Executive Summary

The new EU binding targets of 40% carbon reduction are a challenge but also an opportunity.

Amongst the priorities of Europe the establishment of a single functioning Energy market is judged to be a critical step in fulfilling the objective to position Europe as a world leading economic power. The strategy for Europe includes amongst other things a requirement to reduce external energy dependencies, to decarbonize by leading in the use of Renewable Energy resources, and to develop and apply member state solutions which are complimentary to the single market requirements. A balanced approach between sustainability, competiveness and security of supply is needed as the EU and Bulgaria moves towards a low carbon economy. The AES -3C Maritza East 1 investments specifically fulfills this approach by providing the most efficient power generation system in the region, and an environmental performance in full compliance with the forthcoming binding 2016 requirements of the Industrial Emissions Directive. This investment is also an effective exploitation of a strategic national resource of Bulgaria.

Bulgaria has an opportunity to improve energy strategies, by enhancing policy making and enhancing sector governance. Most recently World Bank and the European Commission (EC) Directorate General (DG) Energy have published in the late spring of 2013 critical remarks which layout the specific thematic’s that have to be addressed by the Government of Bulgaria (GoB). Recently the GoB has found itself subject to sanction by the EC Competition authorities for alleged electricity market foreclosure by the Bulgarian Energy Holding (BEH), and most recently is subject to sanction over the continuing actions to implement the South-Stream Gas interconnector project at a time when Europe is applying sanctions against Russia over its actions in relation to Ukraine.

Bulgaria is therefore faced with addressing many issues which are summarized as the following;

• Demonstrating a full compliance with the range of EC directives on environment and energy, at the same time contribute to the regional strategic energy security initiatives

• Elaborate clear and concise Energy strategies which properly recognize existing obligations to sector participants, provides the timelines for the achievement of change, and also contains specific emphasis on energy efficiency

• Abandonment of the social pricing policies, and the introduction of market pricing policies that allow for the proper remunerations of investments in the sector, and furthermore incentivizes new investments in the sector

• Create new mechanisms that establish predictability, transparency, trust and delineate responsibilities of sector governance and management

• Inject new capital to address sector liquidity issues

• Provide long term assured capacity building programs for key areas such as the State Regulator

• Introduce a properly conceived, and functioning energy poverty program that is approved by the EC

• Develop and implement policies in the natural resources sectors that are complimentary and supportive of these action steps

I would now like to address the three Key issues for Bulgaria

Energy Costs seem to be a highly emotive topic;

Bulgarian energy costs are on a relative basis amongst the lowest in the EU. Energy cost is seen as a significant component in any production cost assessment and as such regarded as being a discriminating factor for market competitiveness. With the Government of Bulgaria (GoB) talking of economic re-energization and growth led by foreign direct investments, significant pressure exists to keep energy costs at a competitive level. The GoB wishes to ensure the country remains a first choice investment destination. As Bulgaria supplies base metals aluminum, copper etc. and other globally priced commodities, it is essential energy prices remain advantageously positioned.

Energy costs in Bulgaria, specifically electricity cost are however artificially low and the consequence is the sector is dramatically under-remunerated with some investors unable to show a satisfactory financial performance of the investments in capacities they have installed. The GoB has specifically allowed the emergence of renewable energy systems (RES) in the market with only light oversight. This has allowed the achievement of the GoB 2020 RES target 7 years ahead of time. At the same time introduction of large scale conventional energy supply systems such as AES-3C ME1 have added to the financial obligations that have to be met by society. The adoption of a social pricing model with tariffs and their structures set against the ability of the end user to pay, has resulted in the electricity sector running deficits of the order of $500M/yr and arrears of $1.5B.

New tariff rises are needed to address this situation together with the introduction of a properly formulated energy poverty program. Currently the arrangements for winter heating support to vulnerable end users is very dysfunctional with multiple Ministries and multiple pieces of separate legislation applying to how such financial support is administered and dispersed to those in need. A major overhaul of the system under the guidance and direction of the EC is needed such that the issues of price become de-politicized in society. Further the level of protection to society from the burdens of the full adoption of the EU policies on climate mitigations needs to be determined and equitably applied.

The GoB does need to develop a long term plan for industrial and energy sector investments that assure the economic performance, and the sustainability of development within society as a whole. Recent publications by DG EcFin were very critical of the deficits in the sector

Alternative Energy Sources also need to be recognized and embraced as important for Bulgaria;

Bulgaria has a diverse range of energy resources assessed as Wind, Solar, Bio-mass, Hydro, Coal and a small quantity of off-shore natural gas. There is an unassessed potential in relation to unconventional gas. Meanwhile Bulgaria has released the latest round of off-shore licenses to evaluate gas potential.

