CAN
CLIMATE ACTION NETWORK
Europe

Connecting the dots:

The EU's funding for fossil fuels

Brussels, September 2016

Contents

CAN Europe gratefully acknowledges support from the European Commission. The contents of this publication are the sole responsibility of CAN Europe and can in no way be taken to reflect the views of the European Union.

CAN Europe also gratefully acknowledges support from the OAK foundation and the KR foundation.

Published in September 2016 by Climate Action Network Europe, Brussels, Belgium.

Graphic design: Puistola Graphics

Introduction

"Changing existing patterns of high-carbon infrastructure investment is a major challenge and the later it is left the more difficult it becomes. We must focus attention on the scale, quality and urgency of investments required to accelerate the low-carbon transition."

Professor Lord Nicholas Stern, 7 October 2015, Lima, Peru

In recent years, governments all over the world have emphasised the crucial role that finance plays in tackling climate crisis. Finance and financial policies are essential to catalyse the global energy transition to 100% renewable energy and zero carbon societies, and to enhance our resilience against impacts of climate change. However, finance, coupled with weak policies and regulation, can also act as a barrier to enhanced climate action. Both current and future investment plans can lock our economies into high-carbon infrastructure, while prolonging the lifeline of polluting fossil fuels and preventing the realisation of plans for renewable energy and energy savings. Public financial support for fossil fuels, or fossil fuel subsidies, represents one of the main barriers to higher climate ambition. Such finance is provided through numerous mechanisms and various institutions, and it comes in many forms – from investments to tax breaks for fossil fuels.

Paris means no more funding for fossil fuels

In 2015, the EU and its Member States adopted the Paris Agreement, demonstrating their ambition to limit global temperature rise to 1.5°C. The Paris Agreement stipulates that financial flows need to be made "*consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.*"[1]

The Paris Agreement requires major overhaul of not just climate and energy policies in the EU, but also financial policies and investments to ensure a shift in support away from fossil fuels and instead towards a renewable energy, energy efficiency and climate resilience.

CAN Europe asserts that this objective means ending all financial support for fossil fuels and urges the EU and its Member States to address the existing misalignment between the relevant mechanisms and policies which support fossil fuels.

The EU needs to lead the way in ending fossil fuel finance

Despite the rhetoric that the EU is the most ambitious actor in the fight against climate change, this briefing points to a number of cases that illustrate how it continues to fund fossil fuels with billions of taxpayers' money. Public finance needs to stop going to fossil fuels; funding fossils is not in the interests of EU citizens or countries – it works against our health, natural environment, a stable climate and long-term economic security.

As a strong actor in the G20 and internationally, the EU should lead the way in ending financial support for fossil fuels. Through its pledge to end environmentally harmful subsidies, the EU has committed to phase out subsidies for fossil fuels by 2020. This commitment now needs to be translated into real action and operationalised by all countries, including the EU, and across all of its relevant policy areas. The EU needs to address fossil fuel subsidies in a clear and coherent way. Identifying that subsidies exist across numerous policy areas is an essential first step.

Financial institutions and funding mechanisms must be required to develop clear roadmaps for how to end all forms of support for fossil fuels as soon as possible. The commitment also indicates that there should be no future funding for fossil fuel production.

In this briefing, we lay out a number of specific recommendations for those areas where it is clear that more structured oversight and governance is needed if the EU and its Member States are to successfully end public finance for fossil fuels.

1 http://unfccc.int/files/essential_background/convention/application/pdf/english_paris_agreement.pdf

Outline of this briefing

This briefing brings together different EU instruments and policies that contribute to the on-going support for fossil fuels across EU Member States. These elements and actors are fragmented; they fall into different policy areas and under various competencies in EU decision-making – from finance to energy, and from taxes to climate policy. As a result of this fragmented nature, it has been hard to capture the level and extent to which these various policies and financial actors impact broader EU climate and energy ambition. But as this briefing will clearly show, they all still support fossil fuels in one form or another.

The briefing focuses on a number of EU funds, institutions and policies that either directly or indirectly support fossil fuel production and use. The aim is to give a snapshot of how all these various institutions and processes continue to finance fossil fuel production and consumption and connect the dots: unless bold reforms are taken, funding for fossil fuels will continue to stand in the way for speeding up Europe's energy transition.[2]

Listed below are the elements of EU funding covered by this briefing. They were chosen because they are some of the most prominent actors, policies and funds that exist in the EU. The funds and financial institutions play a crucial role in supporting national development plans and energy infrastructure; many EU Member States depend on the financial backing of EU funds and development banks to follow through on their development projects. They also have great potential to help speed up Europe's energy transition.

The policies and tools were selected as they are equally important for facilitation of public support for energy production. EU policies should be fully coherent with its climate and energy targets and should contribute to realising those targets. However, there is a misalignment between the relevant mechanisms and policies which end up supporting fossil fuels.

1. **Funding mechanisms**
   - Connecting Europe Facility
   - European Regional Development and Cohesion Funds

2. **Financial Institutions**
   - The European Investment Bank (EIB)
   - The European Bank for Reconstruction & Development (EBRD)

3. **Policies & Tools**
   - The EU Emissions Trading Scheme
   - State aid control
   - Capacity remuneration mechanisms including their State aid aspects

Summary of key findings

The EU's development banks continue to channel funds into various aspects of fossil fuel production across Europe, while two of the EU's main funds are giving preferential support to fossil fuels over alternative energy sources.[3] EU policies have further facilitated fossil fuel support through mechanisms such as State aid, including capacity mechanisms (explained in more detail later in the briefing).

Specifically:

- Two of the EU's most influential funds have allocated over €1.6 billion in funding for gas infrastructure and pipelines for 2014 to 2020, while supporting consumption of fossil fuels indirectly through intensive transport infrastructure and co-firing of biomass and coal;
- The EIB provided up to €7 billion in funding for fossil fuel projects from 2013 to 2015;
- The EBRD made investments of up to €5 billion in fossil fuel exploration from 2013 to 2015;
- EU Member States have used loopholes in the EU Emissions Trading Scheme to help prolong the life of toxic coal plants through stipulations in the current ETS framework; specifically, 90% of investments through Article 10c have been coal and lignite based;
- A specific case study on capacity markets in the United Kingdom shows that over €800 million is set to be channelled to coal and diesel investments from 2014 to 2018.

