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WRITTEN EVIDENCE OCTOBER 2015

HOUSE OF LORDS EUROPEAN UNION COMMITTEE INQUIRY ON EU ENERGY GOVERNANCE

RESPONSE FROM E3G

Introduction

1. The House of Lords EU Energy and Environment Subcommittee is addressing the topic of EU energy governance at an opportune moment. At European level, the agreement of new energy and climate targets for 2030 and the development of the EU Energy Union agenda provide an important opportunity for improving the robustness and resilience of energy governance. The shape of the future energy governance system is under active discussion, with proposals expected to be tabled by late 2016.
2. In this context, there are two important priorities for reform of EU energy and climate governance in the near term:
 - Increase consistency and policy coherence, between member states, between energy sectors (including heat and transport as well electricity and gas), between policy areas, and between levels of governance (including local and regional as well as member state and EU).
 - Ensuring an 'orderly transition' as Europe decarbonizes its energy system: avoiding stranded assets; providing predictability for investors; increasing reliability of outcomes and maximizing the value delivered from consumer or taxpayer spending.
3. The remarks below should be considered with these priorities in mind.

Case Study One (national energy security): Capacity Mechanisms

Capacity mechanisms are being introduced by some Member States in order to assure national security of supply.

1. *How might the development of some form of governance system mitigate any impact of separate national capacity mechanisms on the EU's energy policy?*
2. *How far can co-ordination of such mechanisms go before it becomes politically unacceptable?*
3. *How has this tension between EU and national objectives been handled thus far?*



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4. As EU energy markets continue to integrate, they are becoming increasingly interdependent. This is the result of clear and consistent political decisions from member states to pursue an integrated internal energy market, and should not be seen as an external imposition. This integration offers significant and well-documented benefits, including potential EU-wide cost savings of €40-70 billion per year by 2030¹. It also means, however, that it becomes increasingly important for any market interventions to be done in a coordinated and predictable fashion, or they will be liable to deliver perverse results.
 5. National capacity mechanisms that are introduced without coordination with neighbouring states are problematic in an integrated system, for at least three reasons:
 - First, capacity adequacy calculated nationally rather than at regional level will systematically overestimate the resources required for safe operation of the system, as it discounts available capacity in neighbouring countries.² This leads to wasteful and uneconomic over-procurement of resources.
 - Second, in an interconnected system, it does not make sense to try to maintain a higher security standard in one jurisdiction than in its neighbours. This produces perverse signals for the location of new generation, and effectively means that consumers in countries with capacity mechanisms are effectively cross-subsidising the energy security of consumers in countries without such mechanisms.
 - Third, uncoordinated or poorly-designed capacity mechanisms are market distorting and risk undermining the business case for demand-side resources and for interconnection. This, in turn, risks pushing up the overall costs of decarbonisation across the EU.
 6. The issue of political acceptability cannot be disconnected from this picture of policy incoherence. It should be politically unacceptable for consumers to be liable for the costs of redundant resources and market distortions as a result of the unwillingness or inability of national governments to cooperate on security of supply.
 7. The European Commission has previously sought to address this problem through producing non-binding guidance by DG ENER, developing state aid guidelines on capacity mechanisms, and carrying out a sector inquiry into capacity mechanisms in 11 European countries. The European Commission is also currently consulting on a Market Design Initiative with a view to introduce appropriate legislation in late 2016.

¹ Booz & Co. Benefits of an integrated European Energy Market.

https://ec.europa.eu/energy/sites/ener/files/documents/20130902_energy_integration_benefits.pdf

² The Pentilateral Forum (Austria, Belgium, France, Germany, Luxembourg, the Netherlands, Switzerland) has developed a methodology for regional capacity adequacy assessment. To date, however, the UK has not been included.

<http://www.tennet.eu/nl/nl/nieuws/article/first-regional-generation-adequacy-assessment-report-published.html>.



