FRAGMENTED EUROPEAN BIOFUEL MARKETS: THE CHALLENGES AND OPPORTUNITIES AHEAD

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The European biofuel industry is grappling with a number of issues, including ongoing over-capacity, waning political support for first-generation biofuels, policy uncertainty past the year 2020 and a low oil price environment that diminishes further the economic rationale for biofuel usage. The increasingly fragmented nature of the European biofuels market, both in terms of member state biofuel policy and the geography of trading patterns, adds to the challenge of navigating through an already difficult industry for some participants but can also create opportunities for traders. A more coherent approach to regulation and policy has long been called for by industry bodies, while shifts in the way the market trades also offer the potential for innovative new pricing solutions.

Doing business in such a fragmented marketplace is more than just an inconvenience. It can add to economic inefficiencies and transactional costs and hinders the ability of market participants to hedge and manage risk. Kevin Mcgeeney, CEO of Starsupply Commodity Brokers, a Swiss brokerage focused on biofuels, renewables and agriculture, sees it as a major ongoing challenge for the biofuels industry. “The increasing fragmentation of biofuels in Europe is making both broking and trading and origination and supply more difficult,” Mcgeeney said in early April. “A dip in market liquidity as a result of geographic fragmentation will increase frictional costs of trading for all participants.”

When compared to the state of affairs in the United States, where more unified policy across the country and the presence of thriving trading hubs has allowed the market to benefit from transparent and liquid physical and derivatives markets, the European regulatory framework and trading structure appears to place European operators at a significant disadvantage. Language barriers and regional differences in contract pricing methodology add further complication.

The European Union political project often takes the approach of setting overarching policy aims, with flexibility for member states to achieve them in a manner that they see fit. The lofty goal of securing 20% of energy from renewable sources in Europe by 2020, put into law in the form of the Renewable Energy Directive in 2009, set out a framework for member states that not only allowed a divergence in overall targets for biofuels usage, but also allowed a wide scope in the specifics of how policy is implemented.

This has resulted in a potential minefield of different national regulatory standards, which add another layer of complexity on top of naturally occurring specification idiosyncrasies. Market participants have to deal with potentially different requirements in each individual member state, varying support for waste-based biofuels and a range of different hoops to jump through that sometimes require specific local knowledge and connections. While Germany measures its mandate on the basis of greenhouse gas savings, other states have targets for energy or volume from biofuels, creating large disparities in blending economics for end-users. Spain has a quota system for producers that limits the

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**FRAGMENTED NATIONAL REQUIREMENTS FOR BIOFUELS**

**UNITED KINGDOM**
- 4.75% vol biofuels
- Double counting: UCOME, TME
- Fatty acids made from palm not accepted
- Active certificates market
- Discussions on E10, GHG savings

**NETHERLANDS**
- 7% biofuels
- Double counting: UCOME, TME (cat 1, 2)

**POLAND**
- 7.1%
- Introduction of double counting postponed to 2017
- Preferential system for domestic product

**FRANCE**
- Tax cuts for French producers
- Double counting: UCOME, TME
- 7.7% bio, 7% ethanol
- E10 in place

**ITALY**
- Double counting: UCOME, TME (cat 1, 2), PFAD
- 5.5% biofuels mandate

**GERMANY**
- GHG saving mandate at 3.5%
- TME not accepted
- No active certificates market
- Discussions on E10

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number of non-Spanish sellers and France grants a tax cut for purchases from local producers. The list goes on.

To make matters worse, all of these things are in a state of constant flux. In March, the Italian government withdrew double-counting support for palm-fatty-acid-distillate-based waste-biodiesel and then reinstated it within the same week, in a series of confusing notes that left market participants scratching their heads. The overall effect is to foster uncertainty and a short-term outlook. “It’s tricky to foresee what your demand is in each country and see where margins should be,” one market source said in early April. “There are also producers who spend money on technologies that turn out not to be as valuable after a policy change.”

Alongside the policy challenges, a dramatic fall in imports in recent years due to punitive import tariffs has caused physical trading to move further away from traditional hubs such as the Amsterdam-Rotterdam-Antwerp region, to more localized and direct, producer to end-user markets. The effect of this has been to decrease transparency, increase basis risk for individual transactions and diminish the relevance of the traditional hubs for marginal spot trading activities. While traders sometimes welcome differences between specification and nation regulations, as opportunities to find trading arbitrages, this move of the market towards direct sales has seen both trading and broking desks shrink. “If you’re able to have a book on those things and you have physical storage, you’re able to trade around it… now you have less opportunities and that’s why you see trading houses scaling back,” said a second market source in early April.

Any attempt to completely standardize allowable feedstocks and specifications across member states seems unlikely, with the interests of local industry usually at the forefront of policymaking. However, for the European biofuels sector, the shift in emphasis from volume-based mandates towards considering carbon intensity or greenhouse gas emissions, may yet offer an opportunity to standardize some of the expectations around the shifting sands of the fragmentation. Capturing an effective value for the real contribution that biofuels make to road fuel emissions provides a common thread that ties together the disparate smorgasbord of biofuels, from palm oil, to used cooking oil, to corn-based or beet-based ethanol.

Germany’s adoption of GHG as the standard has already done much to tighten up and incentivize producers into targeting higher GHG saving approaches, along the entire life cycle of the fuel, stimulating further investment, and innovation in championing the opportunity. Should wider Europe follow Germany’s lead, that GHG aspect may yet become a defining factor in the placement, demand for and ultimate price of biofuels, no matter what their feedstock or origin. Further, adoption of a trading system specifically for GHG savings across EU member states could simplify end user requirements and pool liquidity to an extent that new opportunities for trading and risk management emerge. The Catch-22 though, is that as GHG savings creep higher, the proportional requirement for biofuels within the final road fuel blend actually shrinks. The reward for the successful is likely to be smaller volumes, unless mandates increase correspondingly.

The usage of GHG saving targets would also likely stimulate further imports into Europe. Alongside any relaxation or abolition of duties on ethanol and biodiesel from the US, Argentina and Indonesia, this would likely revive trading hubs and go some way at least towards offsetting the purely geographic fragmentation that occurs as a result of the spread out locations of European biofuel producers. The WTO ruling that anti-dumping duties were not correctly applied against Argentine biodiesel and a new, more economically open political regime in Argentina may yet see the European Commission change its stance. But again, any move in this direction will come at the cost of local producers unless mandates are also increased. The agricultural and to a lesser extent biofuel industries remain powerful lobbyists at both the member state and EU level and any move in this direction is likely to be hard fought.

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