2 The briefing focuses on *direct* support for fossil fuels production and consumption: namely extraction of resources and construction of energy infrastructure (transmission, distribution and power generation). However, *indirect* support for fossil fuels, such as funding for construction of roads, is also mentioned as something to keep an eye on and something which also needs to be phased out in the long run. We also note the important role that private finance plays in the global energy transition, but the focus of this briefing is on public finance due to its nature in driving crucial change in financial policies and investments.

3 Due to limitations in accessing data and information on some institutions, this figure does not capture the full extent of support going to fossil fuels and should therefore be considered as minimal and indicative of the level of funding for the fossil fuel sector.

Recommendations to the EU and its Member States

The **1.5°C target set out in the Paris Agreement should serve as guidance** for all current and future investments in the European energy sector, including projected energy needs and demands under a 1.5°C scenario.

The EU must develop and agree on a roadmap to phase out all forms of direct fossil fuel subsidies by 2020. Such a roadmap should include strict timelines for the phase-out of fossil fuel subsidies with country-specific and measurable outcomes. European countries outside the EU must do the same.

The goals and targets set out in **Agenda 2030 should provide additional guidance for financial investments** and support based on the principle of universal and integrated action, that incorporates sustainability and climate resilience.

The EU's financing facilities, policy tools and development banks should undergo **ambitious reforms** that lead the way in the transition of the EU economy away from fossil fuels and towards renewable energy and energy savings.

There must be **better evaluation and transparency** of the EU's funds and funding mechanisms involved in more integrating our energy systems, including evidence that the projects funded are indeed enhancing the EU's broader objectives, particularly its climate and energy objectives. Transparency measure should be part of an international initiative to advance publicly disclosed and consistent reporting for all subsidies to fossil fuels.

Phasing out fossil fuels, if done in the right way, can have multiple benefits, including increasing energy security, providing access to energy for all and delivering more sustainable jobs for the EU's workforce. Finance streams need to ensure that **the decarbonisation pathway provides for a just transition**, and a sustainable energy future, including support to workers affected by industrial changes.[4]

4 Just transition is generally described by civil society as the transition towards a low-carbon and climate-resilient economy that highlights public policy needs and aims to maximize benefits and minimize hardships for workers and their communities in this transformation.

1) EU funds

INTRODUCTION

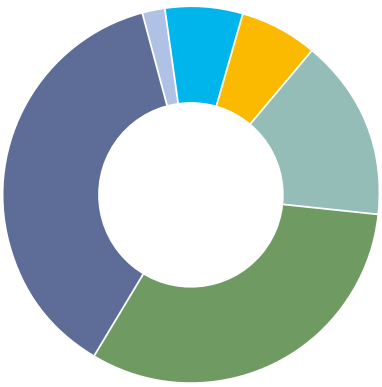
A number of EU funds have been established to enhance regional development in the EU's less developed regions, create jobs, strengthen the integration of economies, and expand the provision of goods and services to European citizens. With these objectives in mind, EU funds have to a great extent been used for projects in sectors such as infrastructure, energy, transport and innovation.

These sectors are highly important for the realisation of the EU's energy transition away from fossil fuels, and towards low-carbon societies. Equally, the funds behind projects in these sectors are crucial to the EU's climate and energy objectives, including the EU's commitment to mainstream climate action into the Union's long-term budget spending. This briefing looks at the role of two of EU's key funds and financial mechanisms. Indeed their operations are not yet in line with EU's climate and energy objectives; they are still channelling money into unsustainable projects across EU Member States and the European neighbourhood. Since 2014, when the EU budget came into force, ESI Funds and the Connecting Europe Facility have allocated up to €1.6 billion to fossil fuel projects.

European Structural and Investment (ESI) Funds

ESI Funds is an overarching term used for a number of EU funds that deliver financial resources to EU Member States with the view to leveraging private financing and triggering more projects in sectors such as energy, agriculture and transport. ESI Funds include the European Regional Development Fund, the European Social Fund, and the Cohesion Fund [among others - the European Agricultural Fund for Rural Development, and the European Maritime and Fisheries Fund]. Funding through these different EU cohesion policy resource pools amount to approximately €346 billion, for the 2014-2020 EU budget period, the so called Multiannual Financial Framework.[5] ESI Funds can serve as another tool to help translate the EU's climate and energy commitments into concrete investments and projects.

The EU budget 2014-2020: €960 billion



1.9% 3 "Security and citizenship" (Asylum, Migration, consumer protection, creative Europe etc.)
6.7% 4 "Global Europe" (pre-accession, neighbourhood, development, etc.)
6.5% ?
15.7% 1A "Competitiveness for growth and jobs" (CEF, horizon 2020, COSME, ERASMUS etc.)
31.8% 1B "Economic, social and territorial cohesion" (Cohesion Policy)
37.4% 2 "Sustainable growth: natural resources" (CAP, LIFE, fisheries etc.)

The multiannual financial framework (MFF) lays down the maximum annual amounts ('ceilings') which the EU may spend in different political fields ('headings') over a period of at least 5 years. The current MFF covers seven years, from 2014 to 2020. By defining in which areas the EU should invest more or less over the seven years, the MFF is an expression of political priorities as much as a budgetary planning tool.

5 https://cohesiondata.ec.europa.eu/overview

Recent data and information on the plans and projects funded by ESI Funds illustrates that a large amount of investments are going to activities that undermine the broader objectives of the EU to decarbonise its economy.[6] The data show that almost €1 billion has been earmarked for natural gas projects, while large-scale support has also gone to the transport sector, particularly roads.

Connecting Europe Facility (CEF)

The Connecting Europe Facility (CEF) aims to enhance and expand cross-border infrastructure, connections and territorial cohesion in Europe. The CEF also identifies tackling climate change as part of its overall objectives. It has a total budget of approximately €30.4 billion, of which €5.35 billion is earmarked for energy. Energy projects which are put on a list of so called 'Projects of Common Interest' (on the basis of criteria set out in the 2013 Energy Infrastructure Regulation) can benefit from CEF funding and a.o. streamlined approving procedures.

The CEF is providing favourable support to gas infrastructure and connections, above and beyond alternative measures for cross-border connections. For the years 2014-2015, almost €430 million of CEF funding was allocated to gas projects.[7] It is envisaged that up to €800 million will be disbursed by the end of 2016; so far €210 million in funds have been approved for gas projects.[8]

The growing financial support for gas infrastructure and connections in Europe presents a worrying trend in EU funding. On the one hand, the CEF is seeking to ensure security of energy supply, strengthen integration, and stimulate jobs. On the other hand, it is not adequately taking into account the deep decarbonisation pathway that the EU needs to take in order to avoid dangerous climate change.

