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Position on long-term contracts (LTCs) between energy users and suppliers

A. Key messages

1. BUSINESSEUROPE calls for putting in place, without hindering the development of the internal market, a framework facilitating:
 - long-term commercial arrangements based on long-term economics
 - co-investment projects and other projects where risks are shared between producers and users, with prices based on long-term economics and costs actually incurred.

It is essential that the design of long-term contracts can contribute to security of energy supply whilst being in accordance with the liberalisation of the energy markets. The development of long-term contracts of adequate length should be a tool for reaching these two goals.

2. Furthermore, BUSINESSEUROPE urges that the following initiatives are launched:
 - EU capacity for strategic thinking and political action should be fully used to encourage the use of long-term contracts and for dissemination of best practices;
 - Political endorsement by the EU and Member states of the idea of opening possibilities for parties to conclude long-term contracts;
 - Creation of incentives which enable energy-intensive industries to enter long-term contracts or innovative risk-sharing models.

B. Importance of long-term contracts

1. Long-term contracts have become a vital instrument for reaching the goal of a secure supply of competitive energy and for keeping a strong industry in Europe.

This paper concentrates on energy intensive industries, given their greater exposure to energy costs, but it is important to underline that long-term contracts may have also an interest for other sectors.

The importance of long-term contracts can be illustrated by the following elements:

- a) Long-term contracts facilitate realisation of major energy investments because they give financial institutions and energy operators guarantees concerning the long-term viability of these investments.
- b) In order to be competitive on the global market, energy-intensive industries which consume large quantities of baseload electricity need electricity prices which reflect the economics of power stations delivering baseload electricity.

Long-term contracts make it possible to meet this need through contractual conditions reflecting the consumption patterns of energy-intensive industries.

- c) Today businesses have difficulties to make strategic choices:
 - in terms of product portfolio: what portion of their future activities should be positioned in energy-intensive products and processes?
 - in terms of geographical locations: how should energy-intensive activities be spread across European and non-European production sites?

On European gas and electricity markets, most of the established pricing models do not give long-term visibility of the conditions for the supply of energy. This lack of visibility, combined with other factors, discourages decisions to invest in energy-intensive industries, and to make these investments in Europe. The advantage of long-term contracts is precisely that they give visibility of the economic conditions for future energy supplies.

2. As the Council has acknowledged, there is not currently a genuinely competitive and interconnected European market for gas and electricity. Policy decisions to tackle this problem and their implementation on the ground will take time. In addition, it is important to address the negative impacts on competitiveness of the ETS (Emission Trading Scheme) in its existing form and in the form envisaged after 2012. Public authorities can help to deal with these issues by putting in place a framework which facilitates long-term commercial arrangements between energy users and suppliers, co-investment projects and other projects where risks are shared between producers and users.

3. Resolving the issues of the energy-intensive industries is at the core of EU challenges regarding competitiveness, growth, jobs and the environment because:

- they have an important place in the complex supply chains which provide European society with modern goods;
- they play a key role in the development of high-tech materials and advanced engineering concepts which are critical for sustainable production/consumption and efficient infrastructures;
- their relocation of production capacity outside the EU would further increase Europe's import dependence and additionally provide an incentive for subsequent manufacturing sectors in the same supply chain to follow.

C. Current situation regarding long-term contracts

In only a small number of Member States has there been development of innovative long-term contracts:

- between producers and individual consumers, or
- between producers and groups of consumers, demonstrating understanding of the potential of joint approaches at energy-intensive industry sector level.

The development of these innovative models is complicated for the following reasons:

a) At national level, there is:

- an uncertainty about the effective duration of contracts (in some countries, the possibility to enter into solidly based long-term contracts is limited *de jure* or *de facto* by the fact that some parties may terminate these contracts with a short notice) ;
- a limited role played by the state in encouraging parties to discuss innovative partnerships;
- insufficiently diversified pricing models

b) At European level, there are:

- uncertainties generated by the European Commission's decisions and thinking in connection with competition law. Complex issues like agreements with leading producers, which are sometimes the only option for accessing assets presenting the required competitiveness, need to be assessed carefully from the angle of competition law. The Commission is focusing a great deal of attention on possible negative

effects on competition, but it is important also to look at the potential positive effects in terms of increased efficiency gains and guarantees of optimal levels of investment in the sector that can be reached while providing energy users a fair share of resulting benefits. A multi-criteria analysis must be used to assess whether the positive effects counterbalance any negative effects;

- slow development of cross-border electricity interconnections;
- insufficiently effective functioning of the internal energy market, which can hinder engineering of innovative long-term contracts.

The initiatives that BUSINESSEUROPE calls for under point A should help to improve the situation at both national level and European level regarding the above elements.

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