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8. The Market Design Initiative is an important opportunity to address the current incoherence between national capacity market regimes and the broader internal energy market. It should:
- As a minimum, require a common methodology for calculating capacity adequacy
 - Preferably, conduct capacity adequacy assessments on a regional basis (e.g. via ENTSO-E), and require that the regional assessment forms the basis for any national capacity mechanism
 - Prioritise development of demand side and interconnection resources above new or existing thermal power plant
 - Explicitly rule out support for coal generation, as the continued presence of ageing and often amortised coal generation on the system is a key blocker to effective decarbonisation and a major barrier to attracting new investment into new lower carbon alternatives.

Case Study Two (national energy mix): Renewable energy targets

The October 2014 European Council agreed that the EU should cut its greenhouse gas emissions by at least 40% by 2030 compared to 1990 and that this should be delivered through a range of measures including renewable energy: “An EU target of at least 27% is set for the share of renewable energy consumed in the EU in 2030. This target will be binding at EU level.” This contrasts to the 20% renewable target by 2020 which has binding national targets for each Member State.

1. *How could a governance mechanism assist the EU to deliver its stated policy, including not only the 27% renewables target but the overarching 40% emissions reduction target which relies in part on the renewables target?*
 2. *How robust could a governance mechanism be without compromising Member State responsibility for their national energy mix?*
9. EU governments have agreed RES targets for both 2020 and 2030. These increase the credibility and confidence that Europe will meet its climate change goals, by providing a signal for technology developers on the scale of future market opportunities, increasing predictability for investors and providing a basis for investment in enabling infrastructure (e.g. grids and interconnections).
10. Such targets are only effective if there is a credible expectation that they will be delivered. The EU has an unfortunate track record of setting targets that go unmet because delivery mechanisms have not been specified - most recently with the Europe 2020 Lisbon Agenda³.
11. The 2020 renewables target has a clear delivery mechanism: it is legally binding on member states, and countries risk fines if they do not deliver against the target. After pressure from the UK and other member states, the October 2014 European Council

³ EPSC (2015) Europe 2020: From Indicators and Targets to Performance and Delivery.
http://ec.europa.eu/epsc/publications/notes/sn6_en.htm



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agreed that the 2030 EU renewables target should be 'EU-binding' rather than nationally-binding – a hitherto unknown concept.

12. The UK will need to deploy considerable volumes of renewable energy if it is to meet its own domestic obligations under the Climate Change Act – particularly as nuclear power and CCS have proven slower to deploy than previously assumed. It is unlikely that the UK's proportion of a 27% EU-wide RES target would be more than it would need to implement domestically in any case. The UK national interest has little to gain by stripping the 'EU-binding' renewables target of all content: instead the UK should focus on how to use the target and associated governance arrangements to support the UK's own decarbonisation goals, and to create a level playing field in Europe.
13. To be credible and effective, the governance arrangements on the 2030 EU-binding renewables target should have at least two components.
 - First, they should be used to guide EU decision-making across energy and climate policy. The 2030 RES, energy efficiency, greenhouse gas and interconnection targets should be built in to grid infrastructure planning scenarios and evaluation of Projects of Common Interest.⁴ The targets should be used to prioritise innovation funding (e.g. in Horizon 2020). They should also be incorporated into state aid guidelines to avoid undue constraints on renewables deployment. In some cases, it may be appropriate to introduce conditionalities on EU energy funding (including the Connecting Europe Facility, structural funds, the NER400 and the modernization fund) to avoid support for fossil infrastructure if renewables and energy efficiency deployment is not on track.
 - Secondly, arrangements must be developed for meeting the EU binding target if there is a shortfall from the national energy plans. There are two options for this:
 - Indicative national shares could be identified, with a commitment to increase national deployment where there is an EU shortfall in meeting the 2030 target.
 - An EU-level renewables support mechanism could be established to bring forward major innovative or cross-border renewables projects (e.g. offshore wind and marine connected to a meshed offshore grid; large-scale CSP or PV; advanced biogas, etc) where there is a shortfall in achieving 27% renewables at EU level.

