



EASE Short Briefing on the Non-Paper: "Policy Options to Mitigate the Impact of Natural Gas Prices on Electricity Bill"

October 2022



Background: This Commission non-paper is in response to the European Council on 20 October 2022 calling on the Commission to submit concrete decisions on steps to address the EU energy market, particularly options for an EU gas price cap mechanism. Overall, the non-paper lays out possible options for the Commission in a cost-benefit analysis of a cap in recognition of not modifying the merit order of electricity generation, to prevent increase in gas consumption, to address financial and distributional effects and to address the flow of gas beyond EU borders.

Disclaimer: The European Commission itself seems to intentionally not position itself on the topic – or in other words, to make this non-paper a “Rorschach test”: e.g. a reader who supports the Iberian model may read the non-paper as supportive; a reader who opposes the Iberian model will believe the text is de-facto highlighting the limitations. This unclarity is further reinforced by the fact that – on 28 October 2022, the Council met to discuss the non-paper: for now, it is unclear how it is moving forward in negotiations.

Non-Paper Points	Rationale	Impact on Energy Storage
MECHANISM PROPOSED BY SEVERAL MEMBER STATES: IBERIAN MODEL		
<p>Member States would be obliged to pay their gas-fired power plants a subsidy which covers the difference between the actual gas price observed on the day-ahead TTF exchange and a target gas price for power generation.</p>	<p>This gas-cap design comes from the Iberian model, currently being used in Spain and Portugal, which some Member states have advocated for to be applied at a European level. This caps the price of gas used to produce electricity via direct payments to gas-fired powerplants to maintain a certain price threshold for trading and any amount above the set trading price would be covered by direct public subsidies.</p>	<p>Negative: This subsidises gas-peakers who energy storage directly competes with in providing flexibility services to the grid. Additionally, this could distort the market with artificial gas prices and risks the EU not meeting its targets for renewable energy and emission reduction set out in the Fit-for-55 and the Clean Energy Package.</p>
<p>The relevant power plants would be obliged to reduce the price at which they sell electricity into the day-ahead and intraday markets by the</p>	<p>The rationale behind is to make the benefits of the subsidy go directly to lowering consumer electricity prices and to</p>	<p>Neutral: As long as the levelized cost of gas-peakers and ES remains similar, then this means ES can still compete effectively with gas.</p>



<p>amount they have obtained via the subsidy (and national regulatory authorities would have to monitor this obligation).</p>	<p>ensure subsidies are not misused for other purposes by gas companies.</p>	<p>National regulatory authorities should be proactive in ensuring a fair market for energy storage to compete in.</p> <p>Negative: The price which gas-peakers would sell their electricity at could outcompete ES if the price is lower. Overall, it distorts gas prices and risks depleting gas supply and deepening the economic cost of the crisis further.</p>
<p>The subsidy seeks to not only lower the price at which gas-fired power plants sell their electricity on the day-ahead and intraday market but also the overall clearing price in the market, thus reducing the revenues of all plants which produce electricity using different technologies (inframarginal technologies).</p>	<p>The rationale of the mechanism is to not simply lower the price of gas-produced electricity alone, but to more broadly lower electricity prices for all powerplants regardless of technology.</p>	<p>Neutral: It is unclear how this affects ES since they do not technically ‘produce’ electricity but simply ‘discharge’ already produced electricity.</p> <p>Negative: This could reduce revenue for energy storage firms that they would invest in increasing production, employment, deployment, R&D, etc. to meet the needs of the crisis. Many energy storage firms (especially start-ups) do not possess the generational market standing of gas / non-renewable firms so they will struggle more to cope with manufactured lower prices in the current volatility of the energy market.</p>
<p>Contrary to the mechanism currently in application in the Iberian Peninsula, the mechanism analysed for the purposes of this non-paper</p>	<p>The Commission appears to not entertain the notion of subsidising coal alongside gas, because coal is more polluting</p>	<p>Positive: This means that ES would not have to also compete with subsidised coal-</p>



