VOLUME 20 – ISSUE 4

ISSN 0960 2356

UTILITIES LAW REVIEW

UTLR

- Utilities Regulation
- Market Regulation
- Competition Law
- Network Industries

LAWTEXT PUBLISHING

CONTENTS

The Time has Come for a European Energy Union

A comment on the EU Council's 'Conclusions on 2030 Climate and Energy Policy Framework'

Professor Valeria Termini*

Italian Regulatory Authority for Electricity, Gas and Water, Rome

The long awaited European Council of October 2014, after appointing the new European Commission, ended in a set of Policy Conclusions.[1] These focus on the 2030 European Climate and Energy Policy, thus reaffirming the centrality of a sustainable energy sector to foster an industrial growth desperately needed after half a decade of crisis.

October's Council was met with high, possibly unrealistic, expectations that included: the definition of strategic lines for a European energy policy that collectively addresses gas security challenges; an assessment of the electricity sector in light of the revolutionary changes brought forward by decentralised generation; and guidelines that enable energy to assume a key position in EU Investment Plans for the re-launching of the economy.

Let's get things straight. None of these issues[2] were directly addressed. The Council's Conclusions tackle a whole other set of priorities. Indeed, they seem to respond to the objective of reaffirming EU leadership in the United Nations 2015 Paris meeting on Climate Change, hence preparing the battlefield for a strong EU role in international negotiations, in order to obtain burden sharing and globally binding third country targets and commitment.

In this perspective, three of the four goals for 2030 are highly symbolic. The primary target, around which the entire framework is built, is the reduction by 40 per cent of EU greenhouse gas emissions ('GHG') compared to 1990 levels. It is binding, though at a European level only. The second, also binding at a European level, entails a share of 27 per cent of RES in final consumption. The third, merely indicative, defines an increase in energy efficiency to 27 per cent compared to 2005 values. Finally, a fourth objective was included among the environmental goals and foresees, for the first time, the completion of the Internal Energy Market. It prescribes a 10 per cent increase by 2025 and a 15 per cent increase by 2030 of national infrastructures with the objective of strengthening electrical interconnections amongst Member States - Spain, Portugal and the Balkans in particular. Connecting Finland and Baltic countries to sustain Europe's ability to diversify its energy sources is also central to this target. Finally, in order to bolster energy security, the Council recommends that the Commission coordinates investments for Projects of Common Interest ('PCI') and electric infrastructures, completes North-South and South gas corridors, to diversify supply routes, and guarantees a better usage of storage and rigasifier plants.

Aside from re-dimensioning the energy efficiency target from 30 to 27 per cent, these objectives basically reaffirm the Commission's 2030 Framework proposal. Two substantial elements of discontinuity, however, were introduced and consist of a flexibility principle for which no binding targets are defined on a national level and a reinforced principle of solidarity for which some forms of compensation are recognised to support the de-carbonisation of lower income Member States.[3]

The Councils' difficulty in identifying a balance between environmental objectives on the one hand, and competitiveness of European industry on the other, is evident throughout the text. It also results in a series of compromises and compensations so as to reach the convergence of 28 Member States. Indeed, Europe runs a great risk of penalising its economy in order to pursue its de-carbonisation strategy. The Oxford Institute for Energy Studies (2014)[4] estimates that EU industries have witnessed a yearly 3.5 per cent increase in energy prices since 2008, due mainly to climate change policies in the EU. It further forecasts that the EU's share of global export market for energy-intensive

* Commissioner of the Italian Regulatory Authority for Electricity Gas and Water (AEEGSI), Vice-President of the Council of European Energy Regulators (CEER).

1 'Conclusions on 2030 Climate and Energy Policy Framework' European Council 23 and 24 October 2014.

2 Among expectations we can cite a vision able to offer objectives and consistent tools to address the extraordinary changes that, in such a short period, have dramatically impacted the energy sector and affected the competitiveness of European industry. Indeed, for fossil fuels, unconventional gas and oil exploitation has boosted profit margins for American industry, while the increase of GNL has modified gas routes and decoupled gas from oil prices. These changes have driven increasingly national and divergent interests to prevail over the Commission's struggles to unify national energy markets. A similar effect is caused by the drastic increase in new renewable energy sources (RES) that triggers national solutions for electricity to both integrate ICT devices for smart grids and gradually decrease electricity supply from oil and gas CCGT (combined cycle plants). As RES push electricity wholesale market prices to unsustainable levels (less than €30 /MWh), national measures to provide back reserves for intermittent energy sources become more and more necessary.

3 These measures of compensation include: a Reserve Fund of emission allowances (2 per cent) for low income countries with GDP per capita less than 60 per cent of the EU average, and, for countries with a slightly lower GDP per capita than EU average (90 per cent) a 10 per cent share of the yields from Member State allowances auctions.

