

Q64 - Supplementary explanation of the reason for our response:

Standardization of data collection, transparent presentation and consistent terminology on environmental benefits are essential to reduce the risk of greenwashing and to enable a meaningful comparison of different options and schemes. This is an area that warrants further detailed development. However, it is extremely difficult to reduce environmental benefits down to a simple number, without a huge host of caveats and assumptions. It is impossible to know the counterfactual: what benefits or harm would occur if it were left to the market to produce the necessary action? The market also cannot be considered in a vacuum, there are always barriers to competition and innovation. Any quantification approach adopted must be flexible enough to allow for targeted measures, which might be vital for biodiversity or to protect vulnerable groups, but not significant from a carbon savings perspective.

Q72 - Broadening:

Energy Efficiency measures:

Since increased investment in end-use energy efficiency is essential to meeting the European Union's environmental, climate, and economic goals, and because such investments are subject to well-known, pervasive market barriers at the end-user level, it is essential that efficiency programmes be permitted to offer supports to end users without the fear that they will conflict with State Aid rules. Deep incentives are sometimes required to launch successful programmes in new technology areas, or to reach new customer classes or geographic areas. Guidelines should clearly permit Member States to try new programme designs, and to offer deep incentives where deemed necessary to deliver end use efficiency measures. Restrictions (and even uncertainties about whether restrictions apply) that would impair broad and robust efficiency programmes will undermine the Efficiency First principle, and result in a slower and more expensive path to decarbonisation.

Technology Neutrality Within Sectors:

In order to ensure true technology neutrality (and therefore to avoid inadvertently picking winners and limiting competition and innovation), it is imperative that an outcomes-driven approach is taken. This must go beyond simply requiring that all providers of particular goods and services are included. What is the problem that needs to be addressed? Any technology or service sufficiently advanced to deliver a solution to that problem should be able to compete on a level playing field. This will help to future-proof the scheme and to reduce some of the competitive distortions caused by the intervention.

However, mere "participation" of a broader selection of undertakings is not in itself sufficient to ensure a level-playing field. The allocation process or competitive tender scheme must be designed in a manner which, as far as is practicable, takes into account the differing financial needs and operation nature of various technologies, goods and services.

It is all too easy for Member States to inadvertently design aid schemes with an incumbency bias, especially as established market players tend to have strong trade associations, lobbyists and other links to policy makers.

For example, discriminatory policy design can take the form of eligibility criteria that are positive or neutral towards one sector whilst excluding others; onerous requirements for financial collateral; administrative and reporting burdens that disproportionately impact new entrants; and product specifications which impose requirements which are unnecessary to ensure the policy objective. The experience of DSR providers in certain capacity mechanisms demonstrates these concerns.

In order to counterbalance this institutional bias, it is vital that Member State policy makers and the Commission pay particular attention to the voices of

new entrant undertakings, through consultation processes and other stakeholder engagement.

Q81 - Cross border Participation:

Advantages of cross-border participation include:

- enabling renewable generation projects to be built in the most geographically logical areas according to weather/access to the sea etc, regardless of State borders;
- providing additional revenue for Member States with excess renewable capacity compared to demand;
- increasing overall EU/EEA renewables uptake, to help achieve net zero emissions by 2050;
- introducing an element of price competition and comparison, which might not otherwise be possible where there are national monopolies over certain technologies;
- encouraging cross-border market cooperation (including regional collaboration), market integration and overall system efficiency;
- allowing pension funds and other institutional investors in one Member State to benefit from overseas schemes, where their own Member State does not provide green investment opportunities.

However, as with the general question on broadening, it is not sufficient to simply allow participation of foreign participants. The design of the scheme must ensure genuine non-discriminatory access. This has not always been the case with capacity mechanisms. For example, the Polish capacity market only allows foreign capacity providers to hold capacity contracts of 1 year duration, whereas Polish capacity providers can bid for contracts of up to 15 years.

