

ENERGY AND ENVIRONMENTAL LAW

Beginning our special feature looking at energy and environmental law, *Lawyer Monthly* speaks to Ana Stanic from E&A Law.



You have spoken on various topics in relation to the Energy policy in the European Union – how comprehensive do you feel the policies are?

According to the European Commission ensuring safe, secure, sustainable and affordable energy is key to our continued prosperity in the EU. It estimates that more than 200 billion EUR worth of investments are needed by 2020 to modernise and expand the EU's energy infrastructure, provide for increasing and changing demand, interconnect networks across borders and integrate electricity from renewable sources.

Legal certainty and a robust and comprehensive legislative framework are key to ensuring investment in the energy sector, be it in energy infrastructure, energy efficiency, or renewables.

Yet Maros Šefcovic, the Vice-President of the European Commission responsible for the Energy Union, told us in his State of the Energy Union report in November last year that 2016 will be the year in which "we will lay the foundations of a robust governance system bringing predictability and transparency". Is he saying that up to now we have not had a predictable and transparent framework in the EU? Or is this just an attempt to justify the huge amount of legislative changes that will befall the industry this year?

Using the conflict in Ukraine as a pretext, the Commission has set out an ambitious legislative agenda for this year which includes a revision of the Security of Gas Supply Regulation, a revision of the Decision on Intergovernmental

Agreements in the Field of Energy, the adoption of a Strategy for Liquefied Natural Gas and Storage and a Strategy for Heating and Cooling. In addition, it envisages that the Emissions Trading Systems ("ETS") Directive will be revised this year, as well as the Energy Efficiency Directive. And this seems to be only the tip of the legislative iceberg. The Commission has announced it is preparing new legislation in the electricity sector as well.

After the Commission's 2014 deadline for the implementation of the internal electricity and gas market came and went, we now have Mr Šefcovic promising that "2016 will be a year of delivery". Other than significant legislative changes it is not clear what will be delivered in 2016.

The fear of many in the industry is that the Energy Union is much more about the Commission's ambition to centrally manage the energy sector from Brussels and much less about transparent and predictable market based rules. It was Mr Šefcovic who described the Energy Union in 2014 as the EU acting as a single gas buyer – an idea that is anathema to a liberalised energy market.

There has been a significant increase in regulatory risk since the EU gained competences in energy and foreign direct investment with the adoption of the Lisbon Treaty. As a great believer in the European project this has been of great concern to me. The first risk relates to the increased politicisation of energy matters. The current discussions concerning Nord Stream 2 is an example. Nord Stream 2 is a gas pipeline project to bring additional volumes of Russian gas to Europe. In addition to Gazprom the following companies are involved: Wintershall, Shell, E.ON, ENGIE, and OMV. The project has been criticised as being politically motivated. Yet the ones calling to stop its construction are using political rhetoric rather than legal arguments. Just a few days ago President Donald Tusk came out against Nord Stream 2 claiming that it is in "violation of the energy security requirements". But there are no such requirements in the EU acquis. Given the size of this and similar projects, there is no doubt that they will only be constructed if they are commercially viable. To the extent they breach EU law there are clear legal mechanisms to ensure they will not go ahead. Resort to political rhetoric rather than robust legal arguments undermines legal certainty in the EU, damaging our ability to attract investment throughout the EU.

I have discussed the increased regulatory risks that energy companies face in the EU in an article I wrote recently for the International Comparative Legal Guide 2016 (http://ealaw.eu/static/pdf/OG16_Chapter-5_EA%20Law.pdf). Another important risk I discuss there relates to the lack of certainty regarding the interpretation and application of EU law. By way of example, there is uncertainty as to the interpretation of the scope of the exemption from, inter alia, third party access to pipelines under the Third Energy Package. Article 36 of the Gas Directive (EC 2009/73) makes clear that an exemption can only be accorded to gas pipelines which fall within the definition of an "interconnector". An interconnector is defined as a "transmission system line which crosses or spans a border between Member States for the sole purpose of connecting the national transmission systems of those Member States". In other words in order to be an interconnector the transmission system line must (i) "cross or span the borders" of two EU member states and (ii) be built for the "sole purpose" of connecting the two transmission

systems. Yet the Commission approved the decision granting the Trans-Adriatic Pipeline (TAP) an exemption in 2013 even though it does not seem to meet these requirements. First, it does not span two EU member states since Albania is not part of the EU. Second, it is not being built for the sole purpose of connecting two transmission systems as it will have an exit point in Albania. Attempts by other project sponsors to seek an exemption or to be listed as projects of common interest by invoking the TAP exemption as extending the scope of an "interconnector" have so far been rejected by the Commission.