4 Oxford Institute for Energy Studies, 'Costs competitiveness and climate policy: distortions across Europe', April 2014.

goods from 2014 to 2035 will decrease by 10 per cent (from today's 36 per cent). This is in marked contrast with the January 2014 Commission's Communication for an 'EU Industrial Renaissance'.[5] The Council, however, does not demonstrate the political willingness required to take a necessary qualitative leap.

Having said this, three questions remain unanswered:

(1) Are the objectives challenging from an environmental perspective?
(2) Are they realistic?
(3) Are the tools in place to achieve them consistent and effective?

(1) Symbolically speaking, the European objectives may be challenging. However, if we consider the 40 per cent GHG emissions reduction, the main target of the package, we have a rather *business as usual* scenario. Indeed, the 'Progress towards 2008–2012 Kyoto targets in Europe'[6] shows that as of 2013, Europe achieved a 19 per cent reduction of GHG, meaning that the 2020 target has already basically been met six years in advance. This result, however, is mainly due to a slow economic growth. Much to the same extent, the indicator of energy efficiency should be sterilised from the macro economic effects on energy demand in order to adequately reflect the impact of low-carbon technologies and rationalisation of consumption (an energy intensive indicator, that is, 1 kg of oil equivalent per €1000 of GDP, would do a better job than an energy saving one).

(2) The feasibility of the objectives is strictly tied to EU governance. The two themes are closely related, as the model of governance contributes to determining progress, associated costs, and the choice of instruments (coercive, market or otherwise) to employ. Nevertheless, the debate on the European strategy has always focused on the objectives themselves, leaving the identification of the tools to pursue such objectives to sectorial initiatives, while showing little or no interest in the underpinning model of governance. The Conclusions do not investigate this issue either and are limited to underlining the flexibility granted to Member States, re-proposing national plans for environmental objectives and leaving a light role to the EU that consists in 'facilitating the coordination of national energy policies and fostering regional cooperation between Member States' (p.10).

A step towards Europeanisation, following the Commission's emphasis in its 2030 Energy Framework, was anticipated. Regretfully, however, the Council, in its Conclusions, takes a step back. In more detail, the process defined entails the definition of 28 national plans, and national tools to implement those targets. The Commission performs assessment procedures, while enforcement falls within the responsibility of Member States. Accordingly, the assessment phase is allocated to the Commission and should be achieved through the analysis, in an iterative procedure, of national plans and their consistency with the EU targets. Member States should be able, and willing, to build national strategies that are somehow consistent with both each other and with the single, common objective. In other words, one must be extremely optimistic to envisage the autonomous convergence of 28 national plans towards a single EU binding target. The past experience on national plans for emissions trading schemes (ETS), however, constitutes a warning signal that cannot be disregarded.

The Commission itself suggests that 'in a second stage, should the cooperative approach prove ineffective, it may be necessary to adjust the normative model for the management of these policies, foreseeing greater powers to EC organs'. This statement introduces further uncertainty into a regulatory framework that, on the contrary, calls for further certainty and stable rules to promote long-term investments.

The subsidiarity principle is thus respected by this new process, but will it work?

In this scenario two crucial questions remain open. Are there margins within the Treaties for a more effective governance, one that would enable the EU to achieve its targets? And second, and even more challenging, are Member States prepared to empower the Commission on a common energy policy, embracing a forward-looking vision able to comprehend the greater benefits of an Energy Union?

(3) As for the tools, no assessment of cost effectiveness, technical feasibility, nor economic inconsistencies are specifically accounted for. The Conclusions state that 'the main European instrument to achieve the GHG emissions target is a well-functioning, reformed Emissions Trading System ETS'. The Council, however, does not reform, but rather proposes a series of corrective measures for the system in order to mitigate the past criticalities that ultimately led to its failure in the initial experimental phases. The EU ETS established a cap of total emissions for the region; the emission allowances are tradable and the price of carbon is fixed on the market.[7]

Notwithstanding, this system presents at least two critical issues: the price and the initial allocation of allowances. Indeed, the market carbon price must be sufficiently high to induce energy efficiency and innovative investments. In Europe this price was initially estimated to be around €26/28; today the market carbon price in Europe is around €6. Throughout 2005 to 2007 the price, which remained lower than anticipated within a range of about €5 to €15, fell to zero at the end of this first EU ETS period. In the second period, 2008–2012, it plummeted. At the beginning of the recession it remained at around €15 for an excess of offer up until the end of the second term. For this whole period the price of carbon remained at levels that proved insufficient to promote investments in low carbon technologies. However, the Council lacked the courage to reduce ETS allowances to handle this criticality. This would also have increased the credibility of EU policy in Paris 2015.

5 European Commission, MEMO/14/37, 22 January 2014.

6 Report published on 28 October 2014 by the Commission and the European Environment Agency http://www.eea.europa.eu/publications/progress-towards-2008-2012-kyoto.

