

IFIEC RESPONSE

A BRIDGE TO 2025 PUBLIC CONSULTATION PAPER PC_2014_O_01

General Comments

IFIEC Europe agrees with the overall approach proposed by ACER and CEER. A balanced energy policy requires attention at the same time for competitive prices, security of supply and environmental/climate challenges. IFIEC Europe would, however, like to underline the urgency to restore competitiveness for industry (more in particular energy-intensive activities) in Europe. Electricity and gas prices in Europe are at a level where development and even survival of these activities in the European Union is severely jeopardized, and urgent action is needed in order to avoid de-industrialisation of our continent. IFIEC Europe and the Alliance of energy-intensive industries have developed a toolbox that can be used as a reference for necessary actions in that respect (attached).

Furthermore, IFIEC Europe proposes to take into account the following elements:

- Further market integration will require a more converging and, wherever possible, harmonised energy policy on a regional or EU-wide level.
- EU climate policy will have to take into account initiatives in the rest of the world. Europe cannot solve the climate issue on its own, and has to align its post-2020 policy to the international framework.
- Renewables policy post-2020 cannot be just “more of the same”. Further absolute targets would lead to enormous investment costs for European economy and to increasing balancing, back-up and infrastructure costs. Global fossil fuel prices have shown to be far lower than forecast, which have made current renewables technologies far less competitive than expected. Europe should go for Research and Development into new energy technologies (incl. storage) and limit renewables deployment to technologies that are market mature. Renewables have to participate in the market without priority access to the grid.
- Energy efficiency: European industry, and more in particular energy-intensive industry, has been investing heavily in energy efficiency ever since the oil crises in the 70s and 80s. It will continue to do so, because it can only survive if it remains competitive in terms of energy use and cost.

- Demand response: European industry has some flexibility potential that can be used to help balance the electricity system and to compensate for temporary generation capacity shortages. IFIEC Europe insists on the need for demand response measures to be taken on a voluntary basis only with a fair financial remuneration. Furthermore, demand response cannot bring a solution for structural generation capacity shortages. Furthermore IFIEC promotes demand response also in the gas sector.
- Capacity mechanisms are to be considered a last resort solution to be put in place in case of structural generation capacity shortages. High gas prices are by far the major cause of low profitability of European gas power plants, not the level of electricity prices. IFIEC Europe largely supports the analysis of the European Commission in its Communication "Delivering the internal electricity market and making the most of public intervention", and the criteria it mentioned for introducing capacity mechanism in the EU or at member states level.
- ETS: European industry needs a stable and foreseeable framework for emission allocation and trading in the long term. Artificial and arbitrary changes to the system, such as backloading and the higher cross-sector correction factor undermine the credibility of the ETS and weigh on the investment climate in Europe.
- Indigenous gas production: Fundamentally Europe has a gas supply issue. Europe needs to secure new sources gas and the first choice for that gas should be the indigenous resources. Otherwise consumer stay exposed to global prices through free trade.

Gas Wholesale Markets

Uncertain long term gas demand and supply

The demand for gas from industrial users relies heavily on competitive gas pricing in the EU. Industrial consumers in the EU pay two up to four times more for their gas than their competitors in the US. As a result, IFIEC currently observes more and more investments which are not made in Europe but shifted to the US. A prominent example among many others is the evaluation of BASF and YARA for a joint investment into a world scale ammonia plant at the U.S. Gulf Coast.^{1 2}

Europe's advantage is its excellent infrastructure covering a broad value chain with short transport routes. If the price gap between Europe and the US tends to persist over time not only investments from basic materials industries will be shifted to the US. In IFIECs view, it is of utmost importance for the European Union to convince suppliers of natural gas that globally competitive gas prices for European industrial consumers will lead to a win-win-situation for both parties.

¹ <http://www.basf.com/group/pressrelease/P-13-486>

² In 2012 the chemical industry invested 134 bln euro in China (2006: 27), 25 bln euro in the USA (2006: 13) and 19 bln euro in the EU (2006: 18,5) (data: Cefic).

SoS: Increasing role of imported gas and uncertainty surrounding unconventional gas supplies in Europe

IFIEC encourages the Commission and ACER to continue their efforts to preserve transportation capacities for third parties that are willing to enter into the European market in order to lower import dependencies by incumbents.