CAN Europe's Specific Recommendations for ESI Funds and CEF

In order to unlock ambitious climate and energy policies whilst also achieving key economic, social and environmental objectives, the activities of large funds such as the CEF and ESI Funds (Regional Development and Cohesion Funds) must go hand-in-hand with ambitious and visionary public policies for decarbonisation. The EU and Member States must seek to make a long-term shift in investments and incite similar action from the private sector. It is therefore essential that national policies are realigned to meet the climate commitments set out in the Paris Agreement, and the allocation of financial support is subject to those policies and their overall climate and energy ambition. In addition, the EU's decarbonisation pathway means a short-lived future for fossil fuels, including gas. Financing for gas infrastructure should therefore be phased out.

In particular, ESI Funds must:

- Align conditions for EU funding with 2030 and 2050 zero carbon climate strategies and investment plans, particularly in light of the Paris Agreement. It is crucial the national projects do not end up undermining the EU's overall climate ambition;
- Adequately assess how the deployment of funds can meet the full potential of renewable energy and energy efficiency through projects in Member States; this should also include transmission, storage and transport of energy;
- Set out a pathway to reduce funds for fossil fuel infrastructure and incorporate conditional funding that is measured against 2050 decarbonisation targets;
- Phase out support for fossil fuels in the 2021-2027 EU budget.

The CEF must:

- Be subject to regular checks-ups and reporting on how it is contributing to the EU's decarbonisation goal;
- Implement a more transparent and robust assessment of project proposals submitted to the European Commission, including whether the projects will adequately contribute to efforts to reduce overall consumption of fossil fuels, including gas, and which fit with low energy consumption demands in the future;
- Integrate the Energy Efficiency First principle as a guiding criterion. This should better ensure that countries which submit project proposals are prioritising energy efficiency first and foremost.

6 http://ec.europa.eu/regional_policy/en/policy/evaluations/data-for-research/

7 https://ec.europa.eu/inea/sites/inea/files/cef_energy_brochure_-_2_june_final.pdf

8 https://ec.europa.eu/inea/sites/inea/files/2016-1_cef_energy_call_results.pdf

2) European banks

The European Investment Bank (EIB)

INTRODUCTION

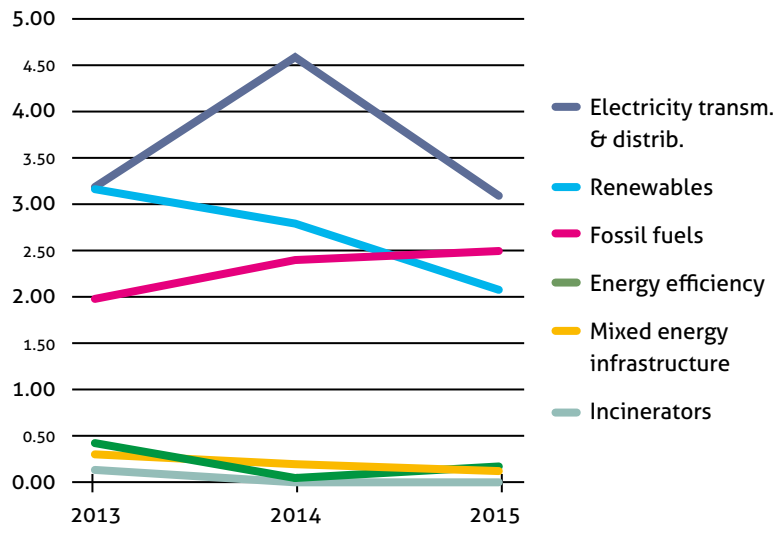
The European Investment Bank (EIB) is owned by the EU Member States, and is thus governed by economic and finance ministries from the 28 EU Member States, in coordination with the European Commission. The EIB acts as a multiplier, usually providing around one third, but sometimes up to 50%, of the finances needed for a project. According to the bank themselves, *all projects must comply with strict economic, technical, environmental and social standards.*[9]

In 2013, the EIB adopted new lending criteria for the energy sector to ensure its activities remain 'relevant, consistent with EU policies; focussed on sectors with the greatest investment needs and highest policy priorities'.[10] The bank states that it still finances projects that contribute to guaranteeing secure supply of oil and gas. In September 2015, the EIB further adopted a new climate strategy, in which the bank sets out to dedicate 25% of its lending to specific climate action projects. During the Climate Summit in Paris last year, the EIB further announced its commitment to fight climate change.[11] **With the adoption of its new operation plan for 2016-2018 in January this year however, climate was taken out from the bank's four Public Policy Goals.**[12]

CURRENT STATE OF PLAY

Despite some promising commitments made by the bank, a recent analysis by CEE Bankwatch Network shows that the EIB provided up to €7 billion in funding for fossil fuels from 2013 to 2015. This represents almost 30% of the total lending in the energy sector. While the total lending to renewable energy was higher than lending to fossil fuel infrastructure[13] during this period, the lending to fossil fuels increased by approximately 25%, from €2 billion in 2013 to around €2.5 billion 2015, compared to a decrease in lending to renewable energy with 21%.[14]

EIB funding streams for energy, 2013-2015



9 http://www.eib.org/about/index.htm

10 http://www.eib.org/attachments/strategies/eib_energy_lending_criteria_en.pdf

11 http://www.eib.org/projects/priorities/climate-action/road-to-paris/index.htm

12 "The Bank continues to maintain the four Public Policy Goals: Innovation; SMEs and Midcap finance; Infrastructure and Environment", http://www.eib.org/attachments/strategies/cop2016_en.pdf. In the old Operational Plan 2015-2017 "Environment and Climate" was among the Public Policy Goals and in the Operational Plan 2014-2016 "projects that specifically contribute to Climate Action" was a separate Public Policy Goal

13 Gas and oil power plants, gas transmission and distribution networks, gas extraction and refining.

14 http://bankwatch.org/sites/default/files/briefing-EIB-Energy_June2016.pdf

The on-going large support for fossil fuels awarded the EIB a red flag in BIC and Sierra Club's 2015 MDB Climate Change Scorecard, which states that *"The energy sector lending of the [IFC/MIGA and] EIB are the most troubling due to their continued high level of support for fossil fuels, including significant funding for exploration projects... Unfortunately EIB's lending to fossil fuels continues at such high levels that it threatens the 2°C target."*[15]