<p>does not envisage a subsidy also for coal-fired power plants.</p>	<p>than gas and the price of coal is not as volatile as gas. Here, the Commission indicates its overall hesitancy with possibly over-incentivising non-renewable energy production more broadly.</p>	<p>peakers alongside gas-peakers at a European level.</p> <p>Neutral: This still means that coal-peakers are tolerated to re-enter the market to compete with ES, but ideally would be priced high enough where ES remains competitive.</p> <p>Negative: This does not prevent Member states from subsidising coal on their own meaning that at the MS-level ES could face stiffer competition by both coal <i>and</i> gas peakers.</p>
<p>Non-Paper Points</p>	<p>Impact on Energy Storage</p>	
<p>SUMMARY OF THE ANALYSIS</p>		
<p>Subsidy Level: Several Member States have proposed a subsidy level significantly higher than the one applied in the Iberian Peninsula and which would limit the price of gas used for power production to the equivalent of a TTF price of 100-120 EUR/MWh. Since the current gas price is about 60 EUR/MWh anyways, this measure would not produce any results.</p>	<p>Positive: Setting a high enough subsidised target price would disincentive the use of gas for power production. The Commission seeking to strike a balance between lower electricity prices for consumers while also ensuring that gas does not become so attractive it reduces the use of 'alternative generation technologies' which ES can be assumed to be a part of.</p> <p>Neutral: In general, if the price ceiling is high, this would not make the gas cap achieve any sort of results in addressing the affordability crisis of natural gas.</p> <p>Negative: In order to ensure the effectiveness of the measure to reduce electricity prices, there could be the risk that the subsidy level is not set high enough to discourage gas-fired energy production.</p>	
<p>Interaction with the Inframarginal Cap: The benefits of the measure would derive from the fact that the subsidy is only paid to gas-fired power plants but the resulting</p>	<p>Neutral: The Commission wants the resulting net benefits of the gas cap to compliment the inframarginal cap to have an overall beneficial effect on curbing inflation and stabilising the energy market.</p> <p>Negative: The inframarginal cap reduces revenue for renewables and energy storage firms providing</p>	



<p>reduction of the wholesale clearing price at the same time reduces the revenues of inframarginal generators, which do not receive the subsidy.</p>	<p>inframarginal services during a period of excessive market volatility, while simultaneously also granting preferential treatment to one power source in form of subsidies which the rest of market has no access to.</p>
<p>Implications for Gas Consumption: The subsidised target price has to be set sufficiently high so that gas-fired power does not become more attractive and then avoiding that EU gas consumption increases as a result of the measure. However, predicting the exact amount of extra gas consumption generated by the measure is very difficult and the overall increase can be higher than current estimates.</p>	<p>Neutral: This section demonstrates that the Commission is highly cognizant of needing to reduce demand and not compromise supply within the construction of a gas cap. It becomes clear here that trying to lower both prices <i>and</i> demand for gas is unachievable from an unofficial Commission point of view.</p> <p>Negative: EU gas consumption could increase as a result of the measure, as it already has in the Iberian Peninsula. EU gas demand could rise by up to 9 billion cubic metres (bcm) and could be even higher. Overall, the amount which demand could rise is unpredictable and highly risks compromising gas supply in the adoption of an EU-wide gas cap.</p>
<p>Avoidance of Increased Flows to Non-EU Countries: To address an increased power flows of subsidised electricity to non-EU countries would require to agree with the relevant third countries on an extension of the scheme beyond EU borders, or via a two-step clearing process: reserving the lower prices created by the measure to intra-EU trades and to export electricity at a higher price.</p>	<p>Negative: If increased power flows to non-EU countries are not addressed, they would lead to an increased power production in the EU using gas-fired plants. This leakage means such a mechanism would distort prices in non-EU countries with large ES markets, like the UK and Switzerland. Furthermore, these non-EU Member states (mainly the UK) could freeride off EU-subsidised electricity and make gas demand reduction targets harder to achieve.</p>
<p>Addressing Financing and Distributional Impacts: The most effective way to manage distribution effects between Member States derived from the measure would be to create a</p>	<p>Positive: Those Member States that are most dependent on gas-fired powerplants – Germany, the Netherlands and Italy – would find the cost of the subsidies is too high and not beneficial. Thus, they could be encouraged to find different flexibility solutions, namely ES.</p>