The third regulatory risk concerns the length of time which the Commission takes to issue decisions. By way of example, the Commission has not yet issued a decision regarding Socar's purchase of DESFA, the Greek transmission operator, even though EU law requires a decision on the certification to be issued within 4 months. The purchase was agreed back in December 2013 with the encouragement of the Commission who saw it as key to stopping Gazprom getting its hands on DESFA. It has now been reported that Socar will have to reduce its planned shareholding in the Greek company from 66 percent to 49 percent in order to comply with EU law. Surprisingly, the Commission has only invoked EU merger rules as the basis for the required divestiture. It is in fact Article 11 of the Gas Directive (known as the Gazprom clause) that expressly requires this divestiture since it prohibits a non-EU gas producer from owning a majority shareholding in a transmission system company. Socar is an Azerbaijan state-owned gas producer. The Commission's failure to date to invoke Article 11 remains unexplained and raises questions regarding the scope of this Article and the certification procedure as a whole.

In countries such as the UK with a robust judicial review system we are used to being able to challenge government decisions, interpretation of laws and changes to the law. In order to minimise regulatory risk in the EU we must ensure that there is a similarly robust system of review of the Commission's decisions at the EU level. Many energy companies are reluctant to challenge the Commission before the Court of Justice of the European Union (Court). There is at the very least a perception that the Court is not willing to review the Commission's decisions with the rigour that Courts in the UK adopt when reviewing the decisions of our government.

What are the implications for existing and future energy investments in the EU? What are the complexities in the relations between the EU and international investment law and how do they impact investment in the sector?

Unless steps are taken to reduce regulatory risks,

the EU will not be able to attract much-needed investment. As I mentioned, according to the Commission more than Euro 200 bn worth of investments are needed by 2020 in the energy sector. Much of this investment will need to come from outside the EU.

To attract this investment we need to convince investors that the EU is a secure place to do business. A stable and predictable legislative framework is key. Another matter of concern to foreign investors is the complex and increasingly fraught relationship between EU law and international law. If this is not addressed, it will undoubtedly deter investment. There is growing uncertainty about the willingness of the EU to comply with its obligations under international law and to permit EU member states to comply with theirs. The most striking example of the increasingly unilateralist approach taken by the Commission in recent years was its decision in March 2014 to order Romania not to enforce an international investment treaty award issued by the International Centre for Settlement of Investment Disputes (Ioan Micula, Viorel Micula, S.G. European Food S.A. et al v Romania (ICSID Case No. ARB/05/20)). This amounted to a breach of an express provision of the Convention on the Settlement of Investment Disputes.

The Commission's vehement challenge of bilateral investment treaties (BITs) and its refusal to accept that international arbitral tribunals are able to decide on matters of EU laws are further examples of increasing tensions between EU and international law. There is no doubt that there is a difference in the nature and scope of the rights granted to investors under EU law on the one hand and under the BITs, the Energy Charter Treaty (ECT) and international law on the other. Not only is the right to fair and equitable treatment under international investment law broader in scope than the EU law principle of legitimate expectation, but the right to arbitrate a dispute with an EU member state or the EU is seen as guaranteeing a more effective mechanism for dispute resolution than bringing a claim before a national court of a member state or the Court.

As an expert in energy and environmental law, what would you say are the challenges that the Hinkley Point C project is facing? How risky is the project for both EDF and the UK government?

It is clear that the project is facing considerable challenges. First, it faces considerable financial challenges not least because EDF's shares have fallen 55 per cent in the past year. This has made it very difficult for the company to finance the construction of two European Pressurised Reactors (EPR) at Hinkley Point. It has to raise some

£12.4 bn at a time when its market capitalisation is only £16.3 bn. At the same time EDF is looking at extending the life of four of its existing power plants at a cost of £77 bn. Its ability to secure financing depends on the terms it is able to strike with its partner in the project, China General Nuclear Power Group, and the readiness of the French state further to underwrite or finance the project (EDF is 85 % owned by the French state).