⁴ This is not currently the case, particularly in the gas sector where ENTSO-G projections for future gas demand are not in line with EU RES, EE or GHG targets. See E3G (2014) Energy Security and the Connecting Europe Facility <http://www.e3g.org/news/media-room/energy-security-and-the-connecting-europe-facility01>



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It is important for the sake of predictability and good governance for the approach to be specified in advance and established in a revised RES directive, rather than waiting for a shortfall to occur.

Drawing the case studies together: Looking forward

- *What are the implications of a strengthened EU approach to energy governance? What are the implications of not making swift progress towards a new – and clear – governance system?*
- *If National Energy and Climate Plans were to be the basis for a strengthened governance, who should be responsible for assessment, review and enforcement? How can transparency of that process be assured?*
- *What role should regional co-operation play in any new governance system?*
- *How can regional co-operation help to overcome the potential tensions between national and EU policy objectives?*
- *Should a new governance framework be enshrined in legislation?*

Overview

14. Delivering the significant sums of investment needed to renew Europe's energy system will require transparent, stable and predictable regulatory regimes, including clarity on how EU-level targets will be met. Erratic regulatory regimes and weak governance raise the risk profile for investments and as a result push up financing costs and energy costs for consumers. This is not a problem that can be resolved within national boundaries alone: the interconnected nature of the European energy system means that states are affected by the decisions of its neighbours. In this context, it is in the interest of all member states have a stable and workable governance regime in place that enables predictability of outcomes. This requires a governance system underpinned by a firm legal basis.

National Energy and Climate Plans

15. A strengthened EU approach to energy governance needs to be focused on collectively addressing and responding to the risks that Europe's energy systems face. EU-level energy security assessments are undertaken for a limited range of potential shocks (e.g. stress-tests for adequacy of gas storage). However no one is currently in charge of monitoring systemic risks. This has worrying parallels to economic crisis, where individually-rational decisions by different actors made the system as a whole collectively vulnerable. The new governance system needs to be able to ensure EU energy and climate objectives are met even in the face of unexpected shocks. As a result we need a system for stress-testing national and European energy plans, as well as a clear view on both the rights and responsibilities required from participants in Europe's Energy Union.
16. In this context, the proposed National Energy and Climate Plans offer the potential to improve the consistency of energy policy across borders and to improve the Europe's capacity to identify and respond to energy system risks. The utility of the National Plans, however,



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depends on how they are developed and used. A collection of 28 national plans developed in isolation and with no feedback loops would make little difference. Instead, it is important that collective assessment is made of the national plans, and the outcomes of this assessment are used to ensure more robust decision-making at both national and European level.

17. This function could most usefully be fulfilled by the creation of an independent Climate and Energy Observatory tasked with supporting member state climate and energy policy development rather than transferring further powers to the European Commission. A Climate and Energy Observatory has the potential to possess the capability to understand how market and regulatory risk management processes can work effectively together to ensure future policy delivery in addition to understanding the underlying systemic risk landscape.
18. The Observatory would, therefore, be able to work with Member State governments to help ensure that policy objectives are being delivered effectively and not exposed to poorly managed risks. It would be tasked with analyzing the National Energy and Climate Plans and proposing how policy could be delivered more cost-effectively. Unless policy actions are actually harming other Member States, the final decision on policy will remain with Member State governments. However, the Observatory process will ensure a transparent public debate over decisions to intervene in the market and how the costs of interventions might be minimised.
19. Key functions of the Observatory would be to:
 - Identify the impact on future policy delivery of Member State decisions on energy mix including where the actions in one Member State has material implications for the risk profile of its neighbours,
 - Explore how future policy outcomes might be delivered more cost-effectively, for example, through resource sharing between Member States,
 - Consider where infrastructure investments (including both network and efficiency investments) might be effective in improving policy delivery,
 - Provide advice on research and development to fill key technology gaps.
20. This technical and policy analysis would not necessarily require new and separately funded resources. It could either operate as a 'virtual' body using expert resources and analysis provided by Member States and the Commission or it could 'piggy-back' an existing independent organisation such as the European Environment Agency. However, the independent nature of this body would be critical since this is necessary to build broad consensus, both within the policy-making community and amongst stakeholders, on the nature of the energy landscape through objective and evidence-based analysis. If successful, it has the potential to dramatically reduce the chilling effect on investment caused by uncertainty about the future which threatens the ability to respond to security concerns and challenges Europe's growth prospects.