Q107 - Supplementary explanation

Overly restrictive eligibility criteria undermine the objectives of requiring a competitive process in the first place and do not future-proof against technological developments. In addition, as mentioned previously, cross-border participation should be encouraged.

Eligibility should be determined in accordance with the ability to meet the policy objectives. This might require the inclusion of different products and services within a sector to form heterogeneous projects. The added complexity should be balanced against the system reliability and resilience advantages of a diverse energy mix, and the need to ensure that market interventions do not stifle innovation. Further detail is provided in the Annex.

Q108 – Heterogeneous Projects

In addition to enabling different types of technologies and products to compete against each other, support schemes should allow for Clean Energy Portfolios (CEPs) e.g. consortia of renewable generation, DSR and storage providers, to compete as a single candidate. This increases access to adequacy schemes for intermittent generation, improves their business model by reducing waste of renewable energy and encourages local balancing and network efficiency. There are underlying market barriers which may need to be addressed in order to facilitate successful CEP, including giving end users access to wholesale market without the need for an electricity supply licence, introducing market liquidity and wholesale price transparency measures, and metering and settlement reform (e.g. net metering, smart meter roll out and settlement of customers against actual consumption rather than deemed demand profiles).

Member States should not be permitted to use technology neutrality as an excuse to subsidize environmentally harmful activities, such as diesel generation (as the UK government has done historically, in relation to GB capacity market design).

Technology neutrality does not mean that all available technologies should always be treated exactly the same as one another. Nascent technologies, such as DSR and electricity storage, have different financial and administrative barriers, operational needs and physical constraints compared with generation, while still being valuable and cost-effective solutions. Member States should be obliged to proactively design aid measures, including eligibility criteria and auction structures, to bring forward innovative, low-carbon solutions. This requires proper consultation with minority stakeholders and new entrants, including meaningful representation in policy design working groups.

Long contract lengths risk foreclosing the market to new entrants and creating fossil fuel lock-in. Shorter contract lengths (1-5 years) are preferred. Requiring all technologies to bid for the same contract length is the best way to ensure competitive price discovery. Otherwise, candidates with longer contract lengths may be able to offer an artificially low price for more expensive solutions, by smearing across many years, to the detriment of consumers and less expensive technologies.

In the case of resource adequacy measures, paragraph (233)(e) EEAG requires that such measures give preference to low carbon resources, in the case of “equivalent technical and economic parameters”. We recommend that an equivalent hierarchy be extended to aid for decarbonization.

In particular, demand-side measures such as DSR, storage and energy efficiency are essential for decarbonization and should be given an equal platform in the real, energy-only market (not just in adequacy measures), rather than resorting straight to supply-side measures such as generation.

In addition, paragraph (220) requires Member States to “*primarily consider*” alternative ways of achieving resource adequacy which “*do not have a negative impact on the objective of phasing out environmentally or economically harmful subsidies, such as facilitating demand side management and increasing interconnection capacity*”.

The different language versions of the text of Paragraph (220) vary, with the English wording “*primarily consider*” being weaker than the corresponding terms “*vorrangig (...) wählen*” in the German language version, meaning “*primarily select*” or “*primarily choose*”. The stronger version is preferred. We suggest clarifying that, where two comparable options exist, the least environmentally harmful option should be prioritized (not merely considered or contemplated), only resorting to the more environmentally harmful option where necessary.

We recommend also making it explicit that there are two points at which Member States must comply with such requirements:

- (1) when demonstrating that there is a need for market intervention in the first place; and
- (2) when designing the subsidy scheme itself, in the event that intervention is indeed justified.

This will help to protect against Member States designing interventions that are notionally open to new entrant sectors and technologies, while implicitly favouring traditional/incumbent participants in the detailed design of the measure.

Q118 - Consultations

Timely and transparent consultation should be mandated:

- at the point of demonstrating the need for State aid intervention;
- in relation to the policy design of aid schemes; and
- before material amendments are notified.

