

The European Green New Deal

Executive summary

The Green New Deal is the flagship of the new European Commission (2020-2025), which has recently shed light on the likely substance of the initiative in a new Communication.¹

The main 'headline' is that the EU Member States have agreed (by unanimity minus one, Poland) to put into law a formal commitment that the EU will be carbon neutral by 2050. Whilst such a legislative commitment can be reversed in future (if, for example, non-EU countries fail to follow the EU's lead and the final stages of decarbonisation hit European competitiveness too hard), it does mean that all EU policy and legislation moving forwards will be predicated on putting the EU in a place to meet this 2050 commitment. The effect of this should not be underestimated.

The measures that will follow in the short term to realise this ambition will, in themselves, already create very significant challenges and opportunities for a wide range of the EU's economy. Regulation will drive the changes to these markets; mastering this complicated framework will be vital.

The key initiatives announced in the Communication, and explained in more detail below are:

- Increasing to 50-55% the EU's existing commitment to cut CO₂ by 40% by 2030 (compared to 1990 levels).
- The ETS will be revised in line with the 50-55% objective, and will be extended or its impact strengthened to other sectors (candidates include air, maritime and road transport, energy-intensive industry...). In parallel the Commission will propose a carbon border tax to protect EU industry at risk of 'carbon leakage' from imports; the Commission recognising that the EU cannot solve climate change on its own and that international action remains the highest priority.
- Member States are expected to increase their existing renewable energy and energy efficiency objectives. To meet the current 2030 renewable energy target, the EU will already need to invest in between 150-200% of the wind and PV capacity that it installed between 2009 and 2020. Under the Green New Deal, the (already ambitious) renewable targets at Member States level are therefore set to further increase. The opportunities for large scale offshore wind and PV, with the consequent grid development, will dwarf the admittedly enormous changes that have taken place over the last decade.
- (Close to) Zero-carbon Hydrogen will be an essential part of the EU's energy mix as it moves towards a carbon-free future. The next Commission will signal the kick-start of this industry, in much the same way that the EU catalysed the exponential growth of the wind and PV markets in 2009.
- The state aid rules will be revised to reflect the Green New Deal objectives.
- Emissions standards for vehicles will be significantly strengthened.

¹ https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf.

- The Sustainable Finance Initiative will be reinforced, and the Commission will develop an EU green bond standard.
- The 'circular economy' will become a central pillar of the EU's industrial policy, presenting new challenges in particular for the plastics industry.

These are just a selection of the measures that will be tabled over the coming months; the Green New Deal goes far beyond impacting only on energy markets, the aim is to 'green' the entire economy. There is 'something for everyone' in the Green New Deal and industry needs to understand the extent of the changes that will now develop, and develop a proactive strategy to benefit from them.

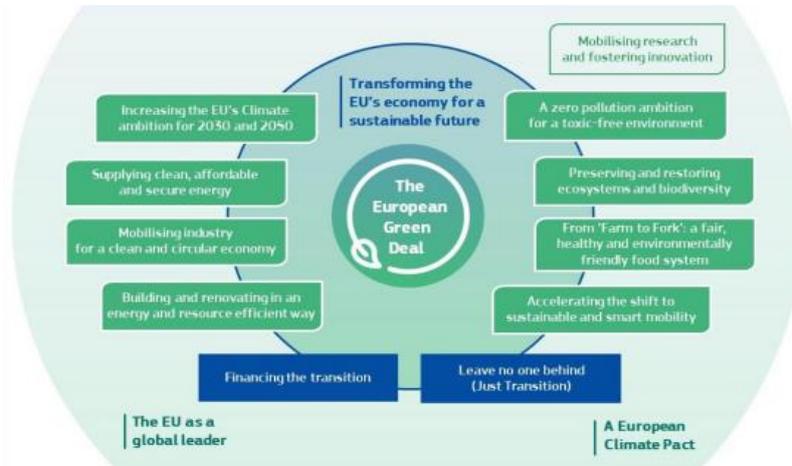
1. Introduction

The new European Commission has now² set out the key contents of the 'European Green New Deal', which is clearly intended to its 'flagship' for the next five years. The cornerstone of the Green New Deal is the EU's commitment, to which all Member States have now signed up except Poland, to put into a new 'Climate Law' that the Commission will table already this March, guaranteeing that the EU will be 'carbon zero' by 2050. Whilst, of course, any climate law adopted today can be modified tomorrow, this will be a clear statement of intent, as well as a standard to which all future legislation will have to meet.

