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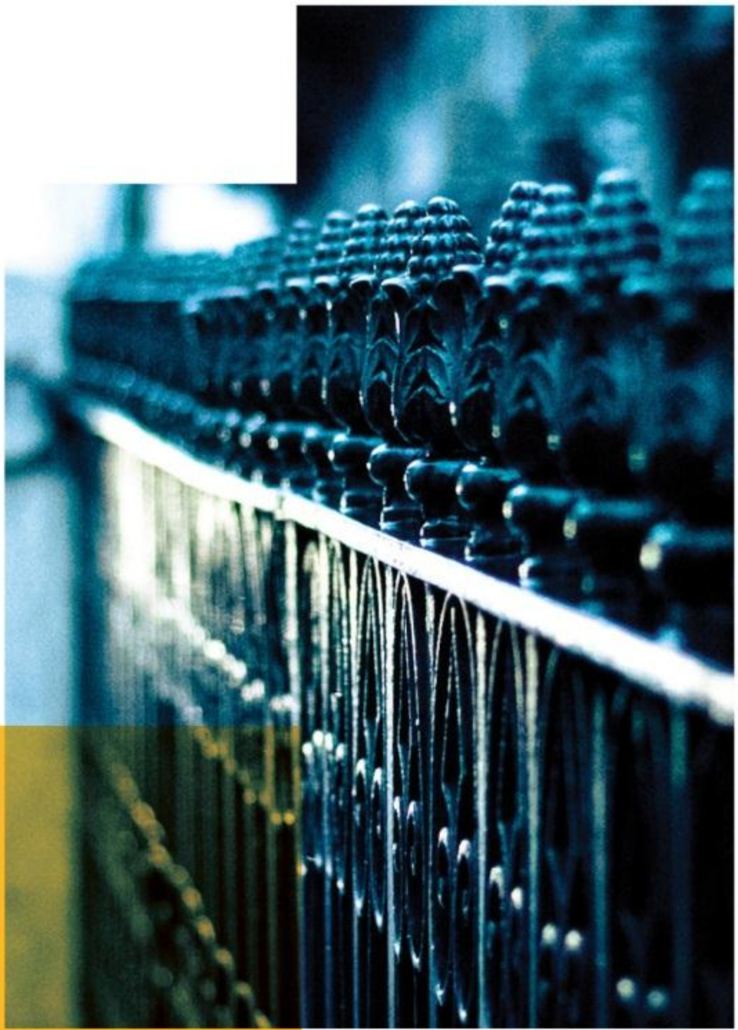

2030 Climate and Energy Framework

22 January 2014

2030 Climate and Energy Framework: Why it matters

- ✓ It is the most wide-ranging set of Energy and Climate proposals since 2008 and should determine the way forward for EU energy and climate policy **for the next 15 years**.
- ✓ Member States will now be defining their positions and priorities, as Heads of States are expected to react officially to the Framework at the **20-21 March European Council** and give further directions to the European Commission for concrete proposals to be issued next year.
- ✓ It already sets the agenda of the institutions for the coming term, as several legislative procedures will follow from the announcements made and unfold in the next 12 to 18 months.
- ✓ The new Framework marks a **clear shift towards competitiveness** to alleviate concerns about deindustrialisation and rising energy costs.
- ✓ Concerns over the risk of 'carbon leakage' (industries relocating outside Europe due to rising carbon-related costs) have been heard. Criteria to determine exposed sectors will not be changed.
- ✓ The **27% overall target for renewables** (but no individual targets for Member States) is seen as step back for NGOs and the renewable industry. A 'business as usual' scenario (with no policy changes and new incentives) would naturally lead us to 24% by 2030. This is a recognition that renewables have matured since 2008 and no longer need the same level of incentives.
- ✓ The absence of any further measures to encourage first-generation biofuels post-2020 underlines European concerns about their 'real' carbon footprint. With the hint that the 6% FQD reduction would not be prolonged post-2020, **decarbonisation of transport is strangely absent** from the new Framework.
- ✓ The Emissions Trading Scheme, the cornerstone of EU climate policy, will be reformed through the introduction of a Market Stability Reserve in Phase 3 (from 2021). This should help **drive up carbon prices** and incentivise lower carbon solutions such as, for example, natural gas in power generation.
- ✓ The Commission's decision **not** to introduce a specific piece of legislation regulating shale gas production is another sign that the Commission wants to maintain a fair balance between European competitiveness and environmental protection, whilst **leaving Member States in control of their energy mix**.

