

TABLE OF CONTENTS

EXECUTIVE SUMMARY	9
The European paradox	9
Security of electricity supply at risk with closure of unprofitable gas plants and retirement of ageing coal fleet.....	10
Gas and coal prices trends will continue favouring coal.....	12
Competition between gas and coal is not driven by commodity and CO ₂ prices only: governments play a key role	13
Future gas and coal contest: reinventing a business case for gas in the power sector	14
STRUCTURE OF THE REPORT	16
PREAMBLE	17
INTRODUCTION: THE EU ENERGY AND CLIMATE POLICY IN THE GLOBAL CONTEXT	18
EU energy policy and world energy developments since 2008	19
The global energy landscape is undergoing major changes	19
The EU energy and climate policy	20
The Internal Energy Market.....	20
The Climate and Energy Package.....	21
1. THE EU ELECTRICITY MARKET	23
1.1. EU electricity demand	24
EU electricity demand has flattened	24
Structural trend: Rising energy efficiency.....	24
The outlook for electricity demand is uncertain	25
1.2. EU electricity supply	27
EU electricity generation: Renewables overtook natural gas in 2012	27
Trends in power generation capacities 2000-2012.....	29
The rapid development of renewable capacity.....	29
...Leads to overcapacity in some markets	30
1.3. Wholesale electricity prices	31
Wholesale base and peak-load electricity prices have declined significantly	31
A general trend toward declining prices, although regional differences persist	33
High and growing cost of subsidies	33
Large increase in retail electricity prices	34
High cost of electricity threatens the competitiveness of energy-intensive industries.....	35
Household bills are exploding	35
Phase-out of subsidies to the more mature renewable energy sources	36
1.4. Gas and coal competition in the power sector	36
Gas has lost its competitiveness in the power sector	36
Clean spark and dark spreads	37
The attractiveness of coal and gas differs in each market	40
1.5. Operational impact on gas power plants	40
Renewable energy sources displace gas-fired power generation out of the merit order	40
Very low load factors for gas-fired power plants.....	41
Closure of old, but also new build high-efficient CCGTs	42
A sharp decline in EU gas demand by power plants.....	45
A resurgence in coal consumption in 2011 and 2012	46

1.6. A short-lived renaissance: 2013, a turning point for coal revival?	46
Market conditions are becoming less attractive for coal.....	47
Clean dark spreads are declining.....	47
Full cost of EUAs is an additional burden	47
Closure of coal power plants due to weak profitability	48
The coal fleet is ageing.....	48
Regulation on air quality	49
Impact of the Large Combustion Plant Directive	49
Impact of the Industrial Emissions Directive	51
Biomass conversion: a new life for old coal plants	55
A strategy followed by Scandinavian countries	57
Limited investment in new coal-fired power plants after the ongoing capacity addition boom..	58
The EU is adding 16 GW of new coal-fired power plants.....	58
Weak projects pipeline amid limited conventional power needs and financial restrictions to coal power plants	59
ANNEX 1. National energy policies	63
Germany: the <i>Energiewende</i> and the role of coal.....	64
Electricity generation and capacity	64
The nuclear phase-out.....	65
The <i>Energiewende</i>	66
Coal and gas competition left to market forces	68
Domestic coal	68
New efficient coal power plants.....	68
Winter reserves and system relevant plants.....	69
A large amount of capacity decommissioning	69
Capacity market.....	70
Short-term gas and coal competition.....	71
No development of CCS.....	71
Poland: coal and security of supply.....	72
Electricity mix dominated by coal	72
Aging coal fleet	72
New build.....	73
Co-firing	73
Energy policy development	73
United Kingdom: carbon tax and Electricity Market Reform	74
Power generation and coal capacity	74
The Electricity Market Reform	75
Carbon tax	76
Capacity market.....	76
Emissions performance standard	77
Contracts for difference and CCS	77
Spain: tax on CO₂ and end of subsidies to the coal sector by 2018	78
A drastic reduction of State aid to the coal sector.....	78
Netherlands: coal tax and new accord to close old coal plants.....	80
1.7. Gas and coal competition as flexible and low carbon options	81
Higher efficiency and reduced CO₂ emissions.....	81
Flexibility of gas and coal power plants	82
Increased variable generation presents significant operating challenges.....	82
Typical flexibility of new natural gas CCGTs and USC coal plants	83