<p>European scheme which redistributes the costs of the measure amongst all Member States, in line with the benefits it brings about. Inflation, energy mix, prices, contracting and more vary from MS-to-MS, so to design a mechanism that does not distort national energy markets along with the European energy market appears quite difficult to achieve. This difficulty surrounding designing the mechanism is further emphasised by a lack of reliable statistics and political challenges.</p>	<p>Negative: Member States that are net-importers of gas-fired power can freeride electricity subsidised by other Member states – such as France – and distort the national ES market. Also, Member states where gas less dominates price-setting (parts of Central-Eastern Europe) would not benefit as much. Furthermore, this would not impact pricing set out in long-term contracts, so such a measure would not benefit Member states who have already covered much of their power needs in long-term contracts, like in Nordic and Baltic Member states. In fact, electricity prices in these countries could increase if the amount set to finance an EU-wide gas subsidy were at the same price universally. Overall, it could lead to distortion and fragmentation of the EU energy market, and thus the ES market at a European level. Given the lack of data and political tension, it seems unlikely a mechanism could be designed that does not distort the EU energy market.</p>
<p>Possibility to National Schemes: Member States are free to notify national schemes of this type to the European Commission. Such national interventions have to comply with EU State aid rules and ensure that cross-border trade between Member States is not restricted.</p>	<p>Positive: There could be national schemes less attractive for gas-fired power generation, in particular from those Member states which would observe less benefits from the application of this measure or would pay the highest costs for the necessary subsidies. Additionally, loosened EU State Aid rules could allow more opportunities for energy storage to get state aid at the national level.</p> <p>Negative: National schemes could be more attractive for gas-fired power generation and make an uneven playing field for ES in certain countries. Overall, this could further fragment the EU energy storage market on the Member state level with ES-friendly countries and ES-unfriendly countries.</p>
<p>LASTING WAYS IN MITIGATING THE IMPACT OF HIGH GAS PRICES</p>	
<p>One Side of the Market: Remunerating Renewables and other Technologies Based on Their True Production Costs.</p> <p>Renewables and other types of inframarginal generators (e.g.,</p>	<p>Positive: Renewable energy and energy storage remunerated under CfD, independently of the marginal price, ensures stable revenue which is important for the energy storage firms’ business case. The lower prices under CfD make RES more attractive than the higher marginal price of gas-peakers in the market. Additionally,</p>



<p>nuclear) would be remunerated with contracts for difference (CfD). The pricing for RES and other inframarginal generators would be independent of the marginal price, established mainly via tendering. The Commission seeks to use this as a mode of locking in renewable electricity at cheap prices within long-term CfD to decouple renewable electricity prices from gas-generated electricity prices.</p>	<p>ES facilities will have lower costs when charging with renewable electricity.</p> <p>Negative: Here, the Commission does not clearly indicate that energy storage is included in ‘other technologies’ and if ES would have access to CfD. How pricing for renewable energy and energy storage in a CfD with little to no production costs also remains unclear. Furthermore, CfD do not address issues in the market design which disadvantage energy storage from fairly competing on the energy market and would likely not compensate for the market distortion in a scenario with the direct subsidisation of gas-generated electricity.</p>
<p>The Other Side of the Market—Effective Competition for Gas in Well-Functioning Short-Term Markets.</p> <p>The role of gas-fired powerplants at the moment is to compensate for the intermittency of RES until ‘alternative technologies’ are increasingly available to replace them. Thus, a well-functioning short-term market must ensure that the cheapest/most efficient technology is used at any moment.</p>	<p>Positive: The Commission explicitly says that ‘alternative technologies like <i>storage</i> and demand-response’ need a fair playing field with a ‘well-integrated and interconnected market’ that has removed ‘barriers’ for them to compete with gas-fired powerplants so they can progressively relace gas alongside renewable energy.</p> <p>Negative: Says that low-carbon technologies will be part of replacing gas-fired plants and does not indicate these needing to be ‘carbon neutral’ which could hinder the EU’s emission reduction and renewable energy mix targets. Carbon neutral operations, like energy storage, should be given preference to replace gas rather than ‘low-carbon’ ones.</p>
<p>POSSIBLE WAY FORWARD</p>	
<p>Depending on co-legislators, such a targeted market design changes can be proposed and implemented quickly.</p> <p>The Commission wants to bring the benefits of lower cost renewables to consumers in line with their share in the electricity</p>	<p>Positive: Further hastens market design revisions that would make a more beneficial energy market for ES to compete in. The focus on the market design opens up ample opportunity for energy storage to pursue reforms the recognise energy storage and the services it provides.</p> <p>Neutral: It can be assumed that ES is part of the market design provisions but it is not explicitly mentioned, which should be elaborated in an upcoming proposal.</p>