The Communication acknowledges the need for international action on climate change, and underlines the importance of The Paris process. Equally it states an intention to ensure that climate change is an integral part of future trade agreements: *"On climate change more specifically, the EU's most recent agreements all include a binding commitment of the Parties to ratify and effectively implement the Paris Agreement. The Commission will propose to make the respect of the Paris agreement an essential element for all future comprehensive trade agreements"*. However, the action identified in the Communication, and the 100% decarbonisation commitment is not presented as being conditional to other countries also taking adequate action.

It is within this framework that the first immediate deliverable of the Green New Deal fits; the Commission will propose measures that will ensure that the EU will meet a 50-55% CO₂ cut already by 2030, up from the 40% cut agreed in 2014. The Green New Deal will, however, reach far further than simply introducing new targets and objectives, it is about the 'greening' of the entire economy; the following illustration from the Commission's Communication illustrates the scope of the initiative:

²https://ec.europa.eu/info/sites/info/files/european-green-deal-communication_en.pdf



2. The Emissions Trading System (ETS)

The Commission commits to bringing the ETS into line with the new 2030 objectives. Under the existing revision for 2020-2030, agreed in 2018, it was agreed that the speed of withdrawal of ETS certificates would increase from 1.74% per year to 2.2%, combined with a 'Market Stability Reserve' that acts when ETS prices are too low. This alone caused ETS prices to more than double.

Logically, if the EU's CO₂ reduction ambition is increased from -40% to -50-55%, one should expect this withdrawal rate to increase, to around 2.6-2.7% p.a, with a corresponding effect on ETS prices. No commitment is, however, made to tabling such a proposal, and given the likely effect on industry of such an increase it is far from certain the Member States would agree.

The Commission nonetheless commits to proposing the extension of the ETS into other presently exempt sectors, where free allowances are given due to the risk of 'carbon leakage' due to international competition. Steel, cement, chemicals and fertiliser are good examples. The Commission intends to propose a 'carbon border tax' to deal with this, taxing imported products from countries that do not have equivalent measures in place domestically. This will be legally contentious and economically difficult, but the Commission's intention is clear.

Finally, the Commission clearly intends to expand the ETS further into the transport sector, increasing its application to the airline industry, maritime and even, possibly, road transport.

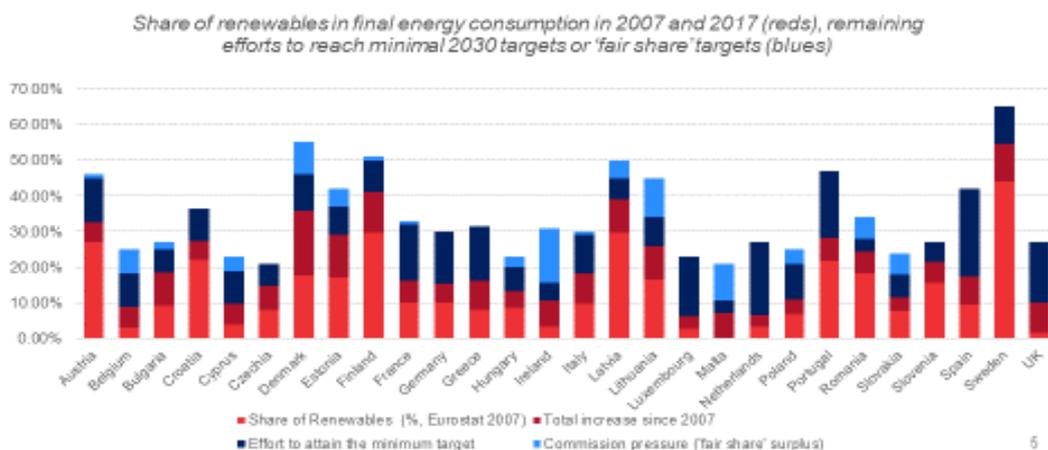
3. The Energy Sector

During the last Commission, new energy targets were agreed for the 2020-2030 period, together with the headline 40% CO₂ reduction objective. The EU committed that, by 2030, 32% of its entire energy demand would be met from renewable sources, together with a 32.5% improvement in energy efficiency.

Whilst 32% may not seem ambitious, in fact, the opposite is true. As it is difficult to get renewable energy into the industrial, buildings and transport sectors in the short term, electricity will have to make the lion's share of this increase.