Regional cooperation

21. Regional cooperation provides the opportunity to access many of the gains of an integrated energy market while continuing to be able to adapt to national specificities. Agreement between a smaller number of member states may also be easier to achieve than at the level of the EU-28.



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22. In some cases, such approaches may sidestep subsidiarity concerns. However they will never avoid such questions entirely, particularly if regional level initiatives are endowed with powers previously exercised by member states individually.
 23. There are currently a large number of regional initiatives active in the EU, ranging from longstanding regional market integration platforms such as Nordel and Mibel to more ad-hoc initiatives such as the North Seas Countries Offshore Grid Initiative, the Baltic Energy Market Integration Plan, and market coupling groups such as the Pentalateral Forum and the 5 Market Coupling initiative. The myriad regional cooperation initiatives in the EU have different objectives, overlapping geographies and a decidedly mixed track record of success.⁵
 24. Many regional cooperation initiatives start with ambitious political objectives, but lack credible means for delivery on their initial ambitions. They often suffer from a lack of capacity and resources, an uncertain institutional basis and an inability to translate their conclusions back into national policies. This limits their effectiveness.
 25. To fully capitalise on the potential offered by regional cooperation, a different approach is needed. Institutional structures for Energy Union governance should be established on the presumption that Member States wish to share resources. It is important, however, that this structure still allows Member States the freedom to deliver solutions on a purely national basis if desired. The structure should also avoid those aspects of policy delivery that have little to gain through pan-EU co-ordination and these can be left to Member States to design as appropriate.
 26. Those aspects of the wholesale electricity market that have the potential to deliver particular cost savings include renewable generation procurement (e.g. FIT/premium allocation), capacity and other system services procurement to deliver resource adequacy and system balancing, network planning/system architect, market operation and market surveillance. These functions align closely with those undertaken by regional independent system operators (ISOs) which are common in other international power markets. Establishing such regional delivery bodies within the IEM as part of Energy Union governance would have significant advantages, and this should be investigated as a matter of urgency.
 27. As a final comment for the Committee to consider, it is important recognise that governance is not a zero-sum game between member states and the Commission. There are many more players with a direct stake in the Energy Union, from individual citizens to national parliaments. In particular, cities and regions will be critical to ensuring the Energy Union actually works in practice. They are active actors in the low carbon transition, with many cities being even more ambitious than their national governments. However, they face a number of

⁵ See Ecologic (2015) Regional cooperation in the context of the new 2030 energy governance <http://www.ecologic.eu/sites/files/publication/2015/regional-cooperation-energy-2030.pdf>; and ECF et al (2013) From Roadmaps to Reality [http://www.roadmap2050.eu/attachments/files/Fromroadmapstoreality\(web\).pdf](http://www.roadmap2050.eu/attachments/files/Fromroadmapstoreality(web).pdf)



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structural barriers that need to be addressed: access to finance, lack of capacity or an unclear legal basis to undertake the necessary changes. The governance debate should open the space to rethink the role of local actors within the low-carbon transition and give them the means matching their ambitions. The Energy Union governance proposals must be clear about what cities and regions are being asked to do, and what cities and their citizens can expect from both member states and European institutions.

About E3G

E3G is an independent, non-profit European organisation operating in the public interest to accelerate the global transition to sustainable development. E3G builds cross-sectoral coalitions to achieve carefully defined outcomes, chosen for their capacity to leverage change. E3G works closely with like-minded partners in government, politics, business, civil society, science, the media, public interest foundations and elsewhere.

More information is available at www.e3g.org

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