EIB fossil fuels lending 2013-2015 by categories (in EU)

	2013	2014	2015
Gas power plants	0.0	32000000.0	114168550.1
Oil power plants	0.0	80000000.0	110000000.0
Gas extraction	200000000.0	900000000.0	200000000.0
Gas storage	870000000.0	50000000.0	0.0
Gas transmission and distribution	892500000.0	1314791280.8	1487675314.2
Gas metering	0.0	0.0	200000000.0
Electricity & gas distribution	0.0	0.0	329000000.0
LNG	64976397.7	78250000.0	40000000.0
Coal and biomass co-combustion	0	0	38400000.0
Total	**2027476397.7**	**2455041280.8**	**2519243864.21**

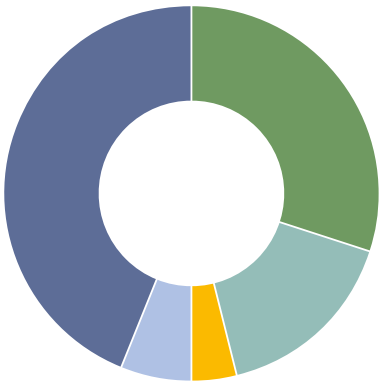
CASE STUDY: The Juncker Plan for Jobs and Growth – The European Fund for Strategic Investments (EFSI)

The European Fund for Strategic Investments (EFSI), launched jointly by the EIB and the European Commission, is part of an initiative to help mobilise private investments and should catalyse new investments in projects with high economic, environmental and societal added value. Its current 3-years investment target of €315 billion is supposed to be accomplished by financing provided by the EIB to projects carried out by private or public investors and based on a guarantee of €16 billion from the EU budget, complemented by a €5 billion allocation of the EIB's own resources. The EIB should provide funding for those economically viable projects which have a higher risk profile than ordinary EIB activities. By July 2016, the EFSI provided financial support for 94 infrastructure projects, out of which seven were fossil fuel projects, and six transport projects.

CASE STUDY: Hundreds of millions to gas infrastructure in Spain

At the end of 2015, the EIB approved a EUR 600 million loan to Spanish company Gas Natural Fenosa.[16] The loan is only the first part of a total loan of EUR 900 million to expand the gas transmission and distribution networks in Spain until 2018. The EIB aims to ensure an increase of the natural gas penetration in Spain by providing finance for construction of pipelines, power plants for liquefied natural gas and distribution networks. This despite the growing body of scientific evidence stating that we need to leave most of all known fossil fuel reserves in the ground – including gas. With roughly 300 days of sunshine per year and regions that receive strong winds, Spain has very good conditions for renewable energy production. CAN Europe believes it should be obvious for the EIB to focus on tapping these potentials, instead of investing millions in gas infrastructure.

Fossil fuel projects supported by EFSI



15 http://www.bankinformationcenter.org/wp-content/uploads/2015/10/MDB-Climate-Change-Scorecard-formatted.pdf

16 http://www.eib.org/infocentre/press/releases/all/2015/2015-317-el-bei-financia-la-expansion-de-la-red-de-distribucion-de-gas-natural-fenosa-con-un-prestamo-de-600-millones-de-euros.htm

The European Bank for Reconstruction and Development (EBRD)

INTRODUCTION

The European Bank for Reconstruction and Development (EBRD) has the mandate to promote transition to market economies and sustainable development in the countries of Eastern Europe, former Soviet Union, the southern and eastern Mediterranean as well as Mongolia and Turkey. The bank is owned by 65 countries from across the world, the European Union and its Member States and the European Investment Bank. To respond to challenges such as increased demand for natural resources and growing environmental concerns, in 2006 the EBRD established the Sustainable Energy Initiative[17] with the aim of promoting efficiency and innovation in the areas of energy, water and materials.[18] In 2013, the bank also adopted a new Energy Strategy which excludes financing for new coal power plants, with possible exceptions for Mongolia and Kosovo. In 2015 the EBRD Board agreed on the Green Economy Transition (GET) approach seeking to increase investments in sustainable energy and resource efficiency to 40% of its entire portfolio by 2020.

CURRENT STATE OF PLAY

So far so good, but **a recent report by CEE Bankwatch Network clearly shows that the EBRD is far from being a front-runner in sustainable investments, continuing to finance controversial fossil fuel projects which has increased some countries' economic dependence on natural resource extraction**.[19]

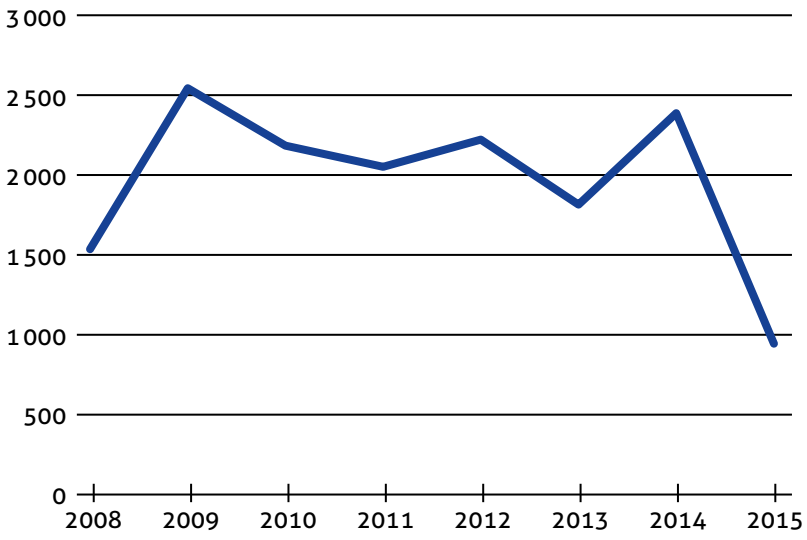
The chart on the right, sourced from Oil Change International's database on fossil fuel subsidies tracks the level of EBRD investments in fossil fuel *exploration*. For the years 2008 to 2015 fossil fuel investments amounted to over €15 billion; for the years 2013 to 2015, investments amounted to approximately €5 billion. Note that the figures just display support for exploration. This means support towards the discovery and potential expansion of oil, gas and coal reserves which is just one part of fossil fuel production. The figure does not cover all levels of fossil fuel production.