Contents

Executive Summary

On 22 January 2014, the European Commission published its new framework on climate and energy for 2030. The document lays out the EU's plans for its energy systems while tackling climate change over the next 16 years.

The main pillar of the Communication is the call for a **40% GHG emissions reduction target by 2030 and a 27% binding EU target for renewables.** At present, under the current 2020 Climate and Energy Framework, the EU has committed to a 20% GHG reduction target by 2020 and a 20% renewables target by 2020. These targets were set in 2007 and, in order to give investors certainty in the post-2020 period, the Commission has come forward with its new proposal for binding targets for 2030.

As part of the European Commission's efforts to **reform the Emissions Trading Scheme**, the chief instrument for tackling climate change in the EU, the package was accompanied by a legislative proposal introducing a market stability reserve for the EU emissions trading system (ETS), starting in 2021. The objective is to give the underperforming carbon market stability and raise the price of CO_2 allowances closer to the 25-30 euro a tonne mark originally envisaged when the ETS was first designed. The Commission also came forward with **non-binding recommendations on unconventional gas exploration and production in the EU**. The document outlines best practices for shale gas exploration but, given its non-binding nature, will have very minimal impact. Instead, for the short term, it will be the role of Member States to develop their own legislative framework on shale gas development.

Elsewhere, although less reported in the mainstream press, the Commission also gave some very interesting insights into its thinking in a number of other key energy and climate policy areas. **A Communication was released on energy prices and costs** which compared the EU with other regions of the world, most notably the US, where the shale gas revolution has had a dramatic impact on prices. The Communication was accompanied by a very detailed report on the drivers of energy prices in Europe.

In the Communication, the Commission has included a line of text calling for an end, from 2020, of the 6% GHG reduction targets for transport fuels, as part of the **Fuel Quality Directive**. The text seems to indicate that the Commission is coming to a growing realisation that the implementation of Article 7a presents too many hurdles and that the FQD should be scrapped. The Commission adds that that **first generation biofuels in transport should not receive public support post 2020**. This position represents bad news for some parts the biofuels industry. In an effort to appease more energy intensive sectors the Commission said that it will not modify the quantitative criteria for the **list of sectors exposed to carbon leakage for 2015-2019** and thus will continue to use the 30 euro a tonne CO_2 price in its modeling.

Looking ahead, the European Council is expected to consider the framework at its spring meeting on 20-21 March. The Commission's proposal represents the start of a process which must go through co-decision and receive the support of Member States and the European Parliament. In its Communication, the Commission invites the European Parliament and Council to agree by the end of 2014, that the EU should pledge a GHG reduction target of 40% by early 2015 as part of the international climate COP negotiations that will be held in Paris in 2015.

1. 2030 Energy and Climate Framework

GHG Reductions

The centerpiece of the EU's climate and energy policy for 2030 is the target of a **40% GHG reduction below 1990 levels**. Interestingly this would be met "through domestic measures alone", meaning that Member States will not be able to offset their reductions by paying for carbon reduction projects in other countries.

To achieve this target, it is assumed that ETS emissions would need to be cut by around 43% from 2005 levels. To reach such ambitious levels, the annual linear reduction factor will have to be increased to 2.2% after 2020 (from the current 1.74%). The non ETS sectors (transport, agriculture, etc) will need to reduce their emissions by 30% compared to 2005 levels.

Renewables

The Communication calls for an EU-wide binding target for renewable energy of at least **27% above 1990 levels by 2030.** However, while an EU-wide goal has been set, this will not be translated into national targets through EU legislation. The Commission says that this will leave flexibility for Member States to transform their energy systems in a way that is adopted to national preferences and circumstances. These will be reviewed as part of the new governance process, while the attainment of the EU renewables target would be ensured through a new governance system based on national energy plans.

