

# GOVERNING THE ENERGY UNION

## THE ARCHITECTURE OF THE ENERGY TRANSITION

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As part of the Clean Energy for All Europeans package, the European Commission has proposed a regulation that would streamline existing planning, reporting and monitoring requirements of energy and climate policies. This is the first attempt by the European Commission to take a comprehensive and integrated approach to the energy transition at such scale. The approach has the ability to facilitate investments, act as a switchboard between levels of governance and enable an orderly transition. As such, it can ease the delivery of the energy transition, particularly the 2030 targets for renewable energy, energy efficiency and climate policies.

### Facilitating investments

**Investment levels are still too low in Europe to deliver the energy transition but a transparent and credible governance framework will contribute to making Europe's energy and climate projects more attractive.** Public and private investors are resuming investing in Europe, but levels of investments are still lower than pre-financial crisis levels. There is an annual investment gap of EUR177bn to meet the EU's 2030 climate and energy targets.<sup>1,2</sup> There is however no shortage of capital to invest in energy and climate projects. The capital needed to deliver the Energy Union in line with 2030 targets and to replace Europe's ageing energy infrastructure is significant.<sup>3</sup> On the other hand investors are ready to provide the capital needed to close the financing gap<sup>4</sup>. Ongoing reflections on the role of finance in Europe and the revision of the

<sup>1</sup> European Parliament Research Service (2017) **Economic and budgetary outlook for the European Union**

<sup>2</sup> European Commission (2017) **Assessing the European clean energy finance landscape, with implications for improved macro-energy modelling**

<sup>3</sup> The European Commission estimates that €379 billion needs to be invested annually between 2020-2030 (excluding transport) to reach the EU's 2030 climate and energy targets (European Commission (2016) **Impact Assessment accompanying the revision of the Energy Efficiency Directive**). The European Investment Bank estimates the average annual investment at €130 billion over the period 2001 to 2015 (EIB (2016) **Restoring EU competitiveness**).

<sup>4</sup> Analysis shows that global institutional investors have funds of \$1trillion at their disposal for potential investments in European infrastructure assets over the next 10 years (Linklaters (2014) **Set to revive: Investing in Europe's infrastructure**).

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Capital Markets Union will help close this gap<sup>5</sup>, but more is required to address the specificities of energy and climate projects.

**Political risks and poor choices have shaken the confidence investors have put in Europe's commitment to deliver a low carbon economy.** Over the past few years abrupt regulatory changes, the role back of public financing schemes and adoption of low targets have damaged the credibility of member states' commitment to delivering long term climate and energy targets.<sup>6</sup> Public and private investors are calling for ambitious policies and a framework that provides transparency and certainty about the direction and the pace of travel.<sup>7</sup> **The Energy Union Governance plan can help provide clarity on the direction and pace of travel, the commitment by member states to reaching the 2030 and 2050 targets and public resources available.**

#### **Compatibility with a low-carbon world**

**European climate and energy policies need to be geared towards delivering end-goals compatible with the Paris Agreement on climate change.** Currently the legislative framework includes no formal, binding long-term targets. This is a significant missing part of the architecture as binding long-term targets provide clarity on the pace and the direction of travel.<sup>8</sup> They help define infrastructure needs and allow assessments of whether short term objectives are appropriate. Targets also send clear signals to businesses, stakeholders, cities and regions about what is expected from them and help them understand their role in the future.<sup>9</sup>

**The requirement to develop a long term low emission strategy is an opportunity to send a strong signal to stakeholders. These strategies however, must become the spine of energy and climate planning and their long-term goals should be their final aim.**<sup>10</sup> This can be done by adopting a target of net zero emissions well before 2050<sup>11</sup> in line with the Paris Agreement supported by 2050 energy targets for renewable energy, energy efficiency and interconnections<sup>12</sup>. The strategy to deliver these targets needs to be developed before or alongside the national energy and climate plan as the latter should be a product of the former.<sup>13</sup>

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<sup>5</sup> The Commission set up a High-Level Expert Group on Sustainable Finance in December 2016 (European Commission (2016) **Commission appoints members of the High-Level Expert Group on Sustainable Finance**). The Commission has also conducted a mid-term review of the capital markets union action plan in June 2017 (European Commission (2017) **Communication on the Mid-Term Review of the Capital Markets Union Action Plan**).