Carbon Capture and Storage	84
Poor records in Europe.....	84
Public opposition to onshore CO ₂ storage	86
Uncertain costs of CCS.....	87
UK leadership in CCS projects.....	89
1.8. Financial impact on power utilities	90
Write-downs of conventional plants.....	90
Value destruction	91
Focus on cost reductions and divestments.....	92
Gas power plants bought by non-traditional buyers.....	92
A new business model in the EU and growth in thermal power generation outside Europe.....	94
1.9. Investment in new thermal plants at risk	94
The missing money problem	94
Security of supply threatened	95
A huge investment in generation is needed	96
A new market design is required	97
Different forms of capacity mechanisms	98
National CRMs and the Internal Electricity Market.....	100
DSR, storage and generation.....	101
Existing (fossil-fuel) plants vs. new capacity	101
2. GAS PRICES IN EUROPE:	103
WHAT WILL BE THE IMPACT OF ADDITIONAL GAS AND LNG SUPPLIES?	103
2.1. Main developments in the global gas market	104
Global gas demand on the rise	104
Huge gas resources	104
A global LNG market has emerged.....	105
Gas prices divergence	106
2.2. Gas Pricing	106
A historical linkage with oil	106
Major changes since 2009	107
Hub pricing means market-driven prices.....	110
Recent fall in European gas prices: a taste of a liquid and global gas market.....	110
2.3. Shale gas production in the EU	111
Significant shale gas resources in Europe	111
Potential European production, costs and impact on gas prices.....	112
2.4. A new wave of LNG supplies	116
The LNG industry in 2013	116
Growth in demand restricted by supply.....	116
At short-term, global liquefaction capacity still grows slower than demand	118
From 2015/16, a new wave of LNG	118
Future LNG demand driven by Asia.....	122
Downward pressure on prices	124
New pricing of US LNG exports	124
Asian market desire to move away from oil indexation	126
But high costs of some new greenfield LNG projects	127
Oil linkage still dominates, with lower slopes	128

2.5. A new partnership framework for gas pricing into the EU power sector?	129
ANNEX 2: EU gas supply and demand trends	132
Demand: the lost decade	132
Major changes in gas supplies	134
Future European gas supply and demand trend	135
3. COAL PRICES AMID CURRENT OVERSUPPLY	138
3.1. Global coal supply and demand	139
Global coal reserves are enough to fuel more than 100 years of current production	139
Since 2000, world coal production has increased by 70%.....	141
Coal is a dominant fuel in the global energy mix	142
Global coal demand has increased tremendously over the past decade	142
Growth is concentrated in China	143
The power sector is leading the growth	143
The share of coal and its evolution vary by region.....	145
China’s government commitment to reduce coal share in the energy mix.....	145
US coal demand has contracted.....	149
India struggling with increasing energy demand	150
Coal allows traditional Asian buyers to keep down their energy bills	151
Global demand has transitioned from high growth to low growth and may move to negative rates.....	151
3.2 Growth in steam coal trade to moderate	152
Global coal trade is growing but still represents a small share of total production	152
A shift to the Pacific Basin	153
Six leading coal exporting countries.....	154
A recent slowdown in steam coal trade	157
Exporters faced with overcapacity.....	158
The key role of China on the international trade	158
Global steam coal imports growth to moderate	160
European coal imports to decline slightly	161
3.3. Price dynamics	162
International steam coal prices are mainly determined by market forces. “Boom and bust” is the rule	162
The coal market is a global one: prices are similar on the Atlantic and Pacific basins.....	163
China is the current price-setting country	164
Excess supply has driven international coal prices downward	165
Production cost escalation has been a feature until 2012. Since then costs have been reduced	165
Slow, insufficient production cuts.....	166
New projects are shelved or abandoned, but the projects pipeline for global thermal coal exports is large	167
Current low price levels are not sustainable in the long run	167
At short term, the market is expecting a slight recovery in prices, but many caveats	168
ANNEX 3: EU coal demand and supply	170
Despite the recent coal renaissance, EU coal consumption has lost 40% since 1990	170
European coal reserves are significant. They are dominated by lignite	172
EU coal production is falling but still represents around 60% of total demand	173
Recent rise in European coal imports and a structural shift in coal supplies	176

4. THE EU CO₂ MARKET	179
4.1. The EU ETS.....	180
A cap and trade system.....	180
The third phase introduces significant changes for the power sector	180
RES development, the economic crisis and the influx of Kyoto offset credits resulted in a huge EUA surplus.....	182
The surplus has plagued the market and led to a collapse in EUAs prices.....	184
4.2. The power sector in the EU ETS	185
The largest emitting sector in the ETS.....	185
Rising CO ₂ emissions due to coal use compensated by reduced emissions from gas	185
While the EU ETS is long in EU allowances, the power sector has always been short.....	186
A large use of international carbon credits	187
4.3. Structural reform of the EU ETS	188
900 Mt of allowances to be backloaded in 2014-16.....	189
Further reforms: the market stability reserve	189
4.4. Increases in CO₂ price, but insufficient at short term for coal-to-gas switching.....	191
Backloading, impact assessment	191
Market stability reserve, impact assessment	192
Impact on the power sector	194
Coal-to-gas switching?	195
5. GAS AND COAL COMPETITION IN THE FUTURE.....	196
5.1. Outlooks for gas and coal in the power sector.....	197
WEO 2013: high regulatory uncertainty	197
EUROGAS: a better outlook for gas...but not in this decade	199
EURELECTRIC: hard coal squeezed by 2020	201
A decrease in coal demand does not automatically translate into increased gas demand.....	202
5.2. Conclusion: The gas and coal contest.....	202
Renewables are the only winners	202
Coal and gas prices remain the key determinant at short term	203
In the absence of a carbon price signal, gas demand is not expected to recover	203
Competition between gas and coal will continue to be contrasted depending on national energy policies	203
Security of electricity supply and investment issues must be addressed.....	204
At medium/long term, EU regulation on CO ₂ or national decarbonisation policies will take the lead.....	205
A future with gas: reinventing the business case.....	205
ACRONYMS AND ABBREVIATIONS	207
MAIN CONVERSIONS	210
LIST OF TABLES, FIGURES AND BOXES	211
TABLES	211
FIGURES	211
BOXES	214