

How to make the Hydrogen and Gas Markets Decarbonisation Package more effective

5 KEY RECOMMENDATIONS

Market design and enabling regulation will be key to advancing the ramp-up of markets in biomethane and in renewable and low-carbon hydrogen, while at the same time preserving security of energy supply. This has been made more challenging by the decision to phase out Russian gas on an accelerated timetable.

The proposed Hydrogen and Gas Markets Decarbonisation Package contains a number of principles where different views have been pursued by the different European institutions. Here are our recommendations on the best measures to encourage commercial investment and efficient operation of interconnected energy markets over the transitional period.

- 1** Certification of renewable and low-carbon gases must be consistent across EU
- 2** Transportation tariffs should continue to incentivise efficient use of networks
- 3** Emergency provisions should not be made permanent
- 4** Rules for unbundling and Third Party Access should encourage the conversion of natural gas infrastructure for renewable and low carbon gases
- 5** Security of supply and efficiency of operations require integrated network planning

EFET recommends improvements to make the Hydrogen and Gas Markets Decarbonisation Package more effective

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The proposed Hydrogen and Gas Markets Decarbonisation Package contains a number of principles where different views have been pursued by the different European institutions. The European Federation of Energy Traders (EFET¹) presents here the views of market parties on the most important elements to ensure it will encourage commercial investment and efficient operation of interconnected energy markets over the transitional period.

Key recommendations:

- Certification of renewable and low-carbon gases must be consistent across EU and aligned with the Renewable Energy Directive to avoid disconnected national schemes emerging.
- Transportation tariffs should continue to incentivise efficient use of networks and not be used to cross-subsidise specific technologies.
- Emergency provisions were beneficial in the short term but will be distortive in the longer term and should be phased out rather than made permanent.
- Rules for unbundling and third party access should encourage the conversion of natural gas infrastructure for renewable and low carbon gases.
- Integrated network planning will be necessary to ensure security of supply and efficiency of operation.

1. Certification of renewable and low carbon gases

The emergence of disconnected national schemes to promote renewable and low carbon gases risks creating barriers to the establishment of an internal market in decarbonised energy. Different forms of certification that cannot be traded cross-border will impede flows. The Package can avert this by ensuring that certification processes converge in terms of both standards and information content. **They should also be tradable independently**

¹ The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles. We currently represent more than 140 energy trading companies, active in over 27 European countries. For more information, visit our website at www.efet.org

from the underlying commodity in order to maintain effective markets, and to allow the emergence of price signals for particular environmental characteristics such as carbon abatement or sustainability.

In particular, it is urgent to determine the role of low carbon hydrogen (e.g. when produced in combination with CCUS or when electrolysis is conducted using energy from nuclear plant) and how this can be judged to meet the GHG emission reduction threshold of 70% against an unabated fossil equivalent. This must provide alignment with the forthcoming Delegated Acts under the recast Renewable Energy Directive (RED II), the revision of the Renewable Energy Directive (RED III) and the implementation of the already adopted Trans-European Networks for Energy (TEN-E) Regulation. **Without such alignment, the investment environment is more uncertain.** Similarly, unanticipated adjustments of the fossil fuel comparator (allowed by proposed new article 8.5a) create additional unnecessary risk that is chilling to investment.

EFET therefore supports the text favoured by ITRE in respect of extending certification of renewable fuels to include also low carbon fuels, and to abandon proposals to track molecules which would significantly restrict how a meshed network in gases can be operated. However, the Package still needs to be amended to allow a conditional book and claim system for Guarantees of Origin, which can subsequently be upgraded for registration in the Union Database. The creation of multiple instruments, with different trading characteristics and unclear conversion rules makes it extremely difficult for parties to evaluate their impact.

Finally, the version of the recast Gas Directive supported by the Council seems to allow the EU Commission to approve national mass balancing certification schemes by means of individual Implementing Acts. **A stronger obligation to create conditions for convergence would better protect the ability to trade across borders inside EU.** This could be achieved by mandating a common instrument with common definitions, though with initial ability of member states to determine national targets and how they can be met. In time, these targets could be determined across broader geographies.

2. Transportation tariffs should not be used to cross-subsidise specific technologies

Transportation costs represent a relatively small proportion of the overall cost of delivered renewable or low carbon energy. **To allow certain fuels to obtain discounts for transportation across an interconnection point, but not others, is likely to have very small impact on their uptake, but creates a great deal of complexity in how to administer such a scheme.** Where physical flows of gas do not mirror contractual flows, it creates uncertainty over which borders a discount should apply to, and how a rebate may be paid when there is no initial booking because gas has flowed along a different route.

