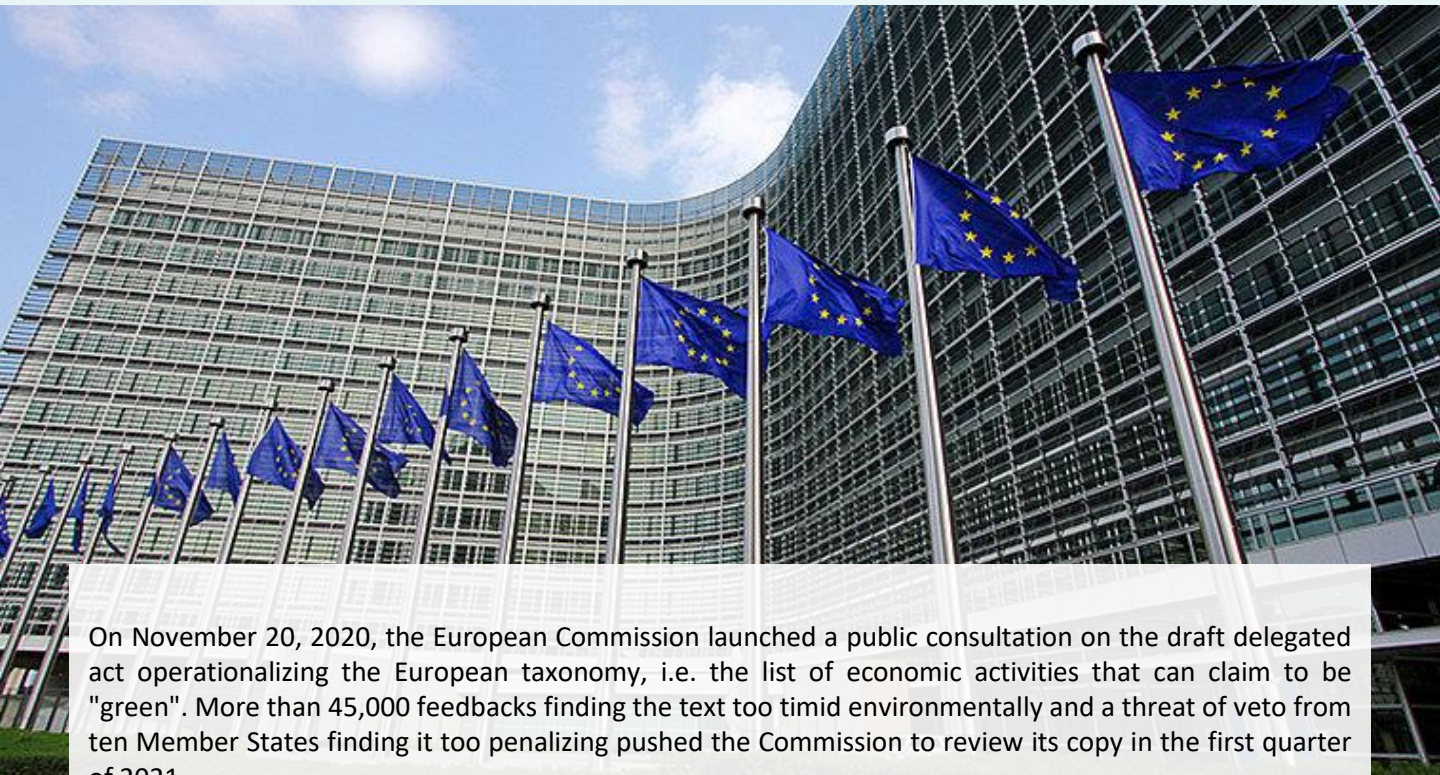


Delayed start for the European taxonomy on sustainable activities



On November 20, 2020, the European Commission launched a public consultation on the draft delegated act operationalizing the European taxonomy, i.e. the list of economic activities that can claim to be "green". More than 45,000 feedbacks finding the text too timid environmentally and a threat of veto from ten Member States finding it too penalizing pushed the Commission to review its copy in the first quarter of 2021.