To meet the 32% 'RES' target, between 50 and 55% of total EU electricity supply will need to be from renewable energy sources by 2030, up from 30.7% in 2017. To do this, the EU will need to install between 150 and 200% of the wind and PV capacity that it installed between 2009 and 2020. Some individual Member States have committed to move even quicker; Germany has a 65% RES electricity commitment for 2030, Denmark more than 100%, the Netherlands 66%, and Spain 74%.

The following chart illustrates quite how challenging the existing voluntarily set targets of individual Member States are, based on draft national action plans, comparing capacity installed since 2007 to the 2030 existing commitment. It also illustrates the additional effort that the Commission considers they need to make to meet their 'fair share' of the EU's overall 32% RES objective, which will most likely be reflected at least to some degree in the final plans that will shortly be published.



To achieve these commitments we can expect to see massive investments in PV and wind in Europe over the next decades, and above all in offshore wind, with major new complex integrated developments and massive infrastructure investment in the far North and Baltic seas, the emergence of floating offshore in the South of Europe, and major scale PV. New network investments, possibly HVDC underground cables, to bring this power to consumption centres, which are often inconveniently situated away from the best renewable generation sites will follow. Investors in these developments which succeed in mastering the highly complex and innovative regulatory and finance challenges that such projects provide, will be the major beneficiaries of the Green New Deal.

Equally, moving forwards, reports of the death of nuclear may well be exaggerated. For countries without copious offshore capacity, notably in Central Eastern Europe, we are seeing signs of new investment in Hungary and potentially in Slovakia and Poland.

The third part of the energy picture that is rapidly emerging relates to hydrogen. There are some parts of the economy that cannot sensibly be decarbonised using renewable electricity; for example, high heat energy-intensive industry (steel, cement, chemicals...), some transport (goods transport, some maritime), and some energy use for buildings. A lot of hydrogen is already used today in fertiliser

production, but this is grey hydrogen, which is produced by splitting natural gas into hydrogen and CO₂, the latter being vented into the atmosphere. Equally, renewable electricity may not be able to meet all the potential sources of demand that it may theoretically be appropriate for: it may not be possible to build the necessary interconnection lines to bring the extra power where it is needed, households may fail to convert from boilers to heat pumps in time, etc.

It is therefore common ground that a future decarbonised EU energy system will need an awful lot of zero-carbon hydrogen.

Zero-carbon hydrogen can be produced from renewable electricity (electricity being used to split water into hydrogen and oxygen - this is called 'green' hydrogen). Alternatively it can be produced from natural gas (this is called 'blue' hydrogen); instead of venting the resultant CO₂ into the atmosphere it is, however, either stored in the ground (for example in empty gas fields, via CCS), or converted into solid carbon which can then be used by industry ('pyrolysis').³

The Commission is committed to bringing forward legislation and support measures to frame and kick-start this industry, much as it did in 2009 for the renewable industry, which resulted in huge cost reductions and exponential investment in wind and PV, both in the EU and across the globe. The Commission is seeking to emulate this success in the hydrogen market. If the EU must be fully decarbonised by 2050, it is not possible to wait until 2040 to invest in getting the (currently high) cost of green and blue hydrogen down, and building up the enormous production and transport capacity that will be needed (hydrogen can be transported in modified existing gas pipelines).

It seems rather certain that this new legislation, which should be tabled by the Commission in June 2021, will therefore shape the regulatory framework for the future green and blue hydrogen market, setting standards, interoperability as well as establishing guarantees of origin. In addition, the Commission will certainly commit to support both R&D and demonstration facilities, using its Horizon (a minimum of 35% of the Commission's flagship R&D budget will be Paris-related) and ETS Innovation (demonstration) funds. Support will no doubt reach billions of Euros over the next 5 years, and combined with commitments to support H₂ development at national level (in particular Germany), this offers a significant opportunity to de-risk first-mover investments.

In addition, it appears highly likely that the Commission will seek to kick-start a market for green and blue hydrogen in the short-to-medium term. It might follow the model that it used for RES - minimum national targets leading Member States to tender for capacity and thus subsidise production - or even propose minimum blending requirements (one can inject 10-20% of hydrogen into the natural gas mix without anyone really noticing). However, given the cost of such measures, a more likely approach will be the above-mentioned extension of the ETS system to industries likely to use green and blue H₂ as they decarbonise, notably the steel, chemicals, cement and possibly fertiliser industries, combined with a carbon border tax.

