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EU Clean Industrial Deal: lowering energy bills will face hurdles

Following the energy crisis triggered by Russia's invasion of Ukraine, and the persistent high energy prices impacting European households and industries, the European Union has published its Clean Industrial Deal with the intention of laying out possible solutions. Our conclusion is that hurdles already exist and that actions may be limited

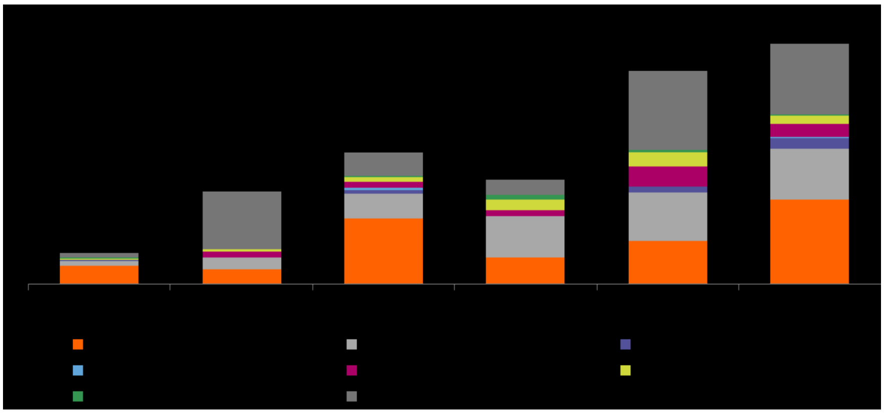
The European Commission says its Clean Industrial Deal sketches out "concrete actions to turn decarbonisation into a driver of growth for European industries". The aim, it says, is to reduce energy prices, create jobs, and help companies to compete against fierce competition. In our view, some of the proposed measures could yield results in both the short and long term. But there are obstacles that could limit their overall impact. In this article, we summarise some of the key measures that the EC is proposing and explain why we think they might fall short of achieving the intended outcomes.

Clean Deal's discussed options to lower energy bills and uncertainties

- **Natural gas joint purchasing**: In the short and medium term (up to 2030), energy costs, which constitute half of the energy bill, are largely determined by the global liquified natural gas (LNG) market, as natural gas is the price-setting technology in most countries. EU members' joint purchasing of LNG can lower prices.

- **Reduce taxes and network costs**: The commission allows and promotes member states to reduce taxes and network costs, which make up the other part of the energy bill.
- **Increasing Power Purchase Agreements**: The increase of Power Purchase Agreements (PPAs) can reduce the exposure to commodity price volatility (PPAs) and lead to long-term savings by securing fixed energy prices. Power Purchase Agreements are also quite often contracted for the delivery of green energy, helping companies and industries to advance their sustainability goals.

Power volumes in EMEA sold through PPA contracts grow year after year (in GW)



Source: BNEF, ING

- **Establishing a contracts for difference mechanism**: Electricity could be sold between a minimum and a maximum set price. The mechanism would safeguard minimum margins to power generators while protecting consumers from predatory tariffs. The new power regulatory regime in France starting in 2026 goes in that direction. Electricité de France (EDF) is guaranteed a wholesale price floor of €78/MWh. EDF is required to redistribute 50% of its income to consumers for power sold between €78 and €110 per MWh. Above €110/MWh, 90% of the surplus income must be redistributed to consumers.
- **Boost flexibility and lower peak demand:** The European Union wants to boost power generation flexibility and lower peak demand through storage and demand response.
- **Increase energy efficiency:** Increase energy efficiency and deliver energy savings with the financial support of organisations such as the European Investment Bank for small and medium enterprises.

Clean Deal's stance on infrastructure and AI development

- **Accelerate permitting process and infrastructure building:** EU states should find ways to shorten permitting procedures and speed up energy infrastructure construction, especially cross-border connections. A quicker process for permission and construction will increase power transportation flexibility across Europe.
- **More nuclear power:** Stimulate nuclear power, especially through the building of small modular reactors. While the measure would allow more energy independence, this can only work in the long term due to the time lag imposed by innovation and construction.

- **Smart Metering and artificial intelligence:** Increase smart metering, digitisation, and AI in the energy sector.

Our opinion about the EU Clean Industrial Deal

We believe that some of the proposed measures could deliver results in the short and long term, but some hurdles may limit their impact.

The document lacks alternatives for gas. First of all, we think that the 40-page document is lacking alternatives to increase gas production within Europe, such as natural gas as well as bio-gas, geothermal heat, solid biomass and the utilisation of residual heat through district heating. Second, the EU-ETS deadline for a net-zero industry and power sector by 2040 has not been extended. This goal was already ambitious but seems unrealistic in the new geopolitical world. With this target still in place, Europe seems to be at risk of de-industrialisation rather than achieving a green transition, regardless of how much energy prices are lowered.

PPAs and contracts for difference already face criticism

PPAs are not always perceived favourably. The volume of energy sold under power purchasing agreements has increased across Europe and will continue to increase. However, in some countries, negotiations between energy providers and clients have been extremely difficult. The terms of PPA contracts are sometimes seen as favouring energy providers. Conversely, utilities may prefer to sell power at variable market prices, seeing it as a more financially advantageous option and thus are reluctant to sign PPAs. Moreover, long-term contracts are a source of concern for industrials who lack visibility about their future energy needs. Similarly, utilities may hesitate if they anticipate benefitting from higher tariffs in the future.

Contracts for difference could be a very good measure to shield consumers from extremely elevated prices while ensuring energy providers the minimum margins for the sustainability of their business. Nevertheless, just like for PPAs, the setting of the regulatory rules could be seen as favouring energy players. In France, the cap and floors proposed by the regulatory body have been largely criticised. Consumer associations believe that the regulatory mechanism will lead to higher energy bills in comparison with the current tariffs.

Thus far, financial incentives have been too low or inefficient

Support from the European Investment Bank to increase energy efficiency and deliver energy savings to SMEs and Energy Service Companies (ESCOs) already exists. ESCOs have been a rather unsuccessful recurring topic for years and have proved to be hard to scale. Thus far, energy savings have been triggered because of elevated energy prices. The measure lacks action such as the obligation to green houses and buildings within a limited number of years after the purchase of the asset.

We believe that energy storage is an effective way for consumers to enhance their energy consumption flexibility. The Netherlands and Germany are leaders in this domain. However, energy-intensive companies have been reluctant to adjust their energy demand and production. Thus far, financial incentives have been too low and inefficient.

Increasing subsidies or lower taxes could aggravate the budget deficit. Increasing subsidies and/or lowering taxes on energy bills is difficult in the context of high budget deficits. A large number of EU states have a growing budget deficit and are increasing the tax burden on citizens and companies to meet their funding needs. The European Union is willing to look into changing the budget deficit limits to accommodate the €800bn EU defence plan. However, with deficits already so high in countries such as France and Italy, the appetite to reduce taxes and increase subsidies for the energy sector may be very limited.

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