On March 23, 2021, the leak of the Commission's new draft delegated act renewed tensions over the inclusion of natural gas-fired power plants, a battleground for irreconcilable players both inside and outside the Commission. Despite the postponement of the official publication, the debates remain heated on this highly sensitive subject, politically, economically and environmentally.

A showdown awaits the Commission, as it tries to find a balance between the threats of veto and the environmental ambitions of the project, which is intended to be a cornerstone and a global reference for sustainable finance. This clash reveals a West-East divide between countries still largely dependent on carbon-based electricity sources and those more advanced in the transition of their electricity mix.

This expert opinion, written in March 2021, aims to shed light on the ins and outs of a European project in turmoil.

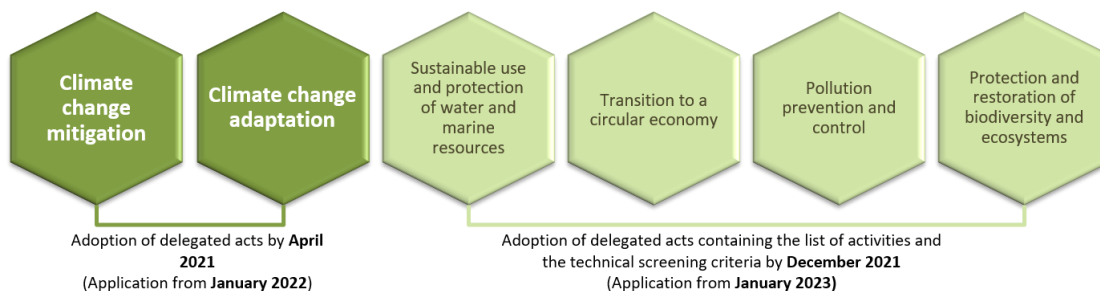


1 – Some background: what is the European taxonomy about?

On March 8, 2018, the European Commission announced the launch of its Action Plan on sustainable finance, for a "greener and cleaner" economy. Drawing heavily on the recommendations of the High-Level Expert Group on sustainable finance established in 2016, the European roadmap included as a prerequisite to "establish a common language for sustainable finance, i.e. a unified **EU classification system - or taxonomy** – to define what is sustainable and to identify areas where sustainable investments can make the biggest impact" [1].

The logic is simple: faced with multiple challenges (climate, biodiversity, pollution, resource and waste management, etc.), Europe is deploying ambitious environmental objectives, notably within its Green Deal. To keep these promises, public investments will not be enough: it is essential to be able to direct private and public capital towards the sectors and economic activities that are most likely to have a significant positive impact. While financial actors deplore the lack of clarity in distinguishing sustainable activities without greenwashing, the taxonomy proposes to identify these activities and their associated minimum environmental performance, in a scientific and transparent manner, in line with the different European ambitions.

The "Regulation on the establishment of a framework to facilitate sustainable investment", adopted by the Parliament and the Council on June 18, 2020 and entered into force in July 2020, sets the framework for the taxonomy [2][3]. For an economic activity to be considered green, it will have to be covered by the taxonomy and demonstrate that it makes a substantial contribution to an environmental objective without causing significant harm to the other five environmental objectives ("DNSH" criteria, for Do Not Significant Harm). In addition, the activity will have to meet certain social minima (see infographic below). However, the regulation does not explicitly contain the taxonomy itself, i.e. the list of activities and the associated technical criteria: Articles 10 to 15 empower the Commission to define and publish these activities in the form of delegated acts.