Member States should be required to publish the key research and data leading to the policy positions being consulted on. For example, in the case of resource adequacy assessments, the System Operator’s underlying capacity assumptions and associated sources must be published, otherwise meaningful scrutiny and consultation is not possible.

Special care should be taken to facilitate feedback from new market entrants, which are less likely to have well-established and well-resourced trade associations and access to lobbyists.

Policy makers should ensure proper representation of new entrants in working groups and allow adequate time to respond to consultations. Significant policy changes made after consultations close, especially as a result

of industry lobbying, should require a new consultation so that impacted stakeholders have an opportunity to comment on the revised proposals.

Member States should be required to report on any industry secondments to the policy team, including from TSOs, and to set out which steps have been taken to avoid conflicts of interest. The provisions relating to independence of Regulatory Authorities from industry, contained in Article 57 of Directive EU 2019/944, could serve as a useful blueprint for these obligations.

Q136 - Supplementary explanation

In principle, it is good to expose all consumers to price signals. Only then can avoidance be realized at minimal economic cost. Accordingly, it is better to implement repayments instead of exemptions (for industry, for example, according to value added), similar to what Switzerland has introduced for citizens per capita repayments with the CO₂ levy. See next question for continuation of this response.

Q137 - Cost Exemptions for EIUs and the Significance of Charging Methodologies

Aid for decarbonization:

The ability under the EEAG to exempt energy-intensive users (EIU) from a proportion of RES support costs has limited the negative impact of renewable support on competitiveness and presumably avoided the leakage of jobs and trade from the EU. However, the different approaches to exemption taken by individual Member States risks the distortion of trade within the EU. Exempting EIUs from the full costs of RES support has also undoubtedly increased the cost burden on the remaining customer base. This has presumably added to the general discontent over the impact of RES support costs on consumer's bills.

We recommend a more robust linkage in the EEAG between the award of exemptions and commitments to reduce energy consumption, for example conditioning cost exemptions on energy intensive users investing in energy efficiency measures or demonstrating energy intensity improvements.

Aid for resource adequacy:

EIU exemptions from adequacy scheme costs:

- directly increase the overall aid amount, by reducing peak-avoidance incentives amongst the very users best placed to achieve this. This means that non-flexible customers - including residential and vulnerable groups - are burdened with not only an *increased share* of a fixed cost (as is the case with RES support), but also *higher overall costs* than would be the case if peak-shaving were properly incentivized;

- stifle innovation in the DSR sector in two respects, (1) by disincentivizing uptake of DSR services in DSR's primary market (industrial and commercial sector) and (2) by removing a potential secondary market for CM cost avoidance, which could operate in a similar way to existing balancing and ancillary products such as network constraint cost avoidance (i.e. paying users for behaviour that benefits the system/reduces costs/increases reliability for everyone);
- increases the likelihood of longer-term adequacy subsidies and fossil fuel lock-in.

This is explained in more detail below.

Exempting EIUs from some or all costs relating to adequacy measures such as capacity mechanisms is substantively different to equivalent exemptions in respect of RES support costs. In the case of RES support, there is a more-or-less fixed cost and a policy decision on how that cost is distributed amongst energy users or taxpayers. Conversely, with adequacy measures such as capacity mechanisms, EIUs actually have the power to inflate or reduce the total cost, through their action, or lack of action to reduce consumption during critical peaks.

When setting the subsidy amount for future years, TSOs and policy makers predict peak-time capacity margins. If it can be established that EIUs will be adequately incentivized to reduce consumption during peaks, this will reduce, or even remove, the need for intervention altogether. Therefore, there is a question of how much must be paid to achieve the policy goal, not just who must pay it. Indeed, the EEAG requires intervention schemes to be designed in the most cost-effective and least environmentally harmful manner.

Equitable distribution of cost and risk

Although in decades gone by, DSR actions may have been associated with EIUs being forced to completely shut down their industrial operations for extended periods of time, this is not the case with modern, voluntary DSR. Today, algorithms and smart appliances can be seamlessly combined with electricity storage and onsite renewables to enable customers to avoid using the grid at peak times and during system stress events, with minimal business disruption. Such technology uses automation, so that users do not have to manually track market prices. It also creates new markets for DSR aggregators and other intermediaries, as well as smart energy technology providers.