CASE STUDY: Support for continued fossil fuel exploration in Greece

In May 2016, the EBRD signed two loans with Greek oil company Energean Oil and Gas S.A to finance further development, exploration and appraisal of its onshore and offshore fields in Greece. Firstly, as part of a ~€180 million project to further develop the offshore fields in the Gulf of Kavala, the EBRD approved a loan of up to €67 million.[20] Secondly, the bank is investing an up to €18 million (total project cost €45 million) subordinated loan for exploration and appraisal of four additional oil fields. Greenpeace Greece's Energy Revolution study for Greece shows that half of the electricity demand in the country could be covered by renewables in 2020, if the right policy and investment choices are made.[21]

EBRD fossil fuel exploration investments, 2013-2015

(€ millions)



OCI, www.shiftthesubsidies.org, May 2016

17 Which later became the Sustainable Resource Initiative (SRI)

18 http://www.ebrd.com/what-we-do/sectors-and-topics/sustainable-resources-and-climate-change/sri.html

19 http://bankwatch.org/sites/default/files/lost-in-transition.pdf

20 Project cost 1 USD200 million, EBRD contribution USD 75 million, Project cost 2 USD 50 million, EBRD contribution USD 20 million http://www.ebrd.com/work-with-us/projects/psd/energean.html

21 http://www.greenpeace.org/greece/PageFiles/98261/energy-revolution.pdf

CAN Europe Specific Recommendations to EIB and EBRD

The EU's development banks must work in a mutually re-enforcing way to increase investments in clean energy projects while rapidly phasing out support for fossil fuels. This must include phasing out all direct lending to fossil fuel projects by 2020 and a long-term plan to phase out funding for projects that contribute to downstream consumption of fossil fuels, such as gas infrastructure and transport;

The Energy Efficiency First principle should also guide both banks' entire portfolios, and until a full phase-out of lending to fossil fuel projects has taken place, apply higher emission performance standards for power generation projects in order to only support the most efficient power plants.

The EIB must:

- Raise the percentage of climate specific spending from 25% to at least 50% by 2030 (including for the Juncker Investment Plan – EFSI), following the adoption of the EU 2030 climate and energy targets;
- Develop country-specific approaches in support of national climate action plans in line with the Paris Agreement and the EU roadmap for a competitive, low carbon economy in 2015;
- Ensure that the European Fund for Strategic Investments (EFSI) becomes a solid catalyst of sustainable investments and climate action, by providing additionality to the bank's standard operations in these areas;
- Revise the bank's climate policy with a view to including absolute emissions reductions of its portfolio, in line with limiting global temperature increase to 1.5°C;
- Revise its methods for measuring greenhouse gas emission estimations for its projects so that it not only accounts for emissions directly caused by the infrastructure in question but also accounts for so-called Scope 3 indirect emissions – those which arise later as a result of its use.

The EBRD must:

- Revise its methods for measuring greenhouse gas emission estimations for its projects so that it not only accounts for emissions directly caused by the infrastructure in question but also accounts for so-called Scope 3 indirect emissions – those which arise later as a result of its use.

EU financial institutions at a crossroads: The Southern Gas Corridor

The Southern Gas Corridor, if realized, will be a 3500 kilometres-long chain of gas pipelines from Azerbaijan to Italy, expected to start pumping gas to Europe by 2020. Such a large infrastructure project would lock in gas dependency for decades to come, in a time when all fossil fuels need to be phased out as soon as possible.

Publicly funding this project thereby goes against EU's international commitment under the Paris Agreement and defies the European Commission's own projections that the demand for gas in Europe is dropping.[22] In a letter to the president of the EIB earlier this year, a group of 27 NGOs highlighted key controversies surrounding the project, and called for the project not to be financed. The signatories of the letter correctly point out that "if the Southern Gas Corridor does materialize and ends up pumping more gas into Europe, the chances of meeting the EU's climate and energy targets for 2030 and its longer term decarbonisation objectives, would hardly be attainable".[23]

The total cost of the project is estimated to be $45 billion[24]. It is a massive investment in a project which ultimately risks becoming an uneconomic, stranded asset. The EIB and EBRD contributions for the Transadriatic Pipeline, the section of the Southern Gas Corridor going through Greece and Albania to Italy, are expected to be the biggest single loans in the history of each of the banks (up to €3 billion and €1.5 billion respectively[25]). The rest of the project would need to be financed by private investors, but the bulk of the project is ultimately dependent on public money via loans of public banks and guarantees from governments of transit countries to be realized as they are crucial for private investors as a guarantee.

Refusing to finance the Southern Gas Corridor would free up financing for further diversification of the energy supply in Europe if invested in renewables and energy efficiency. In addition to the climate aspect and the pure financial arguments against the project, the Southern Gas Corridor is controversial in terms of human rights and democracy issues in the countries it will cross, especially in Azerbaijan. Cancelling this project would be an important signal to the rest of the world that the EU is serious about not supporting corrupt and repressive regimes.

22 http://ec.europa.eu/smart-regulation/impact/ia_carried_out/docs/ia_2011/sec_2011_1565_en.pdf

23 http://www.counter-balance.org/wp-content/uploads/2016/01/NGO-Open-Letter_EIB-President_Southern-Gas-Corridor_28-01-2016.pdf

24 http://www.tap-ag.com/the-pipeline/the-big-picture/southern-gas-corridor

25 – http://www.eib.org/projects/pipeline/2014/20140596.htm
– http://www.naturalgaseurope.com/ebrd-is-considering-providing-a-syndicated-loan-of-up-to-1.5-billion-for-sgc-29795
– http://www.eib.org/projects/pipeline/2015/20150676.htm

3) EU policies and tools

The EU policies and mechanisms that the briefing looks at are designed to support EU Member States in their efforts to reduce greenhouse gas emissions, enhance security of energy supply, and facilitate public support in the energy sector when it is needed. The policies are therefore highly important to guide national decisions and investments, and ensure coherence between support schemes in the energy sector and broader EU climate and energy objectives. This briefing looks at three such policies and mechanisms.

The EU Emissions Trading Scheme

INTRODUCTION

The EU Emissions Trading Scheme (ETS) aims to help the EU achieve its long-term greenhouse gas reduction goals more cost-effectively and is meant to encourage investments in low-carbon technologies. It receives little attention towards its role as a facilitator of support for dirty fossil fuels. While not being in the direct spotlight, the ETS also plays a role in prolonging the life of coal power plants and other fossil fuel use through ETS funding.