Similarly, the zeroisation of tariffs at interconnection points of hydrogen networks reduces cost-reflectivity and may discourage the construction of capacity.

These weaknesses are more easily overcome through use of direct support for particular technologies, where this is considered to be a policy decision, rather than distorting transportation tariffs. EFET is therefore supportive of the Council position, allowing NRAs to derogate from the application of discounts, rather than the Parliament position which could lead to a need for Inter-TSO Compensation schemes, which were hugely controversial in electricity markets.

A further form of cross-subsidisation could be enabled through the transfer of assets from natural gas to renewable and low carbon gas transportation at heavily discounted values. Although this may be seen as one way to enable a faster build-up of hydrogen transportation assets – particularly when there may be few users to allow cost recovery – this may simply not be possible if natural gas networks also must be maintained for supply security reasons but with reduced throughput.

EFET supports the strictly conditional authorisation of financial transfers between natural gas, hydrogen, and electricity regulated services proposed by both Parliament and Council. **We are also in favour of intertemporal cost recovery, whereby under-recovery in early years can be rolled forward until there is adequate flow to generate larger revenues in subsequent years, as foreseen in the ITRE report on the recast Gas Regulation.**

3. Emergency provisions should not be made permanent

The Russian invasion of Ukraine, closely following the post-pandemic recovery, created price shocks as the system rebounded. The addition of new LNG import capacity and the reconfiguration of systems to accommodate new gas flows took time and are ongoing. A number of measures were introduced during these times of uncertainty to ensure that gas storage was filled and that supply could be prioritised if necessary. We now know that some of the measures were enormously expensive both directly in terms of acquiring gas at highly inflated prices, but also in terms of market distortion, which remains problematic. Costs which must ultimately be recovered from consumers and taxpayers will be significant.

We should foresee a return to normal market operation as soon as possible, with emergency measures phased out. Any measures which are being considered for extension beyond emergency conditions should be subject to full regulatory scrutiny including an impact assessment and proper consultation to ensure that their costs are well-understood and justified before such a decision is taken.

In particular, some measures such as allowing regulated entities to participate in traded gas markets, the continued publication of an LNG benchmark by ACER rather than existing Price Reporting Agencies, and constraints on bidding for capacity at entry points from Russia or Belarus are all unhelpful in periods of normal market operation and should not apply outside emergency conditions.

4. Unbundling and Third Party Access

Unbundling and third party access rules applicable to natural gas networks should in principle apply also to hydrogen grids. A more rigid implementation of unbundling requirements for Hydrogen Network Operators (HNOs) risks posing a barrier to the repurposing of natural gas networks and to the materialisation of synergies between methane and hydrogen network operators.

EFET therefore welcomes the possibility offered by both the ITRE and Council versions of the recast Gas Directive for different unbundling options to apply after 2030. This will help to enable deployment of the hydrogen backbone in member states where the ISO model is already in place. Flexibility in the imposition of full regulated third party access would also be advisable, given other uncertainties.

5. Integrated network planning will be essential

The timetable for roll-out of renewable and low carbon gases is highly uncertain, heavily influenced by how quickly technological progress can be made, and dependent on external factors. **We must prepare for electrification at the same time as relying on natural gas capability for supply security in the short to medium term.** Seasonal storage of hydrogen is still only at a research stage and there are substantial issues yet to be overcome. Capacity in electricity, hydrogen and natural gas systems will be necessary to protect security and allow decarbonisation and to make use of available storage and flexibility tools. EFET supports the provisions of both Parliament and Council in this regard.

Flexibility should also be provided for technological change. Improved membranes and turbines that can accommodate variable mixes of gases could both allow for more efficient network balancing and even for co-transportation of gases in the same pipeline with the possibility to separate at the delivery point. Legislation should not foresee only fixed solutions in this area (e.g. different rules for transportation of hydrogen in hydrogen-only networks and possible co-transportation (as distinct from blending) in mixed gas networks. This may also be a key to unlock greater longevity of natural gas networks.

6. Conclusion

Options remain within the details of the draft Hydrogen and Gas Markets Decarbonisation Package that could create alignment or conflict with the EU Internal Energy Market. EFET strongly recommends that the principles of competition and choice should be retained as this will best enable the private investments and commercial operations that are necessary to deliver decarbonisation economically and efficiently.