- An economic activity shall qualify as environmentally sustainable where that economic activity:
 1. **Contributes substantially** to one or more of the 6 environmental objectives above
 2. **Does not significantly harm** any of the environmental objectives ("DNSH" criteria)
 3. Is carried out in compliance with **minimum safeguards** (OECD Guidelines for Multinational Enterprises, UN Guiding Principles on Business and Human Rights,...)
 4. Complies with **technical screening criteria** that have been established by the Commission in the delegated acts

Environmental objectives and prerequisites – Source: I Care & Consult

[1] https://ec.europa.eu/commission/presscorner/detail/en/IP_18_1404

[2] <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852>

[3] The obligations relating to the publication of the share of activities "eligible" for the taxonomy will only be effective from the entry into force of the delegated acts detailing these activities and their eligibility criteria, if any (January 2022 for climate objectives, January 2023 for other objectives)

To advise the Commission, the Technical Expert Group on sustainable finance (the TEG) had been mandated in 2018 to provide its recommendations for activities and technical screening criteria to be included for the climate taxonomy (activities that can contribute to climate change mitigation and adaptation). Based on the latest TEG report [4] of March 2020, the Commission proposed for public consultation a draft delegated act for both climate objectives in November 2020. It is this delegated act whose adoption (scheduled for the end of December 2020) has been delayed by more than three months in the wake of the veto threats against it.



2 – A text caught in the crossfire

In order to avoid critics, the Commission had done everything it could to defuse the situation: Relying on an independent expert group, the TEG, whose rigorous work has been recognized by most; claiming a robust methodology based on universally recognized scientific knowledge (IPCC and IEA in particular); referring to environmental targets fixed by the EU itself; conducting throughout the project several rounds of consultations within the Commission and the Member States, as well as public consultations to allow the various stakeholders to have a say and to form an idea in advance on the direction of the taxonomy in the making. Finally, the tricky question of the integration of nuclear power, which has crystallized opposition at all levels, had been postponed without giving any guarantees to the supporters and opponents of nuclear power [5].

Unsurprisingly, when faced with such a long-awaited and far-reaching text, one could expect numerous critics from actors with incompatible views. Among the many concerns, we find industrialists and experts criticizing the criteria for being too ambitious [6], or deploring a too tiny sectoral coverage of the taxonomy so far; on the other side, we find NGOs and members of civil society calling for a more ambitious environmental policy; and remarks about the complexity of applying the taxonomy, due to the lack of data in companies. In addition, changes of certain criteria from one version to the next (such as the share of eligible existing buildings) may have led to a lack of clarity for the sector stakeholders concerned [7].

With more than 45,000 feedbacks for the public consultation on the draft delegated act in November-December 2020, the exercise was marked by the environmental advocacy carried by about twenty NGOs, composing the overwhelming majority of the comments received. This feedback, based on a fifty-page technical paper, welcomed the progress made in the text on a few toughened criteria or new sectors covered that were deemed useful, urged the Commission to return to the TEG's recommendations in the event of a weakening of the criteria, and called for the deletion of several activities deemed too harmful to be sustainable (livestock farming, bioenergy, maritime freight, etc.).

[4] https://ec.europa.eu/info/files/200309-sustainable-finance-teg-final-report-taxonomy_en

[5] While there is no doubt that nuclear can make a substantial contribution to climate change mitigation, its ability to do so without undermining the other five environmental goals is not clear-cut; the Joint Research Center was commissioned to provide a report on the issue in 2021 to inform decision-making on a formal inclusion or exclusion within the taxonomy. This JRC report, leaked in late March 2021, can be found here:

https://politico.eu/wp-content/uploads/2021/03/26/JRC-report_March-2021-clean-Copy-printed.pdf

[6] See for example the open letter from the aluminium sector: <https://www.euractiv.com/section/energy-environment/opinion/eu-taxonomy-for-sustainable-activities-a-means-to-an-end-that-risks-being-the-end-of-many-european-industries/>

[7] See statement by Sean Kidney, former TEG member: <https://www.environmental-finance.com/content/analysis/eu-taxonomy-has-messed-up-buildings-criteria.html>