<sup>6</sup> See for instance Spain (Financial Times (2011) **Investors make waves in climate policies**) or the UK (The Guardian (2017) **Renewables investment in UK will fall 95% over next three years**).

<sup>7</sup> Institutional Investors Group on Climate Change (2017) **Public letter: EU Institutional investors view on Energy Efficiency negotiations**

<sup>8</sup> The current framework does not include any targets for energy efficiency and renewable energy beyond 2030. The EU framework includes an emissions reduction goal of 80 to 95% goal by 2050 compared to 1990 level. This goal is however only 'supported' and is not enshrined in legislation (European Council (2009), **Presidency Conclusions**).

<sup>9</sup> The Paris Agreement also requires parties to "strive to formulate and communicate long-term low greenhouse gas emission development strategies" (UNFCCC (2015) **Paris Agreement**).

<sup>10</sup> The proposal includes a requirement to develop long-term low emission strategies by 1 January 2020 (**Proposal on Energy Union Governance** Chapter 3 – Article 14).

<sup>11</sup> As the text requires member states to develop long-term strategies, it should also include the long-term targets that represent the end-goal of the transition. This target should be enshrined in articles 1 paragraph 1 and 14 paragraph 1 of the regulation.

<sup>12</sup> These targets should be enshrined in articles 1 paragraph 1 and 14 paragraph 1 of the regulation.

<sup>13</sup> The process for developing these strategies should be aligned. Therefore article 14 paragraph 1 needs to be changed accordingly. Article 14 paragraph 3 needs to be reinforced to make consistency mandatory and clarify the link between long-term strategies and short-term plans.



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Finally the quality of the strategies will depend on the procedural requirements included in the regulation.<sup>14</sup>

### **Unequivocal commitment to delivery of targets**

**Climate and energy targets need to be supported by robust governance to be more than words.** Climate and energy targets signal to businesses and relevant stakeholders the actions they should be taking as well as the potential market for their technology solution. Ambitious targets deliver more benefits to society as a whole<sup>15</sup>, but are also useful to drive technology development and reduce their costs<sup>16</sup>. Targets are useful only if supported by mechanisms to compensate or avert under-delivery. **Indeed, flexibility has a cost as the design of the enforceability mechanism matters as much as the level of the target.** A high target supported by weak provisions will send the signal that the target does not mean much.

**Targets should be looked at for their level as well as clarity of their enforceability.** In this regard, national binding targets are optimal. National targets based on effort sharing are the most straightforward way to ensure a member state is doing its *fair share*.<sup>17</sup> Pledge-and-review systems are sub-optimal as it leaves latitude to member states to define 'fair', making the outcome of the process unpredictable and often difficult to read. **In any case, every credible target architecture should include transparent benchmarks and robust course-correction mechanisms.** National benchmarks set out a country's fair share based on objective and common criteria.<sup>18</sup> They bring objectivity to member states looking to make low pledges. They are an absolute necessity to be able to reach EU-wide targets<sup>19</sup>. The EU energy and climate governance regime should include course-correction mechanisms that would be automatically triggered if a member state drifts away from the required trajectory.<sup>20</sup>

### **Investment friendly framework**

**Climate and energy policies can be better designed to attract private investments by identifying private investment opportunities and targeting public money more effectively.** As rightly identified by the Commission, attracting private investments through specific instruments and designing a policy framework apt at attracting private investments should go hand in hand.<sup>21</sup> The same approach should apply to climate and energy policies.