The fact that the Commission has recognised the role that green and blue H₂ will need to play in the long-term energy mix is also likely to affect the way natural gas is viewed as a transition fuel, and the potential wider role of CCS in decarbonising industry in the run up to 2050. It is logical that the Commission will take a positive view on developing 'no-regrets' H₂ infrastructure (serving end-users that will definitely need H₂ to decarbonise), and even finally support the transition. Supporting the development of CCS more actively in the short-to-medium term, particularly offshore (it is unlikely that

³ As blue hydrogen production will never be truly zero-carbon due to fugitive methane emissions, a limited level of carbon offset (planting trees...) will need to be associated with blue hydrogen for it to be truly 'zero-carbon'.

onshore CO2 storage will gain much traction in EU countries due to environmental concerns), is equally a logical consequence of this evolution in thinking.

The companies that mastered the highly complex regulatory and financial environment of the early years of the renewable energy market are those that have the largest role in today's RES markets, and are reaping the benefits. Those that master what will evidently be an even more complex hydrogen market framework will be the ones that lead what must become the huge hydrogen market of the future. One thing is certain; without a major green and blue hydrogen industry, the EU will not succeed in decarbonising its economy.

Finally, the Commission announces a revision of the Energy Tax Directive, which currently establishes the minimum excise duty rates that Member States must apply to energy products for fuel, transport, and electricity. The Commission announces its intention to propose a revision of the Directive with the aim of ensuring that energy tax structures pursue Paris objectives, and to eliminate fossil fuel subsidies. It is too early to identify precisely the impact this may have, but it should be noted that today electricity attracts higher charges (for RES support) and often other taxes than other fuels such as natural gas, and that the tax treatment of air transport and maritime is generous compared to other modalities.

4. Transport

Transport is one of the key sectors that is proving difficult to decarbonise. It accounts for a quarter of the EU's greenhouse gas emissions, and is still growing. The Communication proposes to strengthen existing measures, and proposes some new ones. Whilst they may not be revolutionary in themselves, taken together they signal a number of difficult challenges ahead for vehicle manufacturers, European airlines and transport operators.

This being said, transport is, by its very nature, often an international activity, and the EU will need to balance decarbonisation objectives with maintaining competitiveness.

As mentioned above, the Commission commits to end fossil-fuel subsidies in the context of the revision of the Energy Taxation Directive, and refers explicitly to aviation and maritime fuels (although completely removing the favourable tax treatment compared to other forms of transport whilst maintaining international competitiveness will be challenging). It will also propose to extend the ETS to the maritime sector, and to reduce the EU Emissions Trading System allowances allocated for free to airlines. *"This will be coordinated with action at global level, notably at the International Civil Aviation Organization and International Maritime Organization".*

In addition, the Commission announces a further push on vehicle emission performance standards, and commits to propose more stringent air pollutant emissions standards for combustion-engine vehicles, as well as revising the legislation on CO2 emission performance standards for cars and vans, *"to ensure a clear pathway from 2025 onwards towards zero-emission mobility"*. Finally, and possibly most notably, the Commission commits to "consider applying" the ETS to road transport.

5. Investment and financing

According to the Commission, achieving the Green New Deal will require EUR 260 billion of additional annual investment, about 1.5% of 2018 GDP.

During the last Commission, the Sustainable Finance Initiative was launched, establishing a system that classifies economic activities according to whether or not they contribute to decarbonisation/Paris-related activities ('taxonomy'). The aim is to improve disclosure requirements on how institutional investors integrate environmental, social and governance (ESG) factors in their risk processes and to create a new category of benchmarks to help investors compare the carbon footprint of their investments. As ESG pressure mounts on companies, this initiative will have considerable effects on financial markets and company reporting.

These proposals are currently being finalised, and one can expect that they will enter into law soon. The current Commission seeks to build on this and extend its impact: *"Sustainability should be further embedded into the corporate governance framework, as many companies still focus too much on short-term financial performance compared to their long-term development and sustainability aspects. At the same time, companies and financial institutions will need to increase their disclosure on climate and environmental data so that investors are fully informed about the sustainability of their investments. To this end, the Commission will review the Non-Financial Reporting Directive."* The Commission also intends to develop an EU green bond standard.