Countries threatening to oppose the delegated act as proposed in November 2020 by the Commission (in orange)

Most importantly, the wave of comments applauded the retention of the 100 gCO₂/kWh threshold for electricity generation (while requesting, again based on the TEG recommendations, to keep a declining trajectory of this threshold to reach 0 g by 2050), *de facto* excluding any recognition of fossil fuels (coal, oil, natural gas). Multiple NGO feedback warned the Commission: *“If you weaken this standard because of the heavy pressure from the industry, you will bring the entire taxonomy into disrepute and contradict the EU's own 2050 climate law”*.

It is precisely the scope of this threshold that has crystallized a large-scale opposition: at the end of 2020, ten Member States (see map above) and some fifty Members of the European Parliament threatened to veto the entire taxonomy project if natural gas was not recognized as a transition energy [8]. On March 23, the new draft delegated act revealed by the magazine Contexte [9] proposed a criterion integrating gas-fired power plants under conditions, causing outrage among NGOs.

Process of delegated act adoption

- To better understand the scope of the veto threats in the draft delegated act published in November 2020, it is worth taking a quick look at the process by which such a text gets adopted. As mentioned earlier in this article, the European Commission has been granted authority by the Parliament and the Council to detail the list of activities covered by the taxonomy and the associated technical criteria.
- Once the Commission has adopted a delegated act, both the European Parliament and the European Council have a period of time, generally two months, to formulate possible objections or even to veto it [10]. To do so, the European Parliament votes by a simple majority, while the Council votes by a qualified majority. The latter is achieved under two conditions: 55% of Member States (15 out of 27), representing at least 65% of the European population. It should be noted that as of January 1, 2020, the ten countries that voted against the text account for a little less than 24% of the European population.

[8] <https://www.euractiv.com/section/energy-environment/news/brussels-postponed-green-finance-rules-after-10-eu-states-wielded-veto/>

[9] https://www.contexte.com/article/energie/info-contexte-les-nouveaux-criteres-de-bruxelles-pour-classifier-les-activites-vertes_129146.html

[10] https://ec.europa.eu/info/law/law-making-process/adopting-eu-law/implementing-and-delegated-acts_fr



3 – Natural gas, the main point of conflict

An energy source with several challenges

Natural gas is used mainly for energy production (electricity and heat) and in the petrochemical sector. It is the third largest source of primary energy in the world (after oil and coal) and is growing rapidly. Like any fossil source, according to BP, natural gas reserves are limited and estimated at 50 years of production - this figure evolving with discoveries and technical developments, such as recently the exploitation of non-conventional hydrocarbons [11].

Natural gas-fired power plants, which are a dispatchable source, produce nearly 20% of Europe's electricity. In terms of greenhouse gas emissions, the production of one kilowatt-hour of electricity is associated with approximately 400 gCO₂eq of greenhouse gases, with variability depending on the technology used; this is less than fuel oil or coal, but much more than renewable or nuclear sources (see infographic on the right). In fact, even with the most advanced technologies, it is not possible for gas to go below the 100 gCO₂eq/kWh threshold advocated by the taxonomy text in the first instance [12].

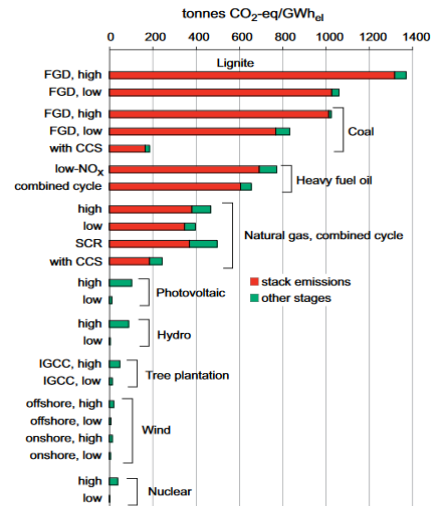
However, the reason why its inclusion in the taxonomy is creating such a debate is that natural gas is a crucial issue because of the role it could play for some countries with a particularly carbon-intensive electricity mix:

- **A potential to phase out for coal-fired plants**

For the ten Member States that are in favor of including natural gas in the taxonomy, this energy source appears to be necessary to decarbonize their electricity mix, which is still highly carbon-intensive today (see graph on next page).