The project also faces regulatory and reputational risks. The UK government agreed to subsidise the Hinkley Point project to the tune of £16bn by entering into contracts for difference which guarantee EDF and its partners a price of £92.50 for each megawatt of power generated over a period of 35 years. In addition, the UK government has agreed to underwrite up to £10 bn of debt on the project. The European Commission approved the state aid package in October 2014. The Austrian government and a group of utility companies from Austria and Germany, collectively known as Action Alliance, challenged the Commission's decision before the Court in July last year. The Court has not yet set a date for the hearing. There has also been a public outcry against the project in the UK since the strike price is almost double the current market price for electricity. Most recently French trade unions have come out against the project because of its potential negative impact on the company's finances.

There are also many in the industry who challenge the EPC technology proposed for Hinkley on the grounds that it is unproven, over-complex, and too expensive. There are growing calls for the UK to consider building small modular reactors (SMRs) instead. DECC believes that these are faster, cheaper and easier to deploy than large reactors and is considering building them near industrial sites to provide localised baseload power. In principle, modular construction is easier and low cap-ex should make SMRs more bankable. However, if you are going to have to obtain a licence for a site, license a new design and go through the whole planning process, the question is whether you will want to do it only for an SMR if you can do it for 1.2 GW instead.

Given all these uncertainties, the board of EDF delayed its final investment decision again on 26 January 2016. This delay in turn raises uncertainty as to the viability of David Cameron's strategy of how to "keep the lights on" in Britain in the next decade. This then takes us full circle and back to the issue of increased regulatory uncertainty facing the energy sector as a whole, which we talked about earlier.

The annual assessment of risks conducted by the WEF before its annual meeting in Davos showed that climate change is seen as the biggest potential threat to the global economy in 2016 – do you agree with these predictions and how do you think are they affect the energy sector?

I absolutely agree. Climate change is the biggest threat to our prosperity and existence as a species. A coherent and robust energy policy is key to tackling climate change. The EU and its member states must send the right signals to the energy industry regarding CO2 emissions. The Commission must fundamentally rethink its much-criticised policy on the ETS. The Commission's current proposal to backload current allowances and introduce a Market Stability Reserve by 2019 is simply too little too late.

The price of carbon allowances has been falling together with oil and gas prices. It is currently below Euro 5/t. At this level, it is clear that the ETS has entirely failed to provide the market with a signal to move away from carbon-intensive energy sources. With the prices of oil, gas and coal expected to remain low, there are increasing calls for the introduction of a carbon tax to replace the allowance system. The gas industry has called for the introduction of emissions performance standards in order to phase out polluting coal-fuelled power plants, which represent 25% of the energy mix used in the power sector, but are responsible for about 80% of the sector's CO2 emissions.

The argument put forward by Miguel Arias Cañete, the Commissioner for Climate Action and Energy, that a fundamental rethink of ETS is not possible since "we cannot change our energy policy every few days", is evidence of lack of commitment and willingness on the part of the Commission rather than a concern for legal certainty and predictability. Šefčovič's

continued calls for the introduction of new energy rules which would amount to a radical departure from market liberalisation principles shows that if it wants to, the Commission is able to make radical proposals.

Sir David King, the UK's Special Representative for Climate Change and UK's negotiator of the Paris Agreement at COP 21, believes that getting energy majors around the world to commit to decarbonisation and lead technological innovation is key to ensuring that global warming stays below 2 degrees C. To do so, we must provide them with a stable legal framework in which externalities such as CO2 are properly costed to ensure viable rates of return on long-term projects.

The price of oil had declined more than 40 percent since July 2014 and has just recently dropped below \$28 for a barrel – how have these trends affected your practice in the sector?

With crude prices hitting a 12-year low some in the industry are asking whether the business model of large international companies is fundamentally flawed. Others argue that the decline in prices is cyclical and that the key for companies is to weather the current storm by cutting costs.

Although I expect that oil prices will rise by the end of the year, I do think that the fundamentals for the energy sector are changing radically. Even though in the UK, in other EU member states and at the EU level, commitment to action on climate change is not yet as solid as it should be, there is no doubt in my mind that energy companies who fail to consider climate change as a key factor when devising their business strategy do so at their peril. **LM**

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