The Commission will also focus on EU spending, ensuring that it is to a greater extent 'Paris-focused'. The EIB has already set the standard here, with the newly adopted target of doubling its climate target from 25% to 50% by 2025.

Clearly, therefore, the Green New Deal will provide both challenges and opportunities for the finance industry.

Finally, as coal will come under increasing pressure to be phased out, the Green New Deal announces a 'Just Transition Fund', targeted to invest EUR 100 Billion between 2021-2027 to assist coal regions where mines are to be closed. The Commission has recently clarified how this will be financed.⁴

- EUR 7.5 billion of fresh EU funds. To qualify for this funding Member States will need to commit to match grants with commitments from national allocations from European Social and Regional Funds, plus own money, leading to total investments of EUR 30 and EUR 50 billion.
- A dedicated just transition scheme under InvestEU (the successor to the EFSI Fund) to mobilise up to EUR 45 billion of investments, and
- An EIB facility to mobilise between EUR 25 and EUR 30 billion of public sector investments.

6. The circular economy

A major part of the Communication is devoted to the 'circular economy'. Whilst the precise measures to be tabled are not indicated, the Commission announces a 'new circular economy action plan' and a 'sustainable products policy' based on a common methodology and principles. For many industries this merits close attention; the Commission indicates that it will prioritise reducing and reusing materials before recycling them and will focus on *"resource-intensive sectors such as textiles, construction, electronics and plastics"*.

It is clear therefore that this Commission will pose challenges for the plastics industry. It commits to *"follow up on the 2018 plastics strategy focusing, among other things, on measures to tackle intentionally added micro plastics and unintentional releases of plastics, for example from textiles"*

⁴ https://ec.europa.eu/commission/presscorner/detail/en/ip_20_17

and tyre abrasion", and "develop requirements to ensure that all packaging in the EU market is reusable or recyclable in an economically viable manner by 2030".

7. Buildings and renovation

Energy efficiency is always quoted by the Commission as being Europe's most important energy policy. However, achieving it is far from simple, particularly with respect to buildings (households account for about 26% of EU energy consumption (excluding services)). Furthermore, there is relatively little that can be done about this at EU level, in addition to the measures already taken (building codes, product standards). Thus, whilst the Commission announces that Member States should engage in a 'renovation wave' of public and private buildings and that it will work with stakeholders on a new initiative on renovation in 2020, few new really effective and concrete measures are announced.

This being said, the EU energy governance measures already in place,⁵ combined with the ambitious energy efficiency targets set by the individual Member States, inevitably means that building renovation will be a major growth sector over the next decades, as Member States target and increase subsidies to meet national objectives. Companies developing business models that profit from these subsidies and create revocation models at scale based on innovative technologies look set to profit considerably. Building renovation may not be the most glamorous focus of the Green New Deal, but given the size of the challenge, it may be one of the areas that offers the greatest opportunities.

8. Competition Policy

E.V.P. Vestager, responsible for competition policy in the new Commission has already announced an intention to review the manner in which the Commission carries out market definition (not least to head-off current Franco-German arguments for a more 'industry-friendly' competition policy). This will no doubt consider what, if anything, is required to ensure that competition policy in the energy sector contributes to, rather than constrains, the achievement of the EU's Paris objectives. Whilst this will never be a 'trump card' in pushing through deals that clearly 'significantly impede effective competition', it may well play a role in future at a more subtle level.

The Green New Deal refers to the ongoing preparations for the revision of the environmental and energy State aid guidelines, committing to their revision by 2021 *"to reflect the policy objectives of the European Green Deal, supporting a cost-effective transition to climate neutrality by 2050, and will facilitate the phasing out of fossil fuels...These revisions are also an opportunity to address market barriers to the deployment of clean products."*

This revision is unlikely to significantly change the basic approach taken by the Commission to RES projects (significant projects to be tendered) or capacity mechanisms (also tendering). However, it may refocus aid to coal and may also provide clarity on how the Commission will deal with aid to hydrogen projects.

⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1999&from=EN>

9. Baker McKenzie's Energy and Climate Team

Fully understanding the regulatory changes flowing from the Green New Deal will be an essential part of practically any EU company's strategy formation. Mastering all the different interwoven and mutually reinforcing elements will be far from simple.

Baker McKenzie's team, bringing together industry-leading experts in the climate, energy, tax and finance and other relevant disciplines provide a comprehensive service to assist clients in this task.

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