For these countries, led by Poland, the difference in the maturity of their national energy mixes must be taken into account when defining the criteria for the taxonomy, and including natural gas-fired power plants as a transitional technology would be necessary to reduce GHG emissions while securing the electricity supply.

The November 2020 draft delegated act does not currently take into account the national electricity mix context for power generation, unlike for example T&D activities [13].



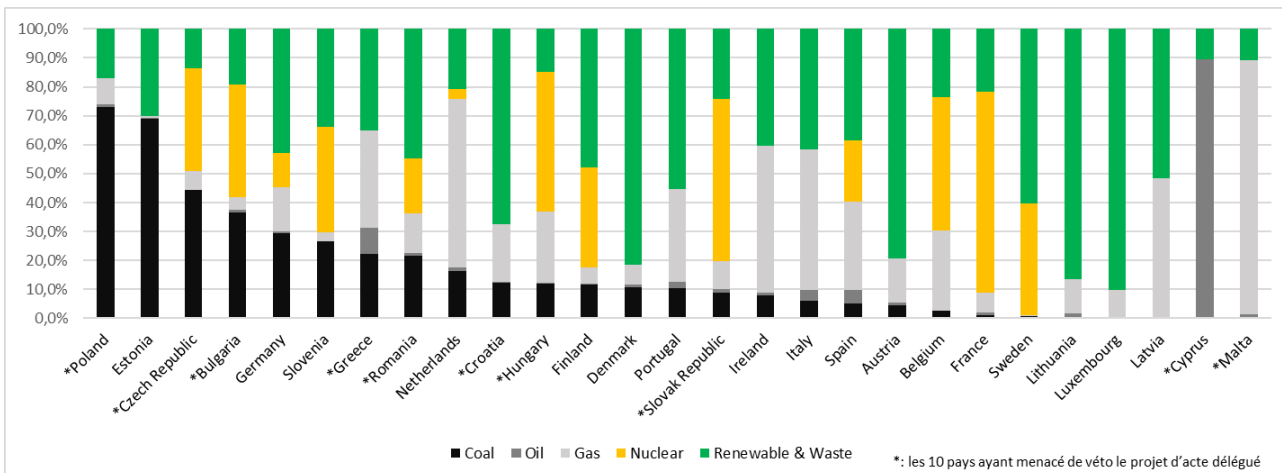
Emission factors for different electricity generation technologies.

Source: IPCC, AR4

[11] BP Statistical Review, 2020

[12] It should be noted that the taxonomy, in the spirit of the TEG, is intended to be technology-agnostic: the criteria proposed in November 2020 does not formally exclude natural gas, but proposes a quantitative criteria towards de facto unattainable electricity generation via natural gas.

[13] For electricity transmission and distribution (T&D), one of the criteria proposes to look at whether the electricity system as a whole is on the right decarbonization path and, if so, makes any T&D activity eligible.



Electricity mix of the 27 Member States of the European Union - Source: IEA, 2019

The American case, a good example?

The U.S. example can illustrate the potential for GHG emission reductions from the transition of electricity from coal to natural gas. In 2016, natural gas replaced coal as the main source of electricity production in the United States, confirming a trend of "nibbling" at the share of coal by natural gas over the past two decades. Donald Trump's term in office will thus have been marked by a significant drop in the country's GHG emissions. In 2019, the United States is even the country with the largest drop in CO₂ emissions, the result of a 15% decrease in the amount of coal used for electricity generation [14].