The Commission believes that there is a need to simplify and streamline the current separate processes for reporting renewable, energy efficiency and GHG reduction for the period post-2020, and to have a consolidated governance process with Member States. The Commission says that it will come forward with Guidance on the operation of new governance process and the content of national plans.

Elsewhere, the Communication adopts a somewhat precarious tone on renewables, noting that their rapid deployment threatens the competitiveness of other energy sources and reduces incentives for generation capacity that will be needed for the energy transition. On biomass, the Commission notes that an improved biomass policy will be necessary to deliver GHG reductions but does not give any details as to when a new biomass proposal could be released (The Commission has constantly delayed a proposal dealing with the sustainability of biomass in recent years).

Energy Efficiency

As expected, energy efficiency plays a less important role in the 2030 package compared to the current 2020 package and the **energy efficiency target has not been extended in today’s Communication**. No clear binding or indicative energy efficiency target for 2030 is given, rather the Commission has chosen not to tackle the issue for now and rather says that the role of energy efficiency in the 2030 framework will be further considered in the review of the Energy Efficiency Directive due to be concluded at the end of 2014.

The Communication’s impact assessment suggests a 25% increase in efficiency by 2030, however there is little prospect of a new target being adopted in the short term.

Stakeholder reactions

Overall, reactions amongst stakeholders have been mixed. NGOs, green business and renewable investors were disappointed by the low level of the renewable energy targets and the absence of individual binding targets for Member States. However, there was relief that the Commission picked a 40% binding GHG reduction target, rather than 35% as some stakeholders had been pushing for.

European Commission President José Manuel Barroso

European Commission President José Manuel Barroso

"Climate action is central for the future of our planet, while a truly European energy policy is key for our competitiveness. Today's package proves that tackling the two issues simultaneously is not contradictory, but mutually reinforcing. It is in the EU's interest to build a job-rich economy that is less dependent on imported energy through increased efficiency and greater reliance on domestically produced clean energy. ***An ambitious 40% greenhouse reduction target for 2030 is the most cost-effective milestone*** *in our path towards a low-carbon economy. And the renewables target of at least 27% is an important signal: to give stability to investors, boost green jobs and support our security of supply".*

Energy Commissioner Günther Oettinger

Energy Commissioner Günther Oettinger said:

"The 2030 framework is the EU's drive for progress towards a competitive low-carbon economy, investment stability and security of energy supply. ***My aim is to make sure that energy remains affordable for households and companies.*** *The 2030 framework sets a high level of ambition for action against climate change, but it also recognises that this needs to be achieved at least cost. The internal energy market provides the basis to achieve this goal and I will continue to work on its completion in order to use its full potential. This includes the 'Europeanisation' of renewable energy policies".*

Connie Hedegaard, Commissioner for Climate Action

Connie Hedegaard, Commissioner for Climate Action said:

"In spite of all those arguing that nothing ambitious would come out of the Commission today, we did it. A 40% emissions reduction is the most cost-effective target for the EU and it takes account of our global responsibility. And of course Europe must continue its strong focus on renewables. That is why it matters that the Commission is proposing today a binding EU-level target. The details of the framework will now have to be agreed, but the direction for Europe has been set. ***If all other regions were equally ambitious about tackling climate change, the world would be in significantly better shape****."*

EPP Group (Christian-Democrats in the European Parliament)

MEP, Richard Seeber and MEP Pilar Del Castillo in a joint statement said:

"EU climate policy must not become an anti-industry policy. It is not sufficient to push for a reduction of greenhouse gas emissions whilst neglecting the roll-out of more renewable energies and the boosting of industry production in Europe."

Green Group

Green climate change spokesperson Bas Eickhout said:

"What the Commission is proposing today would bring EU policies on climate change and renewable energy to a virtual standstill. With president Barroso at the wheel, this would amount to the jackknifing of existing EU climate policy and the all-clear for the fossil fuel juggernaut. We will push to ensure a majority of EU governments and the European Parliament rejects this Conservative volte-face.

