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Briefing note

January 2014

New EU 2030 Climate and Energy policy framework, ETS structural changes and shale gas policy published

The European Commission has published its framework of policies for climate change and energy up to 2030 (the 'Framework')[1]. The Framework proposes 2030 targets for a reduction in carbon emissions of 40% (from 1990 levels) and for 27% of energy to be produced by renewable sources. Also published is a proposal for a market stability reserve for phase 4 of the EU Emissions Trading Scheme beginning in 2021 to prevent surplus allowances depressing carbon prices. The Commission has also made a non-binding Recommendation on measures to ensure shale gas exploitation addresses environmental and health & safety risks.

Key issues

- Climate and Energy Package proposes:
  - 40% binding emissions reduction target by 2030
  - 27% renewable target by 2030 (but only binding at EU level)
- EU ETS reform: New Market Stability Reserve proposed for Phase 4 from 2021 onwards
- Shale gas policy: Non-binding Recommendation proposed to encourage strong environmental and health & safety controls on hydraulic fracturing

2030 Climate and Energy framework

Background

The Framework is built upon the EU 20:20 Climate and Renewable Energy Package which established EU-wide targets for a 20% reduction in greenhouse gas (GHG) emissions by 2020 (based on 1990 levels) and for 20% of energy to be obtained from renewable sources by 2020. The Commission is pleased by current progress: By 2012 an 18% GHG emission reduction had already been reached (although strongly assisted by the economic crisis) and the level of renewable consumption was 13% of total energy consumption.

In setting targets for 2030, the Framework establishes a medium term route towards securing the demanding objective of an 80% reduction in GHG emissions by 2050 provided for in the EU's 2050 Roadmap[2]. The Framework will now need to be agreed by the European Parliament and Council and a difficult period of negotiation is likely to follow to meet the Commission's aim to reach agreement by

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1 A policy framework for climate and energy in the period from 2020 to 2030

2 Roadmap for moving to a low-carbon economy in 2050

the end of 2014 in time for the next phase of international climate negotiations in 2015.

Emissions reductions

The Framework proposes an EU-wide target to reduce GHG emissions by 40% by 2030 (against 1990 levels). This reduction effort would be split in the following way:

- **EU Emissions Trading System (EU ETS) sector**: Reduction in GHG emissions of 43% required against 2005 levels (the 2020 target was a 21% reduction). Currently the EU ETS is structured to reduce regulated emissions on a linear basis by 1.74% annually; this would be strengthened to a 2.2% annual reduction under the proposals.
- **Non- EU ETS sector**: Reduction in GHG emissions of 30% required against 2005 levels (the 2020 target was a 10% reduction). Similarly to the 2020 targets, the Commission proposes setting national targets for emissions reductions based on GDP per capita of the Member States. These will be now subject to negotiation at EU level. Whereas some Member States with lower per capita income were permitted to increase their emissions under the 2020 targets (e.g. Czech Republic, Poland and Romania), the Commission's Impact Assessment indicates that all Member States would now have to make significant cuts to meet the 2030 targets.

Renewable Energy

The Commission has proposed an EU target for 27% of energy consumed in the EU by 2030 to come from renewable sources (but individual sector specific targets will no longer be set). There has been considerable controversy over this target with a number of Member States seeking to ensure it will not be binding. The compromise is that the target will be binding on the EU but not on individual Member States (unlike the 2020 targets where binding individual national renewable energy targets were established). The Commission recognises that Member States should have flexibility over how they meet GHG reduction targets and makes reference to cost-effectiveness in justifying this. For example, the UK Government is keen on exploring the use of shale gas to help meet its reduction targets. However, the Commission has left the door open to a more mandatory approach:

- A new governance framework would require each Member State to have a 'national plan for competitive, secure and sustainable energy' making a clear commitment towards renewable energy (taking into account EU law, and including the 2030 targets).
- Where the Commission's review of national plans indicates that the EU's renewable energy target would not be met, it would seek to reinforce those plans as required.
- Ultimately, the Commission could seek to make the governance framework mandatory which might effectively make targets mandatory at a national level.

This governance framework would apply equally to GHG reductions as discussed above.

Other aspects of the Framework

The Framework deals with a number of related areas including:

- **Energy Efficiency:** The Framework does not propose any new targets. However, pending a review of the Energy Efficiency Directive this year, it notes Commission analysis that a 40% GHG emissions reduction target would require an increased level of energy savings by 2030 of 25%.
- **Reform of the EU ETS:** See below.
- **Land-use change and forestry**: A proposal to include land-use change and forestry within the 2030 GHG emissions reduction target.