An additional option to lower the import dependency is a European regulatory framework for the exploration and production of unconventional gas supplies as a first step. Early studies suggest that Europe has significant resources of shale and other unconventional gas spread throughout the continent. In fact, according to the American Energy Information Agency, Europe has almost as much technically recoverable shale gas as the United States, at around 639 trillion cubic feet –three times more than the continent’s conventional gas reserves. However, exploration and development of shale gas remain at a very early stage, due to political and regulatory uncertainty at member state level. Whilst the challenges faced in extracting shale gas in Europe are different than those in the US, it nevertheless has the potential to form a medium term ‘strategic bridge’ to a longer term greener energy solution – whilst at the same time allowing Europe access to a competitively priced energy source, which will help in retaining industry and jobs. At the same time, Europe has a well developed supply infrastructure which will allow rapid development of shale gas resources, with an increased security of supply and less reliance on Russia and the Middle East and with lower prices compared to a European energy market where shale is not developed.

IFIEC believes that shale gas development in Europe offers a number of benefits for member states. Aside from the wider issue of significantly improving each countries trade balance (through reduced imports of gas), by exploiting its indigenous reserves, Europe can diversify and add security to its gas supply. This additional gas availability will increase competition and make the European gas market more globally competitive, which will turn into an increase of welfare for European industry and households. Furthermore, development of shale gas would also strengthen Europe’s negotiating position against gas importers. We therefore welcome and encourage initiatives to safely explore the shale gas potential in various member states.

More information on the IFIEC position on unconventional gas can be found online:

<http://www.ifieceurope.org/docs/IFIEC%20FE%20shale%20gas%20%20position%20paper%2021%2002%2013.pdf>

Integrating wholesale markets (EU Internal Energy Market)

Additional welfare benefits around 30 billion a year in case of “competitive prices” for European consumers can’t be ignored. As stated before, the European gas prices are not competitive on the global scale. Europe cannot afford not to intervene. Furthermore the internal energy market needs to be implemented as quickly as possible.

In the last ACER monitoring report the following statement can be found on page 179:

“Finally, in the EU, approximately 60% of gas supplies are still linked to long-term, oil-indexed contracts (LTCs). Even if the tendency is for those contracts that were historically oil indexed to be gradually renegotiated and indexed to hub prices, the price increments observed on the global oil market in 2012 did influence European oil-indexed contracts and, in turn, put upward pressure on hub prices.”

If long term oil-indexed contracts are the reason for non competitive gas prices, this problem must be tackled by the European Commission. IFIEC prefers gas prices which are not linked to a fossil fuel, that is controlled by a cartel. Gas prices should be efficient, generated by real demand and supply on a liquid market place (gas hub).

Flexible framework for a liquid pan-European gas market

The network codes aiming at creating an Internal Energy Market (IEM) by harmonizing the rules for the Member States, are confronted with a situation, where different regions in the Union are in different states of market development. The Gas Target Model survey of ACER this spring shows this situation clearly. Trying to link those market zones or regional trading zones first, is in our opinion economically efficient and the right way to go. The goal is – and should be – the realization of an IEM leading to efficient prices based on supply and demand (affordability), and a secure energy supply with efficient incentives for new investments.

Infrastructure investment (incremental and new capacities)

IFIEC believes that the efficient use of infrastructure and the building of efficient new infrastructure will facilitate competition between gas producers. In this matter it is crucial that “new” gas has always the option to enter the system. A general basis for the efficient use of infrastructure is transparency with regard to capacities, use and availability. The data must be provided in an easy and computable way.

Although the instruments for the EU to influence the oligopolistic structure of the gas suppliers have certain limits, the EU can at least create the infrastructural surroundings in a way that gives “new gas” a chance to enter the European market. Therefore physical infrastructure redundancies are supported by IFIEC when necessary to improve competition.