EURELECTRIC

EURELECTRIC Secretary General Hans ten Berge said:

'The current 20/20/20 package has resulted in significant carbon emissions reductions, and has led to further growth, cost reductions and technological development in both renewable generation and energy efficiency. However, it has also resulted in a regulatory jungle of multiple and overlapping targets and instruments. This has had negative impacts on cost-effectiveness.

BUSINESSEUROPE acknowledges some steps made in the right direction

Markus J. Beyrer, BUSINESSEUROPE Director General said:

"*It is positive that the pack of measures published today acknowledges the challenge of high energy prices in the EU and addresses the risk of investment leakage better than in the past. However, the overall level of ambition for a 2030 greenhouse gas reduction target is only realistic if a binding international climate agreement can be concluded in 2015. Therefore we urge the European Commission and the European Council to make sure that Europe will not be once again a lone frontrunner without followers*

2. Reform of the Emissions Trading Scheme

New Structural Reserve Mechanism

As part of its efforts to reform the underperforming ETS, the Commission also came forward with a legislative proposal offering medium to long term reform of the carbon market. In its proposal, the Commission proposes to establish a market reserve stability reserve at the beginning of Phase 4 of the ETS in 2021. The Commission's proposal would not apply in time to control prices in the current 2013-2020 Phase of the ETS. The Commission also said that it wants the rate at which the ETS's total emissions cap falls changed from 1.74% to 2.2% after 2020, which will absorb some of the market's surplus.

The market stability reserve would provide an automatic adjustment of the supply of auctioned allowances downwards or upwards based on a pre-defined set of rules. Starting in 2021, 12% of the accumulated oversupply would be transferred to the stability reserve each year unless the oversupply falls below 833 million allowances. In addition, some of the backloaded allowances would be transferred from Phase 3 (2013-2020) to Phase 4 (2021-2028) of the EU ETS, representing a further backloading of the backloaded allowances. Market analyst Point Carbon estimated yesterday that the average carbon price for 2019-30 would rise to €35.

Stakeholder Reactions

Overall, stakeholders with the exception of the Green group were pleased with the Commission's proposal, particularly its decision not to further intervene in Phase 3 of the ETS.

SSE

Martin Pibworth, Managing Director of Energy Portfolio Management at SSE, said:

"Today, very important steps have been taken towards reviving the EU ETS in the interests of the cost-effective decarbonisation of Europe. Following on from backloading, the proposed EU ETS reforms are positive measures which will help the EU ETS provide a stable and robust investment signal for low carbon investors.

"However, the detail of how the market stability reserve will work is crucial in determining how long it will take for the EU ETS to become the central driver in carbon abatement decisions across Europe, as well as whether further measures will be required to deal with surplus allowances expected to be on the market when the mechanism is introduced."

Green Group

Green climate change spokesperson Bas Eickhout said:

"What the Commission is proposing is too little, too late. It will do little or nothing to address the oversupply of emissions permits, which is depressing the EU carbon market, in the short to medium term. As a result, if these proposals are not radically altered, it would essentially commit the EU's flagship climate change policy to a prolonged period of malfunction. The proposed market stability reserve is a mockery and will utterly fail to deal with the huge surplus of emissions permits that are flooding the market. It will only begin operation from 2021 on, by which time the surplus of permits/allowances in EU's carbon market will have been allowed to grow to 2.6 billion, based on current estimates.

3. Shale Gas

A Communication and Non-binding Recommendation

The European Commission published a Communication and a (non-binding) Recommendation from the EU on unconventional gas exploration and production in the EU. Overall, given the non-binding nature of these documents, their impact will be very minimal. It puts an end to months of speculation on whether the Commission would intervene and issue a specific 'Shale Gas Directive' and is a victory for Member States such as the UK and Poland who were vehemently opposed to a suggested shale gas Directive.