CURRENT STATE OF PLAY

Firstly, most energy intensive industries receive their pollution permits for free. This is because they claim that the ETS would otherwise force companies to move their production abroad to countries with less ambitious climate measures to lower their production costs. There is no compelling evidence that EU's climate policies are or will be forcing companies to move abroad. **These free allowances represent a large subsidy for fossil fuel intensive industries.**

Secondly, Member States can use their revenues from auctioning ETS pollution permits however they wish to. ETS Directive specifies that at least 50 % of auctioning revenues should be used for climate and energy related purposes. But there is no enforcement and what constitutes climate action is defined very broadly. Many governments choose to subsidize energy intensive industries that have high electricity costs. Germany has for example budgeted €756 million for indirect cost compensation in the 2013-2015 period. **Compensating electricity intensive industries for their consumption of fossil fuel based electricity hampers the transition to an efficient, climate-friendly energy system as it reduces the incentive to purchase low-carbon electricity.**

Thirdly, article 10c of the ETS Directive allows lower income Member States (Poland, the Czech Republic, Romania, Hungary, Slovakia, Bulgaria, Croatia, Estonia, Lithuania, Latvia) to hand out up to 40% of their ETS pollution permits for free to power plants. The hand-outs are made under the condition that those same power plants undertake efforts and investments to modernise their systems. **Current article 10c investments have overwhelmingly benefited fossil fuel based plants.** At the same time, the greenhouse gas emissions from power stations that have received support have been falling much slower than the emissions from all other EU power installations.

CASE STUDY: Coal in Poland

The free ETS allowances may have enabled Poland to extend the lifespan of lignite and hard coal power generation. Rather than investing in renewables, up to 90% of investments through Article 10c have been coal and lignite based.[26] Poland's biggest coal plant Bełchatów is one such example of benefitting from support through the EU ETS. The power plant has received support to modernise power units and build a new lignite fuel unit.[27] Given that some units in Bełchatów will have to shut down due to problems such as local air pollution and negative health impacts the support marks an untenable use of resources which could instead be used to increase renewable energy capacity and support a just transition away from coal power.

26 For detail, see the 2015 Commission's Impact Assessment (p.133).
27 Carbon Market Watch, http://carbonmarketwatch.org/wp-content/uploads/2016/04/Fossil-fuel-subsidies-from-Europes-carbon-market-final-web.pdf

CAN Europe Recommendations on the ETS

- It is imperative that the ETS and its related financial flows adhere to the broad principle that no financial support should be given to fossil fuel based, nuclear energy production or biomass co-firing.
- This means that article 10c should be abolished or phased out as it undermines the EU's long-term decarbonisation objective.
- Handing out free allowances and compensating companies for indirect costs should not be allowed under the ETS.

Specific recommendation to use the Modernisation Fund to enhance climate action

Between 2021 and 2030, 2% of the allowances, some 310 million ETS allowances in total, will be set aside to establish the Modernisation Fund. The Fund aims to support lower-income Member States in meeting their investment needs related to energy efficiency, including financing small-scale investment projects and the modernisation of energy systems.

The Modernisation Fund should be led by an investment policy that prioritises phasing out fossil fuels, achieving substantial energy savings and building energy generation on sustainable renewables, including storage and smart grid development. Member States eligible for support from the fund should be required to adopt strategies and national investment plans that outline their contribution towards reaching the EU's objective of 95% emissions reductions by the middle of this century.

Every country or region would have to prove the integration of the Energy Efficiency First principle which ensures that all energy efficiency options have been realised and that new capacities are only installed after taking into account the embedded energy reduction pathways. The European Commission should be responsible for the management of the fund, with the involvement of the EIB and Member States, and participation of local authorities and civil society organisations.

State Aid Decisions

INTRODUCTION

State aid is a powerful tool through which governments have the ability to use state resources to support certain undertakings.[28] Such interventions however, per definition, distort or threaten to distort competition and are thus generally prohibited.[29] However, State aid can exceptionally be allowed in some cases, and the Treaty of the Functioning of the EU (TFEU) empowers the Commission to assess whether this is the case. The details around how these subsidies can be applied – including to what technologies and projects and on what conditions – are therefore regulated at EU level through State aid law as part of the European competition law.

In principle, Member States need to notify their intended State aid measures to the Commission's DG Competition which decides whether the measure indeed is State aid and if so, whether it can be approved.

In principle, the European Commission assumes that there is competition in the EU's markets and public finance is therefore subject to State aid rules. **State aid has the promising potential to advance the EU's climate and energy goals through supporting industries which drive the transition towards a low carbon economy, but at the moment it is often used to allow for continuing fossil fuel production and consumption.**

CURRENT STATE OF PLAY

The latest Commission proposal on State aid entitled *Guidelines on State aid for environmental protection and energy 2014-2020* is an attempt to ensure coherence between State aid rules and EU's climate and energy policies. A recent examination of these guidelines by an environmental law NGO ClientEarth however shows that severe gaps remain. The new guidelines lack appropriate recognition of the need to provide support for developing green technologies, while allowing Member States to give aid to ensure that there will always be a secure supply of power (see the chapter on capacity mechanisms below). Additionally, the definition of 'energy from renewable energy sources' opens up for support to co-firing of coal and biomass.[30] Examples of when State aid is allowed for fossil fuels related energy projects include[31]: closure aid for inefficient coal mines[32], regional aid

28 State aid is only present where the beneficiary is an undertaking. The jurisprudence defines undertaking "as entities engaged in an economic activity, regardless of their legal status and the way in which they are financed" Joined Cases C-180/98 to C-184/98 Pavlov and Others [2000] ECR I-6451, paragraph 74.

29 State aid is, as defined in the Article 107(1) of the Treaty of the Functioning of the EU (TFEU) "[...] any aid granted by a Member State through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States [...]".

30 http://www.documents.clientearth.org/library/download-info/the-effect-of-state-aid-governance-on-eu-climate-and-energy-policy/

31 http://bankwatch.org/sites/default/files/EnCom-stateaid-study-08Jun2015.pdf

32 There is an explicit Council Decision (787/2010/EU) adopted in 2010, which allows some "closure aid" to coal mining.

for investments and new jobs which theoretically and legally can be given to coal mines[33], compensation for stranded assets in the electricity sector[34], if the service is of general economic interest (SGEI)[35], and through rescue and restructuring aid in the energy sector[36].