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<sup>14</sup> Article 14 should include a requirement for the articles 8, 9, 10, 11, 12, 13 and 28 to apply. A binding template should also be foreseen to allow for comparability. For more, see IDDRI and Ecologic (2017) **Developing 2050 decarbonisation strategies in the EU: Insights on good practice from national experiences**.

<sup>15</sup> Adopting a 40% energy efficiency targets instead of the proposed 30% represents a difference of employment of 4.4 million, losing investments of 59 billion per year and polluting 360 million tones more of greenhouse gas. European Commission (2016) **Impact Assessment accompanying the revision of the Energy Efficiency Directive**

<sup>16</sup> International Energy Agency (2015) **Renewable Energy: Medium-Term Market Report**

<sup>17</sup> Adopting national targets allows for the removal of articles 5, 6 and 27 paragraph 1 of the regulation.

<sup>18</sup> See for instance the draft report by José Blanco López MEP on the revision of the renewable energy directive (European Parliament (2017) **Draft report on the proposal for a directive on the promotion of the use of energy from renewable sources**).

<sup>19</sup> In the absence of benchmarks, there is no guide to assess whether a national pledge is ambitious or not. It is therefore more difficult to evaluate which country should increase its contribution to reach the same level of ambition as the others. Member states should be incentivized to pledge high, possibility through a financial intervention. See ClientEarth (2017) **How to make Member States set ambitious national contributions to EU targets on energy efficiency and renewable sources of energy**

<sup>20</sup> For more, see Ecologic (2016) **Compliance with EU 2030 Renewable Energy Target: how to fill a gap**

<sup>21</sup> European Commission (2014) **Communication on An Investment Plan for Europe**



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National governments will identify the public and private finance required to deliver their targets in their national plan.<sup>22</sup> **Investors should be involved in the drafting of the plan so the credibility of the assumptions is not questioned and they benefit from their support from the start. Public finance should support attracting more private investments in Europe.** As the first draft of the national plan will be submitted amid negotiations on the EU's budget post-2020, the multiannual financial framework<sup>23</sup>, there is an opportunity to link the two processes and adopt a more integrated approach. The EU budget could, for instance, include de-risking instruments in order to attract investments in projects or regions deemed too risky by investors.<sup>24</sup>

## Accompanying a multidimensional transition

**The national perspective on its own is often insufficient to properly grasp the transformation energy systems and societies are going through.** Policies and measures are not taking place in a vacuum but in a multilayered governance framework that includes the policies and structures adopted at the international level as well as targets and policies adopted by local authorities.<sup>25</sup> There should be a better interface between these levels of governance to allow for an exhaustive yet streamlined understanding of the transition.

### Bringing Paris home

**The structures and mechanisms agreed internationally should be brought home to prevent duplication and inefficiencies.** Signatories of the Paris Agreement on climate change committed to keep the increase in global average temperature well below 2°C.<sup>26</sup> The final text includes a pledge-and-review mechanism which was a necessary compromise in order to reach a deal. Indeed, current pledges are not ambitious enough to limit greenhouse gas emissions<sup>27</sup> and should thus be revised every five years to increase ambition.

**The architecture set up should therefore allow for more ambition over time while better reflecting the instruments set up in the Paris Agreement.** If the EU is making this step, there is a risk that national plans and targets will not be ambitious enough, or revised swiftly enough, to deliver the level of ambition required and thus threaten the block's credibility. The first step should be to adopt the temperature goal, supported by a carbon budget, as the EU's long-term goal to better inform the ambition required in climate and energy targets and policies.<sup>28</sup> If these targets and policies are not in line with long-term targets, they should be automatically updated at trigger points.<sup>29</sup> Similarly, the revision of the national plan every five years should strictly include only more ambitious targets and policies.<sup>30</sup>

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<sup>22</sup> This is a transversal issue in Annex I of the regulation.

<sup>23</sup> CAN-E (2017) **Position on EU budget post-2020**

<sup>24</sup> DiaCore (2016) **The impact of risks in renewable energy investments and the role of smart policies**

<sup>25</sup> Cities and regions signatories of the Covenant of Mayors will deliver in average 28% greenhouse gas cuts by 2020 (baseline: 1990) while the burden sharing among member states is based on a 20% target.