In the Communication, the Commission discusses the opportunities and challenges stemming from unconventional exploration in Europe as well as the main elements deemed necessary to ensure its safe and secure development.

The highlights of the (non-binding) recommendation are a common set of (non-binding) key principles, which the Commission says will ensure that the exploration and production of natural gas from shale gas formations can be conducted, while ensuring climate and environmental considerations are adequately dealt with. The key principles include, strategic assessment prior to authorization, site risk assessment, and transparency related to the use of chemical substances, etc. The details of these key principles are given below.

Elsewhere, the Commission will keep a scoreboard of Member States measures which should be publically available. The Commission will review the effectiveness of the recommendation 18 months after its publication. The review will include an assessment of the regulation and whether there is a need to come forward with legally binding provision on hydraulic fracturing.

Finally, despite saying that volumes are "significant", the Commission seems pessimistic about the prospects for shale in Europe saying that **best case scenario would see shale gas meeting 10% of EU gas demand by 2035**. No shale gas revolution akin to the US experience is envisaged.

Looking ahead, in the short term it will be the role of Member States to develop their own legislative framework on shale gas development as the Commission has chosen to pass this political 'hot potato'. Member States "invited" to inform the Commission on the measures they have taken in response to the Recommendation on an annual basis by December 2014. The details on these minimum principles, as well as other highlights from the Communication are given below.

Stakeholder Reactions

A copy of the Commission's non-binding Recommendation had been widely leaked to the press last week, thus mooting the reaction. As expected, Green NGOs still make press releases criticizing the Commission for choosing not to regulate shale gas exploration.

The Greens

Green environment and public health spokesperson Carl Schlyter stated:

"These proposals represent a cop-out by the European Commission. Instead of seeking to address the very real environmental and public health concerns with shale gas and the controversial fracking process, Commission president Barroso has bowed to the pressure of the fossil fuel lobby and its political cheerleaders like David Cameron".

ECR

Vicky Ford MEP said:

"The Commission has offered some principles for countries to follow on shale gas but fortunately is not rushing headlong into new legislation– they made that mistake when they proposed a badly worded, expensive and even dangerous regulation on offshore oil which took hundreds of legal amendments to correct.

"There are already effective existing laws on water quality, air quality and protecting the environment. This legal regime should allow sensible exploration and extraction of shale gas – but there won't be a free for all for cowboy operators.

Friends of the Earth Europe

Antoine Simon, shale gas campaigner for Friends of the Earth Europe said:

"Shale gas regulations have been fracked to pieces by corporations and fossil fuel-fixated governments. Insufficient and non-binding recommendations and monitoring mean fracking will go ahead improperly regulated and local communities will be the ones who suffer. Europe is putting the fox in charge of the hen house."

Shale Gas Europe

Shale Gas Europe said:

"Today's announcement follows a thorough assessment and over a year of extensive public consultation involving a diverse range of participants including national governments, the energy industry, NGOs and environmental organisations, scientific experts, the business community as well as the general public. The European Commission has sought to strike a balance between Europe's objectives of an environmentally sustainable, affordable and secure energy mix. However we will need to see how these guidelines are subsequently applied."

4. Carbon Leakage

While noting that there has been little evidence of carbon leakage, in its Communication the Commission said that it is "prudent" to maintain the existing policy framework for those industrial sectors most at risk of carbon leakage until the end of Phase 3 of the ETS. The Commission added that it intended to present a draft decision on the review of the carbon leakage list to the appropriate Regulatory Committee which would maintain the current criteria and existing assumptions. Indeed, in question 8 of the Q&A document, the Commission specifically states that an assumed price of 30 euro a tonne for carbon would be used.

Elsewhere, the Commission proposes to continue the system of free allocation of allowances post-2020 if no other economies take comparable climate action. However, the Commission notes that this system would be "improved" so that it focuses on the sectors at most risk of carbon leakage. It also implies that the Commission will be keen to reduce its list of sectors for the period post-2020.