The shale potential is seen as something that must be assessed and NGO’s needs addressed. Complimentary to this is a need for infrastructure developments; specifically the regional interconnectors. The South-Stream project whilst formally stopped is actually in construction which indicates that ultimately the issues identified by the EU will be addressed so as to ensure market compatibility. At this time the commercial terms for the South-Stream project in Bulgaria are still not resolved with transit fees and offtake potential unclear. Given these uncertainties the potential to advance projects to increase both on-shore and off-shore storage facilities needs to be addressed as a priority.

The Hydro potential within the country remains significant whether a low or high hydrology case is used. The Gorn Arda Dam cascade is a good example. Current configurations include run of river, high head, low head and large scale pumped storage that are currently used to provide Electricity system management services.

The country also has a number of small scale coal deposits with one large deposit of Lignite located in the Maritza basin. This lignite is currently the feedstock for the power plants located in the Maritza basin. The assessed reserves are regarded as extensive and sufficient to support the establishment of up to another 660MW’s in the complex, subject to the retirement of older plants in the region. Should such a development occur it would also require some significant adjustments to mine method’s and practices so to ensure all deposits are economically recoverable. If the EU were to sanction such a project it is expected that this would have to be carbon capture ready or equipped. This reserve is a critical resource!

Energy Security is the new issue for Bulgaria, the region and the EU;

Bulgaria has a significant role to play in the management and delivery of energy security within the EU. It is a frontier state and the nominated custodian of a number of energy corridors. It now has to respond to the energy security needs of the EU.

The EU has recently restated its approach to energy security in the light of the strategic developments in the eastern region of Europe.

In the near term the EU has embarked upon a number of “stress tests” to evaluate vulnerabilities and dependencies of member states. The intent is to develop risk response arrangements, contingency plans such as increasing gas stocks, developing emergency infrastructure, permitting reverse pipeline flows, and the reduction of demand. In the longer term actions are be taken to increase energy efficiency, diversify supply chains, and the completion of the internal energy markets.

From a policy perspective Europe has also to speak with one voice so that unilateral actions of member states like Bulgaria with respect to South – Stream do not attract unwelcome attention.

In Bulgaria the extent of these dependences were revealed during the wintertime gas shortages of 2009. Bulgaria therefore has a potentially significant role to play in enhancing critical infrastructures at the fringes of the EU, creating new understandings at a national policy level on how solidarity shall be provided e.g. by the use of pipeline reverse flows and the use of gas storage facilities. Most importantly Bulgaria is the custodian of a regionally important strategic Lignite reserve.

So what does this mean – a new discussion is required

Bulgaria needs to realize the EU has concluded that the needed energy sector reforms shall be achieved and they will be achieved by creating a sustainable investment climate, which underpin the growth and development of the EU, the region and Bulgaria. Bulgaria also needs to realize that the energy poverty solution is expected to be designed put in place and made to work. The EU has set aside significant sums of money that provide for these changes and as such Bulgaria should seek to take benefit from this.

Bulgaria has to show strong political leadership in order to fulfill its obligations. To do this it has to build the capacities and knowledge base needed. This includes regulatory, commercial, financial, and technical knowledge of the modern power sector. If this is done in an open and transparent fashion the reforms seen will increasingly attract new investments in the economy, the sector and at the same time legacy technologies will become retired from the system. As an example AES – 3C ME1 created over 2800 direct jobs at the peak of construction and in 2013 is assessed as having created 1830 jobs in the region.

Bulgaria’s plans for the full adoption of the requirements of the 3rd Energy Package of the EU for Gas and Electricity is much delayed and the subject of close scrutiny by DG Energy. It is also at the remote end of Europe where generation and interconnector adequacy are key issues. Strong national interconnectors are required. With the advances in the case for Turkeys accession to the EU the development of the energy corridors with Turkey is essential. The development of new interconnectors will lead to the formation of new energy hubs and points of trade which will be new features of the EU internal energy markets. Bulgaria has the potential to lead these developments to ensure the adoption of low carbon technologies, a properly functioning market that meets environmental objectives, a market free of price distortions, and above all provides security of supply.

So in conclusion

When developing its plans Bulgaria needs to seek the counsel, advice, consultancy and the financial resources of the EU so that it can move rapidly through a complex array of issues and transition in a timely and cost efficient manner from where it is today to the fully liberalized requirements of the EU internal energy markets. Where required Bulgaria will also have to co-ordinate its national requirements locally which should be done in an open transparent manner. Without doing this its credibility as a guardian of the state and the energy security of the region will be difficult to uphold.

Finally it is possible for Bulgaria to achieve a complaint set of market mechanisms that achieve environmental performance goals, achieve energy security, create affordable and sustainable energy supplies, and sponsor the adoption of low carbon technologies.