mix with 'targeted market design changes' that can be 'proposed and implemented quickly'. The Commission views this as 'more permanent' solution' to the European dependence on volatile gas markets.

Reactions from Stakeholders on EU-wide gas cap:

- **CEPR (Centre for Economic Policy Research):**

The 'topical gas' instrument aimed at depressing wholesale power prices in Spain has had a modest effect with a net benefit to consumers. Most countries in the rest of Europe are much better interconnected than the Iberian Peninsula, so member states would be faced with serious leakage if they introduced a similar instrument unilaterally. Three conditions need to hold to make the intervention work as intended: little interconnection to neighbouring countries, an unconstrained gas market and only limited forward hedging. However, none of these prerequisites holds in many European countries outside the Iberian Peninsula.

- **EFET (European Federation of Energy Traders):**

A gas price cap would discourage much needed LNG from entering Europe and remove a signal indicating where gas should flow – both will make the current situation worse. Increasing gas consumption in one area will mean less gas being consumed in another. Damage to industry through forced curtailments will be increased. Maximising availability of importation and transmission capacity, enabling gas (and electricity) to flow to where it is most needed, enhancing solidarity, and voluntary joint-purchasing are sensible no-regret measures.

- **Bruegel:**

Since Russia's invasion of Ukraine, wholesale prices for electricity and gas in the European Union have risen five to fifteen-fold. The crisis is creating liquidity problems for energy companies and contagion risks for the financial sector. Emergency-intervention proposals to address the crisis should be evaluated against three principles. First, energy supply must meet demand at prices that do not cause major damage to the European economy. Second, the most vulnerable consumers must be protected. Third, measures should be consistent with the case for investment in a sustainable energy system, in order to safeguard Europe's ability to decouple structurally from fossil-fuel imports. Instead of capping gas prices, the EU should engage collectively with external gas suppliers and negotiate new long-term contracts.

- **Frans Timmermans, Executive Vice-President of European Green Deal, European Commission:**



The era of cheap fossil fuel is over. For good. It will not come back. But the era of cheap renewable energy is real and coming fast, but it is not coming fast enough to solve the problems this year or perhaps next year. So, in the meantime, saving energy, not using energy, is the cheapest energy obviously.

- **Laurence Tubiana, CEO, European Climate Foundation:**

Generous government compensation for fossil fuels risk derailing the green transition. Which is in complete contradiction with the investments we need in renewable energy and energy efficiency. Budgets for energy efficiency and insulation are “magnitudes” apart compared to budgets allocated for fossil fuel subsidies.



About EASE

The European Association for Storage of Energy (EASE) is the voice of the energy storage community, actively promoting the use of energy storage in Europe and worldwide. It supports the deployment of energy storage as an indispensable instrument within the framework of the European energy and climate policy to deliver services to, and improve the flexibility of, the European energy system. EASE seeks to build a European platform for sharing and disseminating energy storage-related information and supports the transition towards a sustainable, flexible and stable energy system in Europe.

For more information please visit www.ease-storage.eu

Disclaimer

This response was elaborated by EASE and reflects a consolidated view of its members from an energy storage point of view. Individual EASE members may adopt different positions on certain topics from their corporate standpoint.

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