- **NER 300 Funding expansion:** The NER300 currently awards funds from EU ETS allowance sales to Carbon Capture and Storage, and renewable, projects. An expansion of this programme would target innovative low carbon technologies in the industrial and power generation sectors.
- **Research and Innovation:** The Framework highlights the recently announced Horizon 2020 programme which will allocate around EUR 6 billion for research and innovation in energy efficiency and low carbon technologies, smart cities and communities.
- **Energy Prices:** The Framework notes the separate publication of a report on energy prices assessing key drivers and comparing EU prices with other trading partners.

The Package will send mixed messages to low carbon investors and environmental groups on climate and energy policy. If adopted, the binding 40% GHG reduction target will at least reassure investors that the EU is not wavering on its long term carbon reduction aims. However, they will be disappointed by the failure to propose binding national renewable targets (and with an EU target of less than the 30% previously floated), and the postponement of setting a new energy efficiency target. It leaves renewable energy policy more at the mercy of national discretion and will allow governments increased leeway to favour investment in potentially cheaper energy sources such as shale gas.

EU ETS reform

With carbon prices falling to record lows in January 2013, it has been clear for some time that some major reforms to the EU ETS are needed to restrict the supply of allowances and bolster prices. The EU has made an initial step in this direction by agreeing to postpone the sale of 900 million carbon allowances in the EU ETS Phase 3 (so-called 'back-loading'). Back-loading will mean the auctioning of these allowances will be postponed from 2014-2016 until 2019-2020. The amount to be reduced in 2014 will be dependent on the start date of the back-loading (but the Commission has said that it expects back-loading to start by June). Low carbon prices are however expected to endure beyond 2020 and a permanent structural fix to the EU ETS is therefore required.

The Commission proposes[3] a Market Stability Reserve (MSR) which will automatically remove a specified number of allowances from auctions and place them in a reserve when specific pre-defined circumstances occur. The allowances may then subsequently be to be released if certain conditions are met. Whilst the thresholds and amounts are yet to be agreed, the proposal gives the following indication of how the MSR might work:

- Where the total number of allowances in circulation reaches at least 1.2 billion (based on the previous year's data), 12 % of the allowances would be placed into the reserve at the next auction.
- There would be a release of allowances into the market if either:
  - The number of allowances in circulation falls below 400 million (automatically, 100 million allowances would then be released); or
  - If, for more than 6 consecutive months, the carbon price is more than 3X the average carbon price in the previous 2 years, all allowances would be released (no matter how many were in circulation).

Allowances would be withdrawn in each Member State pro rata the total amount to be auctioned by national authorities. Aviation would not be covered by these proposals.

The Framework also confirms the continuing application, into Phase 3 of the scheme, of the Commission's approach to carbon leakage (awarding free allowances to sectors where industrial activity is likely to be displaced outside the EU because of the impact on energy prices).

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[3] Proposal for a Decision on the establishment and operation of a market stability reserve

Shale Gas Environmental and Climate Change policy

The Commission has proposed a Communication [4] and non-binding Recommendation[5] on minimum precautions for hydraulic fracturing operations to ensure environmental and health & safety risks are properly addressed. These include:

- A strategic environmental assessment before high volume hydraulic fracturing[6] takes place.
- A site specific risk characterisation and assessment to identify e.g. risks of fractures and existing faults.
- A baseline report of environmental media (e.g. water and air quality, and seismicity), as a reference in case of any incident.
- Notification to the public of the composition of hydraulic fracturing fluids on a well-by-well basis and of wastewater composition.
- Requirements to properly insulate wells to avoid groundwater problems.
- Requirements to avoid venting of gases except in exceptional circumstances and minimise flaring.
- Requirements for companies to conduct adequate public consultation and employ 'Best Available Techniques' in their operations.
- Financial guarantees for liabilities and damage.

The Recommendation asks Member States to give effect to the principles within 6 months. It is significant that this proposed to be a non-binding Recommendation. The European Parliament had suggested a full harmonised framework across the EU including mandatory financial guarantees for liability. A number of States (including Poland and the UK) had objected to this. However, the Commission will review the application of the Recommendation after 18 months and will consider legislating if necessary. The non-binding nature of these rules will be controversial to environmental groups while initial reaction from the industry has been positive.

[4] Communication on the exploration and production of hydrocarbons (such as shale gas) using high volume hydraulic fracturing in the EU
[5] Commission Recommendation on minimum principles for the exploration and production of hydrocarbons (such as shale gas) using high volume hydraulic fracturing
[6] 'High volume' would mean 1000 cubic metres or more of water per fracking stage or 10,000 cubic metres or more over the whole process.

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