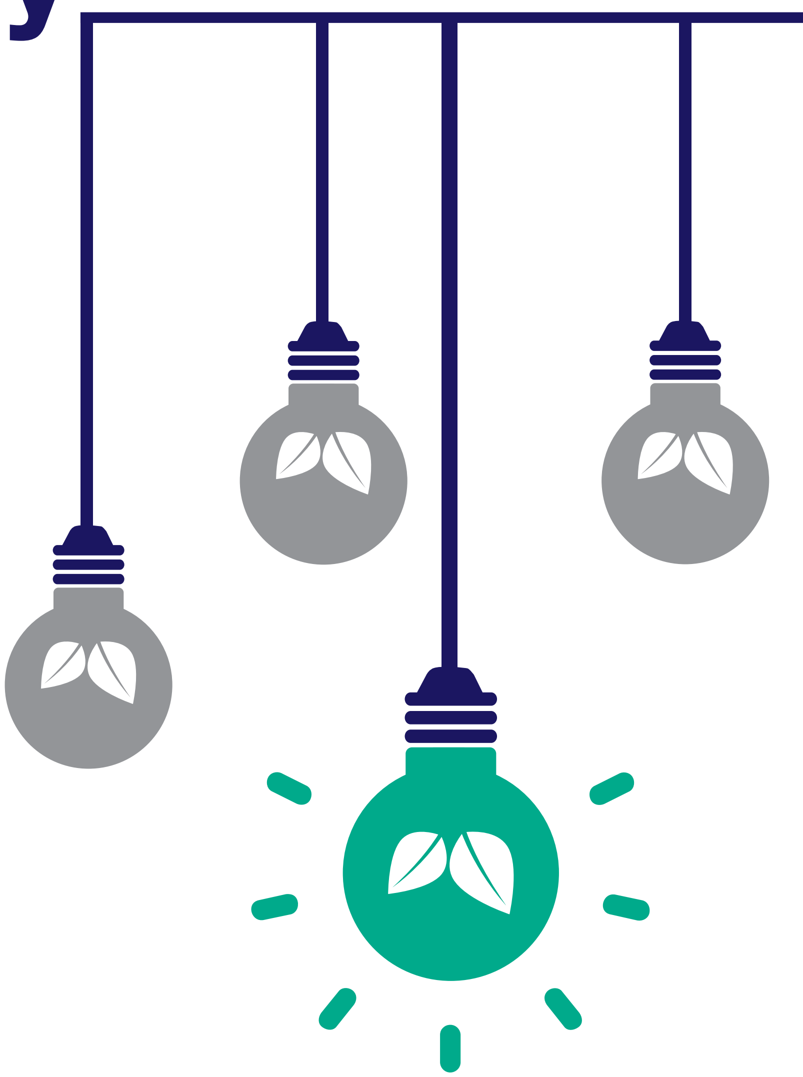
Ibec
For Irish Business

The way forward for Irish energy

Recommendations for policymakers



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Foreword

Some of the policy decisions of the new Irish government will have economic consequences not just for the next few years but also over the next few decades.

In the energy and climate policy space, Ireland faces tough choices compared to most other member states. Huge investments will be needed in electricity generation and networks infrastructure. We face especially challenging greenhouse gas emissions reduction targets. Making the right choices on renewables and energy efficiency can benefit Irish society in a number of ways. The government must resist the temptation to base policy decisions instead on short term political expediency.

A competitive business environment is contingent on maintaining secure, affordable and sustainable sources of energy supply. European Union legislative developments will dramatically alter the energy landscape and impose stringent climate and energy targets.

Ibec's Energy Policy Committee has a vision for Ireland whereby businesses and citizens will materially benefit from the opportunities arising from EU environmental, energy and climate targets. We need to develop a long-term growth strategy underpinned by policy stability. It's time to power up our ambition.

Frank Gleeson

Region Managing Director/Chief Operations Officer Northern Europe, Aramark

Chair of Ibec Energy Policy Committee

About the Ibec Energy Policy Committee

Ibec is Ireland's leading business representative organisation. We articulate agreed positions on energy and climate issues through the Energy Policy Committee (EPC). It represents a broad cross section of Irish enterprises, indigenous and multinational, that are affected by energy legislation or related policy initiatives at national, EU and international level.

The EPC also provides a forum to discuss policy and regulatory proposals, and works to ensure that the national response to our EU mandated obligations is balanced with a competitive business environment. We encourage members to network, share information and find common policy approaches to energy and climate policy. In turn, we represent the views of our member to policymakers, government and regulators. Four Working Groups advise the EPC, respectively covering climate policy, energy efficiency, energy provision and industrial energy competitiveness. In addition, we have convened an expert taskforce to track the continuing development of the *Energy Union package,* the European Commission's latest flagship initiative.

Recommendations for the new government

Energy policy must be based on a consistent, predictable policy pathway

- Enable critical energy infrastructure projects to be delivered in a socially acceptable, timely and cost effective manner.
- Consider expanding the scope of the Renewable Heat Incentive. The non-EU ETS ('Effort Sharing') sector will be prioritised because it simultaneously contributes to meeting our national renewable energy and greenhouse gas emissions targets. However, the Emissions Trading sector should not be excluded while we risk falling short of our legally-binding renewables target for 2020.
- Encourage An Bord Pleanála to focus on strategic national/regional projects, for example by delegating valid appeals on smaller scale projects to another appropriate body.
- Future-proof the re-design of the all-island electricity market to meet existing and anticipated EU legislative requirements.
- Base any approval of further electrical interconnection to Britain or Europe on independent cost-benefit analysis, which should include the perspectives of generators and end-users.
- Review local authority charges and the methodologies used in valuing key energy assets so that they remain in line with other EU member states, thereby removing potential barriers to investment.
- Encourage the development of an alternative fuel infrastructure (CNG) for road freight.