<sup>26</sup> UNFCCC (2015) **Paris Agreement** - Article 2.

<sup>27</sup> United Nations Environment Program (2016) **The Emissions Gap Report**

<sup>28</sup> This could be included in Article 14 on the long-term low emissions strategies.

<sup>29</sup> Following a global stocktake, an IPCC report or in case of over-achievement of targets both at national or European level.

<sup>30</sup> Article 13 paragraph 3 includes a provision similar to this requirement.



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### From planning to delivering

**Facilitating and building upon the actions already carried out in cities will reduce the cost of the transition while speeding up its delivery.** Setting targets is different from delivering them. Targets are often set at European and national level while the delivery of policies often rely on local actors' shoulders. The energy transition is not a theoretical concept but a vision that requires deploying infrastructure. There should be no gap in the policy cycle between vision setting and delivering to allow for a seamless transition.

**However there is still a disconnection between European, national and local policy-makers.** Cities and regions sometimes face unexpected or perverse consequences of European and national policies that hinder their capacity to deliver the energy transition at the scale or the pace needed. The case of the accounting treatment of energy performance contracting is one example.<sup>31</sup> Local and regional actors should have the opportunity to flag these hurdles to the relevant authorities that will be able to judge whether they represent a proportionate burden and are still necessary to deliver their primary aim. This should allow for a quicker and more effective implementation of policies and measures. Local actors are also adopting their own local targets and plans whose contribution should be valued in the national plan.<sup>32</sup>

**Engaging citizens early on is also critical.** Experience shows member states that consult broadly and adopt a long-term perspective are more likely to implement better policies.<sup>33</sup>

### Enabling an orderly transition

**Moving to a low-carbon society will impact the bloc's economic structure and requires more proactive policies to mitigate negative social consequences.** The rise of a decentralised and clean energy system will impact employment structure by creating new opportunities while moving away from others. This dimension should be an integral part of the Energy Union.

In some regions, for example, the presence of a coal mine shapes the entire economic structure of the region. Transitioning away from coal, whether on market or climate grounds, will have an impact on poorly diversified economies, and workers risk paying a high price. Coal phase-out is not the only driver for change. **Policy makers need to have a better understanding of the impacts of the energy transition (both in terms of opportunity and challenges) on European society to be able to pro-actively address them.**<sup>34</sup> If well-managed, the low-carbon transition will not only contribute to the fight against climate change, but also to create considerable new economic opportunities.

**The Commission and national governments should monitor regional energy transitions closely and propose adequate and tailored remedies to social challenges, as it is clear that not all regions will face the same challenges or will move at the same speed.** It is important regional specificities are considered. Regional development strategies should be linked to the national

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<sup>31</sup> Stakeholders letter (2016) [Reviewing accounting rules and/or debt treatment for energy efficiency investments will help close the energy efficiency financing gap in Europe](#)

<sup>32</sup> European leading local and regional networks (2016) [Energy Union Governance: The 3 musts for a new collaborate planning regime](#)

<sup>33</sup> IDDRI and Ecologic (2017) [Developing 2050 decarbonization strategies in the EU: Insights on good practice from national experiences](#)

<sup>34</sup> E3G (2016) [Instruments for a managed coal phase-out](#)

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plan to identify potential changes in the economic structure early on. Simultaneously, the State of the Energy Union should track the delivery of the energy transition at the local level to provide a more accurate picture of the transition and to help identifying potential interventions<sup>35</sup>. Leading regions in reaching low-carbon targets should be able to share experience with others in Europe. Finally, the Just Transition Fund under the EU Emissions Trading Scheme must be strengthened through the involvement of the European budget to support coordination activities between national and regional level.

### About E3G

E3G is an independent, non-profit European organisation operating 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.

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<sup>35</sup> Article 29 of the regulation.

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