However, this is not the result of any environmental policy by Trump, who is, on the contrary, a fervent supporter of the coal industry. It is the decline in the competitiveness of the latter in the face of abundant shale gas, which has been exploited in recent years and that has caused this transition.

- **The dispatchable nature of the electric production from gas to be taken into account?**

Some stakeholders point out that, while there are indeed low GHG-emitting ways to produce electricity, not all sources are equal. In particular, gas is a dispatchable energy source, as opposed to intermittent sources such as solar or wind power.

According to the technical screening criteria defined in the November 2020 draft delegated act, only hydroelectricity is in the same time technologically mature, eligible for the taxonomy and dispatchable [15]. However, this source, due to its geographical and hydrometric limitations, cannot be deployed anywhere and in any proportion [16].

[14] <https://www.iea.org/articles/global-co2-emissions-in-2019>

[15] Other controllable technologies may be eligible for the taxonomy criteria (e.g. biogas plant) but are far from generating electricity in sufficient volumes, due to lack of available biogas.

[16] Some countries can rely on their hydroelectric production capacities (e.g. Norway), but this requires a privileged situation that remains marginal on a European or global scale.

Indeed, there are scenarios for 2050 that consider the feasibility of a 100% renewable electricity system [17]. But such a system is not feasible in the short and medium term, due to issues related to grid stability and storage needs. Thus, it remains necessary today to maintain a base of dispatchable energies in the electricity mix. With the exception of nuclear power, which is discussed earlier in this article, natural gas could claim to be the least carbon-intensive energy source that is both mature, dispatchable and deployable on the desired scale and proportions.

The delegated act submitted for consultation at the end of November 2020 does not distinguish between dispatchable and intermittent power generation activities, even though the service provided is not identical. This classification does not allow for the development of the back-up and stabilizing role that gas can play in the transition under certain conditions of use.

- **Latest news: towards a partial integration of gas?**

On March 23, the new draft delegated act was published by the magazine Contexte [18] and revealed a proposed criteria integrating gas-fired power plants under certain conditions: only projects replacing fuel-intensive thermal power plants located in regions "in transition" by less carbon-intensive thermal power plants would be deemed "eligible". In addition, the dismantling of the replaced plant and the commissioning of the new plant should take place before 2025.

As usual, the European Commission has not commented on this leaked document, but the document has not failed to make Member States, NGOs and politicians react. According to WWF, based on data from the European Environment Agency, if this criteria is adopted, all European gas power plant projects would be eligible for the taxonomy criteria, locking in emissions in the medium to long term and attracting funding to the disadvantage of other projects aligned with the taxonomy [19].

On the other side of the spectrum, the countries that have been campaigning since December for the inclusion of gas (with the exception of Slovakia) have deemed the text to be insufficient, finding the 2025 deadline too early. In a document dated March 26, these nine countries urged the Commission to revise the text to give more space to natural gas [20].

Although nothing has been decided yet, this document at least reveals that the inclusion of gas is becoming more and more likely in the final version of the delegated act.

[17] On a French scale: <https://www.rte-france.com/actualites/rte-aie-publient-etude-forte-part-energies-renouvelables-horizon-2050>.

On a global scale: <http://energywatchgroup.org/new-study-global-energy-system-based-100-renewable-energy>

[18] https://www.contexte.com/article/energie/info-contexte-les-nouveaux-criteres-de-bruxelles-pour-classifier-les-activites-vertes_129146.html

[19] <270 gCO₂e/kWh, -50% direct GHG emissions and compatibility with low-carbon fuels

[20] <https://www.wwf.eu/?2555966/European-Commission-trashes-science-based-recommendations-by-including-fossil-fuels-in-green-taxonomy-proposal>

- **CAVEAT: the consequences of the integration of natural gas in the taxonomy**

The objective of the taxonomy is to direct investments towards the least carbon-intensive technologies possible in the various sectors of activity it covers and to avoid "locking in" GHG emissions over the long term by investing in long-lived assets. This is the problem with natural gas. The associated infrastructure projects are particularly heavy, especially in the EU, which imports almost all of the natural gas it consumes.