EIUs are in the best position to avoid peak-time usage and associated costs, because they are more likely to have flexible assets and their meters are settled against their actual consumption, on a time-sensitive basis. They are also key beneficiaries of improvements to security of supply. Encouraging EIU action through strong price signals is not only an equitable solution - assuming that State aid intervention is in fact necessary and justified - it also protects vulnerable household customers and small businesses (which are for the most

part still inflexible and settled against estimated demand profiles) from unnecessary and unavoidable costs.

Charging Methodologies

The specific manner in which the CM costs are targeted on customers directly affects whether or not the scheme has an “incentive effect”, whether it is proportionate, and whether it facilitates DSR, all of which are already requirements of the EEAG.

In addition to the existing requirement of cost-effectiveness, Member States should be explicitly required to design tariff structures in a manner that minimizes the overall aid amount, by imposing clear, effective price signals for all users to avoid consumption during critical peaks. Focusing charges (or a proportion of them) on those using electricity during the specific peak settlement periods reintroduces key scarcity pricing market signals and creates a short time window, during which time DSR “turn-down” is more feasible.

By contrast, smearing charges across longer periods of time (eg 4-7pm every winter weekday, as is the case in the GB capacity market) increases the likelihood of EIUs resorting to behind-the-meter fossil fuel generation, in order to avoid CM costs, or not attempting to reduce consumption at all, because it is not practical over such a long window. Regulation should be adjusted by more precise (system) cost allocation and proper taxation of behind the meter alternatives to avoid individual solutions which are incompatible with the system requirements and overarching targets. That for, onsite diesel generation should be excluded from the definition of DSR, due to its particular environmental and health risks.

Effective charging methodologies, which reduce demand spikes not only lower aid amounts they remove windfall profits from fossil fuel “peaking plant” providers. Policy makers and the Commission should be alive to the fact that vertically integrated undertakings, which own fossil fuel generation and retail supply businesses, may oppose such methodologies by raising retail supply concerns, as a means of protecting peak-time generation revenues. TSOs that both own lines and operate balancing services are also not neutral players and may be incentivized to favour centralized generation over DSR and other distributed solutions.

Q144 Final comments:

This consultation does not include a section on capacity mechanisms. However, as can be seen throughout our response, this remains a significant area for improvement in the EEAG. Capacity mechanisms and other adequacy interventions should be introduced only after Member States have taken action to remove energy-only market barriers, and where there is still a clear need for intervention to meet an economically reasonable standard for resource adequacy. Approvals of aid measures should be conditional on ongoing necessity, so that Member States cannot carry on granting subsidies in the

absence of a clear demonstration of an inadequate level of investment, where market conditions change or become clearer over time.

Where intervention is justified, measures must be designed in a manner which favours low-carbon resources and promotes system efficiency. This includes ensuring that DSR and other new entrant clean-tech can compete on a level playing field, free from discriminatory criteria and products. The granting of excessive periods of contractual support is a prominent example of failed design, given the ample available evidence that annual awarding of shorter periods of contractual commitment is better capable of delivering an economic solution to the need for adequate resource investment. Member States should be required to construct recharging methodologies that provide clear, concentrated price signals for critical peak reduction through DSR, in order to minimize the overall aid amount, distortions to competition and environmental harm.

The consultation does not refer to the Energy Efficiency First (EE1st) principle, which is a horizontal guiding principle of European climate and energy governance. To be consistent and coherent with the broader set of climate and energy legislation, we recommend that the EEAG define, in the recitals and in the core paragraphs, what the EE1st principle implies for Member States in terms of the need to demonstrate the reasons why cost-efficient, technically, economically and environmentally sound alternative energy efficiency, demand side response and storage measures cannot be expected.