The regulatory framework has to take care of several influencing factors like strategic relevance of the investment, demand by market participants or amount of capacity to be build. In addition it must be assured, that new built capacity will not be exclusively allocated to those market participants with the “biggest pockets”. Regulatory frameworks should therefore recognize externalities like additional competition or security of supply. Investments must be compliant with EU Regulation and goals:

- Multiple supply sources and transport routes for all Member States;
- Where efficient, dual direction (flow and reversed flow) transportation investments throughout the EU;
- Implementation of and compliance with 3rd Package rules and Network Codes;
- No exemptions of Third Party Access;
- Transport Cost Allocation: only efficient costs granted to be reimbursed through Tariffs;

Flexibility: enabling demand response in gas

Many industrial consumers have the option to influence their gas demand within certain limits. They are willing to offer these flexibilities to the market, if the incentives are higher than the associated costs. These flexibilities can be used in cases of gas crisis situations. Therefore it is necessary to create a system where consumers are able to offer their flexibilities to the TSO. Ideally the system is market based. In a crisis situation for example, the TSOs could provide demand response offers on a platform in €/MWh for affected areas in the network. If the price is right, users will accept the offer. If not, the TSOs raise the offers up to the point, where the demand response needs are fulfilled. One advantage is that also consumers with firm capacities could also decide to offer their flexibilities on a short term basis. Additionally TSOs can create a legal ranking with that market based tool. Customers with low switch-off-costs will be switched off first, while customers with high switch-off-costs will be switched off last or can even continue to consume gas. IFIEC would welcome an initiative led by ENTSOG to create such a demand response system together with market participants.

Electricity wholesale markets

The achievement of the internal markets for gas and electricity is urgently needed, but might not be sufficient to make energy prices competitive again compared to the rest of the world. IFIEC Europe and the Alliance of energy-intensive industries have developed a toolbox that can be used as a reference for necessary actions in that respect. Contrary to electricity, natural gas can be stored and has the potential of one day being traded in a global market. Measures aiming at developing the necessary infrastructure must take that reality into account.

Demand response

European industry has some flexibility potential that can be used to help balance the electricity system and to compensate for temporary generation capacity shortages. IFIEC Europe insists on the need for demand response measures to be taken on a voluntary basis only and against a fair remuneration. Furthermore, demand response cannot bring a solution for structural generation capacity shortages.

IFIEC Europe would also like to refer to its response to the CEER consultation on Regulatory and Market Aspects of Demand-Side Flexibility :

Legislative barriers/difficulties

It is not always clear who owns the electricity purchased through a forward contract. Some suppliers claim this power to be their property until it is delivered at the consumer's grid connection, in which case the end user cannot use it any more for contributing to system integrity. It would be useful if it were legally made clear that an end consumer can at any time decide NOT to consume the electricity he bought, but can resell it in the market or to the TSO.

Regulatory barriers/difficulties

Network codes and tariffs / tariff structure are of utmost importance to facilitate demand flexibility to find its way to the market. IFIEC Europe has been active in contributing to recent development of the most relevant grid codes (e.g. Demand connection, Balancing, Load Frequency Control & Reserves,

...) in order to reach that goal. In the finalisation process of the codes, attention has to be paid to make sure demand response remains possible in the future.

Market barriers/difficulties

In order to facilitate demand response, barriers for entry to the day-ahead market need to be taken away as soon as possible (financial cost, administrative burden, balancing requirements,...). Aggregators can play an important role here, but those companies wanting to enter the market directly should be able to do so at the least cost and burden possible. As for balancing mechanisms, TSO and regulators have to facilitate end users' participation by offering appropriate products that allow demand flexibility to enter the market as easily as possible

Capacity remuneration mechanisms

Capacity mechanisms are to be considered a last resort solution to be put in place in case of structural generation capacity shortages. High gas prices are by far the major cause of low profitability of European gas power plants, not the level of electricity prices. IFIEC Europe largely supports the analysis of the European Commission in its Communication "Delivering the internal electricity market and making the most of public intervention", and the criteria it mentioned for introducing capacity mechanism in the EU or at member states level.

Regulators' role

Regulators can and should:

- Closely monitor market functioning and bidding behaviour in order to promote fair competition and prices based on supply and demand.
- Make sure grid tariffs respect the principles of transparency, non-discrimination and cost reflectiveness for all grid users.
- Follow-up price evolutions for all types of consumers and make international comparisons (prices including commodity cost, grid charges and taxes and surcharges).
- Point out threats to global competitiveness for industrial consumers when appropriate.
- Remove barriers to entry for all technologies, for infrastructure as well as for new generation and/or exploration facilities.