Their construction also implies long lifespans and amortization periods (of the order of half a century), which raises the risk of locking in emissions linked to the use of gas over the long term, even if gas infrastructures can be adapted to incorporate "green" gas and are therefore less "locked in" than assets dedicated solely to fossil fuel production.

Finally, as mentioned earlier in this article, natural gas is also a red line for the advocates of its exclusion. The latter will be very vigilant to ensure that the technical criteria related to electricity production remain as demanding as the one proposed by the TEG and presented in the draft delegated act (100gCO₂/kWh), and are calling for the return of the mention of a decreasing trajectory for this threshold. In particular, several Member States [21] have expressed their concern about the integration of this energy source in a letter to the Commission.

Geopolitical issues that fuel the turmoil

Beyond environmental issues, the case of natural gas reveals many geopolitical dimensions. For example, seven [22] of the ten countries advocating the inclusion of natural gas in the taxonomy are also members of the Three Seas Initiative, which is a concrete example of enhanced cooperation between twelve Central European countries [23]. One of the flagship projects associated with this initiative is the development of an LNG infrastructure, with terminals in Poland and Croatia and a connecting pipeline. These infrastructures should make it possible to receive American LNG, as the United States has become a major exporter with the massive exploitation of shale gas in recent years.

This commercial opportunity is thus pushing the United States to fiercely oppose the Nord-Stream 2 pipeline, which would link Russia directly to Germany [24], in addition to more geopolitical considerations: the Old Continent's dependence on Russian hydrocarbons would contribute to supplying Russia with foreign currency [25], while at the same time leaving it with strategic advantages, particularly in the face of Ukraine, which is in conflict with Russia (Crimea, Donbass) and through which most of the Russian gas destined for the EU transits, and which would be short-circuited with Nord-Stream 2.

[21] <https://www.euractiv.com/section/energy-environment/news/leak-eu-considers-expanding-role-of-gas-in-green-finance/>

[22] Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Slovakia

[23] <https://www.diploweb.com/Le-gaz-naturel-en-Europe-quels-enjeux-energetiques-et-geopolitiques-Premiere-partie.html>

[24] Work on this gas pipeline project through the Baltic Sea, bypassing Ukraine and Poland, which had been halted under US sanctions, resumed in February 2021 in Danish territorial waters.

[25] Hydrocarbons account for nearly two-thirds of Russia's exports of goods.



The European Commission is at a turning point concerning the future of the EU taxonomy. After almost three years of expert consultation, within the TEG and the Commission's directorates, the project is inexorably facing more political considerations: some Member States, parliamentarians and industrialists, condemn its overly strict criteria, while NGOs militate for no concessions to be made on scientifically supported environmental ambitions.

On the tightrope between opponents and supporters of the inclusion of natural gas, the Commission faces a difficult choice. To force its way through by maintaining the strict exclusion of gas would undermine the consensual spirit in which the project was built, by attracting the discontent of Member States for which gas will have an important role to play in the transition of the electricity mix. On the contrary, the inclusion of gas is bound to provoke reactions from NGOs and civil society, for whom the inclusion of gas would *de facto* make the taxonomy a tool for greenwashing.

The Commission seems to be looking for a third way, by including natural gas in a partial and very context-dependent way in order to respond to the complexity of managing the transition of the electricity system with its geographical diversity, without giving a complete blank check to gas. The devil will be in the details in this balancing act with significant economic and environmental implications. The complex issue of natural gas promises to be debated again and to cause a stir when the delegated act is officially published, expected in April.

Stay tuned for the next twists and turns in the upcoming weeks!



On the tightrope between opponents and supporters of the inclusion of natural gas, the Commission faces a difficult choice

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