7 In particular, the market price of carbon has the purpose of internalising the social cost of pollution in firms' cost functions, maintaining the advantage of gas and less polluting sources over coal and promoting investment for low carbon technologies.

Following the Commission's proposal, the Council only establishes that the total supply of allowances (cap) would be reduced by a yearly rate of 1.74 per cent until 2020 and by 2.2 per cent from 2021 onwards - today's cap is 2.039 million TOE (tonnes of oil equivalent). The aggregate supply of allowances is further reduced, as 2 per cent of allowances are devolved to the Reserve Fund (Solidarity Fund for investment projects in lower income Member States with GDP pro capita of less than 60 per cent of EU average).

The second critical issue is that the initial allocation of tradable permits, as greatly debated by academics, must be as effective as possible. In fact, grandfathering, that is, the initial free allocation of allowances, risks being translated into extra profit for businesses in the interested sectors, especially for those operating in oligopolistic markets. On the other hand, the allocation through auctions, by increasing production costs, risks creating problems of competitiveness for internal industries, while globally, it creates carbon leakage. In other words, besides penalising the European industry, this pattern worsens global pollution and drives production to countries with less environmentally sophisticated technologies.

To obviate this criticality the Council will establish a set of countermeasures: a share of allowances distributed free of charge until 2020 to firms in sectors that face the risk of 'losing international competitiveness' so as to safeguard efficient power plants from EU environmental measures. However, as the 'benchmark for free allocation will be periodically reviewed, in line with technological progress', a further degree of uncertainty is introduced.

For the sectors not part of ETS, that is, transport, buildings, agriculture and waste, the national objectives of emission reductions to 2030 are re-affirmed so as to respect the principle of subsidiarity.

Concluding remarks: can Europe dare to do more?

Having set out the above considerations concerning the objectives, procedures, tools and feasibility of the environmental targets, the fundamental point remains the creation of an *Energy Union*. This calls for a different political and economic approach at a European level and is not by any means satisfied by the completion of an internal energy market (IEM) by 2014. It requires the empowerment of European organs and an industrial policy.

In this direction some steps may be imagined in a perspective of gradual change. Examples of policy recommendations may be the following.

(1) An important step concerns the promotion and financing of large-scale, mission-oriented investments in low carbon projects on a European level, replacing current national, uncoordinated incentives for specific, small-scale projects (for example, PV solar plants), currently under the scrutiny of the Commission.[8]
(2) At the same time financial instruments to promote specific R&D projects for the energy sector, with EU coordination and support, should be experimented with. A positive example in this very direction can be found in the United States, in the Obama strategy for energy and growth, where, in 2009 with the launch of ARPA-E, the Federal Advanced Research Project Agency for Energy, the Federal Government identified a strategic role for the energy sector. Not generic subsidies but mission-oriented large research programmes are the core of US public intervention. ARPA-E is financed by the Federal program (ARRA) and is already producing spill-over effects for industrial innovative technologies.[9] It is evident that in Europe this process would have to be gradual, and that a series of important amendments would have to be assessed within the margins provided for in the EU Treaties.
(3) From an environmental perspective, a further example is the gradual phasing out of the usage of coal (for example, in Germany). Given the national independence on fuel mix, this requires commitments from Member States' governments. However, following the court's decision against the Polish Government which confirmed the legitimacy of the 20-20-20 Package to impose a share of renewable sources on Member States, the question has been raised as to whether there is ground for imposing fuel targets on Member States based on environmental needs. This court decision opens possibilities for a European Energy Union.
(4) Finally, policy recommendations refer to strengthening both government and governance in the EU energy field. On the government side, there is an urgent need for a EU industrial policy, or at least an EU-level coordination of Member States' industrial policies. The urgent need of an EU strategy towards third countries, energy producers, is also clear.

Although the importance of governance cannot be overlooked, the risk of Europe falling into a trap of excessive bureaucracy is very real. EU and national regulators have almost fulfilled their tasks for the harmonisation of rules (that is, network codes) and the integration of national markets (inpreparation of an Internal Energy Market). It is now time for governments to invest in a new European Energy Union, showing the same political generosity and forward-looking vision they had earlier advocated in the 1950s for the launch of the CECA and the Common Market. Indeed, similar to what occurred two decades ago for monetary policy, in order to plan and implement an effective European industrial policy that is beneficial for all Member States, the devolvement of a degree of national sovereignty on behalf of national governments is required.

8 It is under discussion whether they may be considered forms of 'state aid'.

9 This much in the same way as the Federal Agency on the Defence Sector (ARDA) worked, producing extraordinary industrial innovative technologies from military research after World War II (for example GPS, ICT technologies, and so on), thus enabling American firms to gain a global leadership in these pioneering sectors.