5. Fuel Quality Directive & Biofuels

In the Communication, the Commission has included a line of text calling for **an end, from 2020, of the 6% GHG reduction targets for transport fuels**, as part of the Fuel Quality Directive. The text shows that the Commission could be coming to a growing realisation that the implementation of Article 7a presents too many hurdles and that the FQD should be scrapped. NGOs are likely to react negatively to this, having just last week written a letter to Commissioner Hedegaard urging her to maintain the FQD.

In its Communication, the also Commission says that it "does not think it appropriate to establish **new targets for renewable energy or GHG intensity of fuels used in the transport sector** or any other sector post 2020". The Commission adds that the assessment of how to minimise ILUC change emissions made clear that first generation biofuels should not receive public support post 2020. It argues instead that focus should be on improving efficiency in transport, further deployment of electric vehicles and 2nd and 3rd generation biofuels. The move will anger advocates of renewable transport fuels but please campaigners who are concerned about the impact of biofuels on food prices.

6. European Industry Renaissance

The Commission also issued yesterday a Communication calling "for a European Renaissance". It is the Commission's contribution to the 2014 European Council debate on industrial policy and sets out priorities to boost EU competitiveness. Overall, the Communication offers little news and again reiterates the Commission's aspiration of increasing the contribution of industry to GDP to 20% by 2020.

7. Energy Prices and Costs in Europe

Communication

The Commission released a Communication on Energy Prices and Costs in Europe, arguing that the rise in retail energy prices costs is mostly due to increasing taxes/levies and network costs at national level.

The Communication notes that he EU has until now retained the lead in exports of energy intensive goods. However, it warns that European industry's efforts to compensate for higher energy costs through constant energy efficiency improvements may reach a limit as competitors do the same. Elsewhere, the Commission bemoans that there is a serious lack of credible, comparable and verifiable information on certain aspects of price and costs, in particular on the drivers of transmission and distribution costs.

However, the Communication fails to propose concrete actions. The Commission does say that it may launch an action plan on retail markets before the summer of 2014 and that further work may be needed to benchmark network costs and practices to ensure that European convergence in network practices improves the efficiency of distribution and retail markets.

Elsewhere, the Commission notes that State Aid to protect certain consumers from higher energy costs reduces incentives to undertake energy efficiency measures and distort the single energy market. In its view, vulnerable energy consumers can be better protected through social policy or industrial policy rather than through energy pricing.

Full Report on Energy Prices and Costs

This Communication is accompanied by a report on energy prices and costs, which assesses the key drivers and compares EU prices with those of its main trading partners.

In the report, the carbon price is found not to have any significant impact on electricity retail prices. The level is far lower than what was expected when the Energy and Climate Package was adopted in 2008. Interestingly, it acknowledges that the success of renewables in Europe has contributed to the oversupply of allowances, hence decreasing the carbon price and thus acknowledging the discordance of the overlapping 2020 Climate and Energy targets.

The report says that the impact of energy prices has varied between sectors. The report notes that the EU has been somewhat restructuring away from energy intensive sectors while maintaining an overall share of manufacturing in value added above that of the US. Manufacturing sector has not been affected, mostly due to increases in energy efficiency. The sectors that have been most exposed to energy price shocks in terms of high RUEC (real unit energy costs) levels in the EU are coke and refined petrol, chemicals, non-metallic minerals, metals, rubber and plastics.

The study notes that overall energy-intensive industries in the EU have dealt well with the large energy price differentials with the US. The main reason for the limited impact thus far has been the greater energy efficiency in the EU compared to the US. Looking ahead, the study does give a word of caution and warns that the EU should remain concerned about the price differentials as “the full impacts may only become visible after some delay.

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Sources:

2030 Framework

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ETS Reform

- Proposal for a Decision to establish a market stability reserve amending the ETS Directive:
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- European Commission Q&A on the market stability reserve:
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Shale Gas

- Communication on Shale Gas:
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Energy Prices & Costs

- Communication on Energy Prices and Costs:
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FleishmanHillard

Square de Meeûs 35

B – 1000 Brussels

Tel: +32 2 230 05 45

Fax: +32 2 230 57 06

www.fleishmanhillard.eu