CASE STUDY: Public money continues to support coal in Spain (decision in case N178/2010)

In 2010, Spain notified the Commission of providing compensation and preferential dispatch to ten electricity producers whose production originated from domestic hard coal of up to 15% of the domestic demand. The argument from the Spanish government was enhanced security of supply. It argued that – for instance – backup for renewable energy electricity production was needed. The Commission confirmed the presence of an SGEI and the compliance with the 15% threshold and considered the measure to be compatible aid under Article 106(2) TFEU.

Several third parties submitted complaints during the procedure, stating that it would indirectly be granting advantage to coal mines – which was dismissed by the Commission – risk environmental protection and breach EU climate commitments. The Commission's decision was appealed to the General Court (GC)[37], but the Court accepted the Commission's approach. Regarding the complaint on infringement of environment and climate policies, the GC confirmed that the Commission is not obliged to consider environmental rules in the compatibility assessment if the aim of the measure is not environmental protection. The GC also stated that the Commission cannot use its powers concerning the compatibility of a State aid measure in order to determine whether the measure infringes other parts of EU law.

A detailed outline of this case can be found in the CEE Bankwatch Network publication *State aid rules in the coal sector and linked energy sector under the Energy Community Treaty and European Law*[38].

CAN Europe Recommendations on State aid to Member States

- CAN Europe recommends that Member States should immediately quit giving public money to fossil fuel projects and new EU rules for State aid need to be adopted which fully exclude the ability to provide State aid that allow for continuing fossil fuel production and consumption, thus undermining the EU's overall climate and energy targets.
- The Commission needs further to be stricter in its assessments of the measures that the Member States send in. Since State aid is actually paid by citizens, greater transparency also needs to be given throughout the process, which allow for NGOs and other actors to follow and comment on the progression of the decisions and to challenge them in the public interest if necessary.
- As countries transition away from a fossil fuels based energy system, dedicated financing should be used to support a just transition from fossil fuel to renewable energy based energy systems. It Is essential that this support reaches the workers directly, while it should not be a compensation to fossil fuel companies' profits. Governments should invest in a "just transition fund", instead of approving for example closure aid to fossil fuel companies for uncompetitive mines. The funding should be earmarked to support the workers in those industries in transitioning to jobs in other sectors. Together with the affected regions, workers, local governments and trade unions, just transition pathways should be developed and implemented timely.

33 Guidelines on regional State aid for 2014-2020 Official Journal C 209/1 23.7.2013.

34 Commission Communication relating to the methodology for analysing State aid linked to stranded costs. Adopted by the Commission on 26.07.2001 not published in the Official Journal.

35 Article 106(2) TFEU states that support may be given to services of special characteristics on the market. As regards the electricity sector, Article 15(4) of the current Directive 2009/72/EC stipulates that "A Member State may, for reasons of security of supply, direct that priority be given to the dispatch of generating installations using indigenous primary energy fuel sources, to an extent not exceeding, in any calendar year, 15% of the overall primary energy necessary to produce the electricity consumed in the Member State concerned."

36 Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, Official Journal C 249/1, 31.07.2014.

37 Castelnou Energía, an electricity producer using natural gas.

38 http://bankwatch.org/sites/default/files/EnCom-stateaid-study-08Jun2015.pdf

Capacity Mechanisms

INTRODUCTION

Meeting the ambition set out in the Paris Agreement requires a rapid decarbonisation of the power sector – which needs to be fully decarbonized by 2050 – and the financial support that is provided to power generation. Capacity mechanisms are one form of such support. Capacity mechanisms are measures – or market interventions – taken to ensure that there is adequate capacity available at all times to produce electricity to ensure a secure electricity supply.

Capacity mechanisms take many different forms, but they generally offer payments to capacity providers on top of their income from revenues generated by selling electricity on the market. This is done as a means to prevent the shutdown of existing generation capacity or to incentivise investment in new resources. Capacity mechanisms have an impact on competition and they are therefore subject to EU State aid rules (see chapter on State aid above). **The European Commission acknowledges that they risk to undermine the EU's objective of phasing out fossil fuel subsidies.**

CURRENT STATE OF PLAY

A number of questions and concerns have recently arisen in relation to capacity mechanisms, namely, whether they are as necessary for security of supply as they are perceived to be by EU governments, and how their application may actually result in more subsidies for the fossil fuel sector through the back door which risks contradicting international, European and national climate objectives.[39]

A European Commission report recently pointed out that Member States introduce capacity mechanisms without '*proper and consistent analysis*' of their need. The report for example found that many Member States did not properly assess what would be the best way to increase security of supply. In addition, ODI asserts that the traditional approach to capacity mechanisms that focuses on the capacity to produce power is outdated. This approach fails to secure the flexibility needed to complement variable, weather-dependent electricity generation from wind and solar and risks to undermine decarbonisation. A review of recently introduced and proposed capacity mechanisms shows that this leads to unbalanced favouritism for fossil fuels, as opposed to low-carbon options to enhance security of supply.[40]

Capacity mechanisms may also interfere with cross-border trade and competition, close national markets, distort the location of generation, and finally increase costs for all Member States.

CASE STUDY: The United Kingdom gets a green light for a flawed capacity mechanism proposal

Capacity mechanisms may play a notable role in the deployment of gas in the UK.[41] The UK's coalition government introduced its capacity market in 2014 in order to replace older power stations and provide backup for more intermittent renewables generation sources.[42]

Despite the assertions of the government for further decarbonisation through its capacity market, the figures released from the UK's capacity auctions in 2014 and 2015 suggest a very different story. Not only has the UK government started touting the capacity mechanisms as a form to increase gas production, it has also used it to support dirtier fossil fuels such as coal and diesel. A recent ODI report has found that substantial payments, estimated at €822 million ($966 million) have gone to coal-fired power and diesel.[43] Payments to coal alone through multi-year contracts – which can run up to 2019 or 2020 – have been estimated to reach €337 million.[44]

The Institute for Public Policy Research's review of the UK's capacity market illustrates numerous flaws, many of which are detrimental to the UK's and EU's climate and energy objectives. The design of the capacity market serves as a kind of two-sided coin; although it has been presented as a tool for decarbonisation, the capacity market offers payments and contracts to carbon intensive industries. Not only do these payments prolong the use of high-carbon power sources, but they also allow the industry to supersede external market challenges that would otherwise render them unreliable and uneconomic. This results in a direct contradiction of goals when it comes to climate action and energy transformation; in its present form, the capacity market is creating new subsidies for fossil fuel power that should already be in a phase-out process.

39 https://ec.europa.eu/commission/2014-2019/vestager/announcements/level-playing-field-green_en

40 ODI, https://www.odi.org/comment/10392-how-you-can-stop-uk-giving-millions-dirty-power

41 The capacity mechanism in the UK is designed to be technologically neutral, and rewards all types of capacity (beyond gas). However, the government intends that its CM will bring new investments in gas.

42 IPPR, http://www.ippr.org/files/publications/pdf/incapacitated_March2016.pdf?noredirect=1

43 ODI, https://www.odi.org/sites/odi.org.uk/files/resource-documents/10569.pdf

44 http://www.energypost.eu/understanding-uks-capacity-market/ Conversions from GBP to Euro have been made based on the average conversion rate for 2014 – 2015

CAN Europe Recommendations on Capacity Mechanisms

- It is necessary that the EU and its Member States take a much more critical approach to the use of capacity mechanisms; not just narrowly focus on implications for competition, but also for long-term decarbonisation. Stronger ambition is needed from EU governments to prioritise low-carbon options for ensuring the reliability of the power system and eliminate any support for fossil fuels.
- CAN Europe recommends that the EU establishes clear and compulsory criteria that require Member States to provide adequate evidence of the need to intervene and address power insufficiencies.
- All capacity markets should be fully open to renewable energy capacity, interconnectors, demand response and storage. The carbon intensity of the resources providing capacity should be factored into the possible design of capacity mechanisms so that delivery of the overall carbon reduction targets is not compromised. Mechanisms should not prevent carbon intensive and inflexible power plants from leaving the market, and in cases where capacity mechanisms are used, they should be reversible, and interfere as little as possible with the market;
- If after all other options have been exhausted, capacity mechanisms are still deemed necessary, they should integrate broader climate objectives, prioritise low-carbon power and exclude fossil fuels;
- Subsidies for environmentally unfriendly and highly polluting technologies should not be granted;
- Moreover the approach adopted to deliver reliability should not lead to unintended adverse consequences for investments in renewable energy.

"Capacity mechanisms often involve subsidies with very direct implications for taxpayers."

EU Competition Commissioner Margrethe Vestager

EU processes that can help kick fossil fuels out of EU financing

The EU can stimulate comprehensive action through a number of its existing policy frameworks and negotiation processes. The following frameworks mark a starting point for the EU to stimulate further action:

The Multiannual Financial Framework (MFF)

The review of the MFF, kicking off in 2016, offers the EU an ideal opportunity to bring the EU budget in line with the Paris Agreement. This would mean an immediate end to funding for fossil fuels and a greater imperative to tackle the climate crisis. Climate mainstreaming in the EU budget should be better implemented through:

- incorporating the *Energy Efficiency first* principle for all investments;
- supporting the EU to be "World no.1 in renewables" and investing in grid integration;
- embedding funding into national long-term investment plans for 100% renewables;
- asessing energy demand projections used for allocation of Projects of Common Interest (PCI) funding to be consistent and aligned with European medium and long-term climate and energy targets;
- and introducing guaranteed funds to catalyse locally driven energy transition in EU.

The European Semester

The European Semester serves as a mechanism for EU economic policy coordination of Member States' economic and structural reforms. In principle, the progress towards meeting national and collective climate and energy targets is analysed through the Semester process. Such analysis has included efforts to phase out environmentally harmful subsidies, but in 2015 the climate and energy related analysis has been substantially reduced. As a result, no report or recommendations were assigned to EU Member States on their progress to meeting climate and energy targets. **The European Semester should restore efforts to identify and highlight the economic implications for failing to meeting the EU's short-term and long-term climate ambition.** Key recommendations on economic actions, particularly public financing and support for fossil fuels, should be reinstated amongst the wider list of economic recommendations.

The Energy Union and National Energy and Climate Plans

Covering all aspects of EU energy – from security of energy supply to the decarbonisation of Europe's energy system – the Energy Union should provide further guidance to Member States on measures to phase out fossil fuel subsidies. In the coming years, EU Member States will negotiate so-called National Energy and Climate Plans (NECPs) which will represent the individual efforts of countries to meet the EU's collective climate and energy goals.[45] Those plans should include policies and measures to phase out public financing for fossil fuels, with robust follow-up and review of efforts.

In order to monitor progress, key issues such as the use of State aid and capacity mechanisms, as well as budgetary spending and tax policies associated with energy production and consumption should be reported on through the NECPs.

45 NECPs are part of the EU's energy governance pillar of the Energy Union, where countries will build on their existing climate plans and strategies to achieve more integrated action on climate and energy: http://eur-lex.europa.eu/resource.html?uri=cellar:ebdf266c-8eab-11e5-983e-01aa75ed71a1.0008.03/DOC_5&format=HTML&lang=EN&parentUrn=CELEX:52015DC0572

Conclusion

As a member of the G20, the EU has committed to phasing out fossil fuel subsidies, and it is high time that the EU puts its money where its mouth is. This means comprehensive reforms to many EU policies and tools that both directly and indirectly support the fossil fuel industry, as well as national efforts to phase out subsidies from domestic budgets, public finance institutions, and state funding. In order to ambitiously tackle climate change, EU funds should be channelled towards wide-scale zero carbon strategies. These strategies encompass energy efficiency and renewable energy, including community energy projects, research and innovation, and storage of energy. The benefits of ending support for fossil fuels can be far-reaching for European citizens and countries; not only in the energy sector, but for overall health and well-being, and longer term economic stability.

Climate Action Network (CAN) Europe is Europe's largest coalition working on climate and energy issues. With over 130 member organisations in more than 30 European countries – representing over 44 million citizens – CAN Europe works to prevent dangerous climate change and promote sustainable climate and energy policy in Europe.

MORE INFORMATION:

Maeve McLynn, Finance and Subsidies Policy Coordinator,
maeve@caneurope.org, (0032) 02 893 09 50

Climate Action Network Europe
Mundo-B, Rue d'Edimbourg 26
Brussels 1050, Belgium

www.caneurope.org