Implement energy efficiency more effectively

- Avoid undue costs being passed onto consumers by revisiting the policy of making energy suppliers primarily responsible for meeting the energy efficiency target. The supplier obligation on energy efficiency should complement, not replace, exchequer support.
- Allow the Sustainable Energy Authority of Ireland (SEAI) to fulfill its expanded remit by putting adequate funding and resources in place.
- Review the functioning of the Energy Efficiency Fund to align its operation with the practical needs of industry.

Maintain a competitive industrial base

- Consider following the example of other EU member states that exempt eligible energy and trade-intensive industries from a portion of the costs associated with renewable energy development.

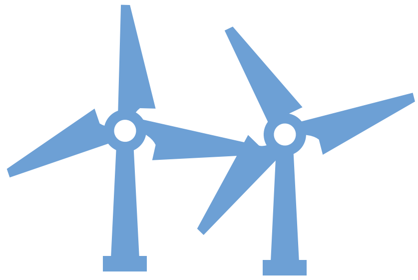
Get the best outcome from European Energy Union

- Consider providing future support for manufacturing industries operating in the EU ETS to offset expected increases in electricity costs stemming from higher EU Allowance prices.
- Identify the most economically advantageous way to meet our Effort Sharing targets for 2020 and beyond. It will entail a judicious combination of ambitious domestic action and the purchase of surplus greenhouse gas credits from other member states.

Introduction

Ireland's energy sector is experiencing a period of unprecedented change. Not only must it meet ambitious environmental targets, it must also help to keep the country competitive for energy consumers. The recent Energy White Paper provides a blueprint for action over the lifetime of this government. Ministers will, however, have to make a number of implementation decisions. It is important to get them right. Failure or retreat on these fronts will prove costly for the Irish taxpayer. Recent experience with the planning process and with public resistance has highlighted the difficulties we can expect in upgrading Ireland's energy infrastructure. Strong government leadership will be required to steer Ireland through this period of radical transition.

Making the right choices will directly benefit our energy cost competitiveness - crucial to our firms that export globally. This government must ensure the approach to energy policy does not add unnecessarily to the cost of delivered energy to businesses and households. Policy uncertainty, stalled development such as the North-South Interconnector, increased operating costs such as rising local authority rates are examples of the risks that threaten Irish energy affordability, security and sustainability. Decarbonising the Irish economy inefficiently for reasons of expedience would prove very costly and damaging in the long run. The following four thematic sections elaborate on this underlying message.



Energy policy must be based on a consistent, predictable policy pathway

A range of EU directives and regulations on climate change mitigation, promotion of renewable energy sources and completion of the internal energy market are driving strategic infrastructure on the island of Ireland. The investors include state-owned network operators and private sector developers. In each case, projects are typically funded by end-user charges or public service obligation (PSO) levies rather than by the exchequer. The government does, however, play a vital role in establishing the necessary supportive policy framework at national and EU level.

A single, low-carbon energy market coupled with high levels of end-use efficiency forms the core of the European Union's long term planning. Ireland needs to meet ambitious climate and energy objectives as a consequence. It will require radical changes in behaviour as well as large scale capital investment. Unfortunately, EU policy development is often slow, and the tendency towards 'one size fits all' approaches for the period to 2020 has complicated our national efforts. A fairer and more transparent policy framework is badly needed to ensure that consumers' bills remain affordable as we strive towards new EU targets out to 2030. The government must hold firm on this during negotiations in European Council.

Last year's White Paper on Energy Policy in Ireland recognises energy as the lifeblood of our economy and society. Based on comprehensive public consultation, over 90 actions have been identified to enable Ireland to meet the EU targets. The aim is to transform the Irish energy system utterly in the long term, dramatically reducing greenhouse gas (GHG) emissions compared to 1990 levels. Where government has a role to play in the selection of projects or the promotion of novel technologies, Ibec advocates the inclusion of the following questions for evaluation. Firstly, would the candidate proposal have a net beneficial impact on our cost base? Secondly would it enhance our economic productivity by eliminating bottlenecks or alleviating congestion? Thirdly, does it have measurable co-benefits such as facilitating balanced regional development? Keeping these points in mind, a balance between security of supply, affordability and sustainability must underpin our decisions on energy infrastructure development.

One good example of this is the *Programme for Government* which commits to a "root and branch" review of the planning system to reduce uncertainty and planning timelines. This should investigate focusing An Bord Pleanála's attention on strategic national/regional projects and delegate valid appeals on smaller scale projects (e.g. one-off housing) to another appropriate body.

We should build upon our existing infrastructure in the pursuit of EU targets. For example, the Whitegate oil refinery has the technical capability to produce novel biofuel mixtures that could be strategically important as we strive towards using alternative transport fuels. Ibec notes that the new programme for government also includes consideration of ways and means to upgrade the road fleet in order to reduce its environmental footprint.

Such measures could include encouraging the switch from diesel to compressed natural gas (CNG), particularly along the TEN-T network.

Recent experience with windfarm and grid projects has highlighted the need for community and citizen engagement. The White Paper suggests that this should occur through a newly established National Energy Forum. Ibec believes that this Forum will be integral to the newly proposed National Dialogue on Climate Change. We also believe that enhanced engagement must be complemented by political leadership. The business of politics is to arbitrate between local concerns and projects of strategic national priority. It is important that decision-makers resist the temptation to adopt a populist stance on long-term problems for short-term expediency.

Some risks which could increase costs for business

- Policy uncertainty is not conducive to creating the right investment environment and increased project risk will be reflected in the cost of capital. If the flow of private investment dries up, it will be left to the State to face the financial consequences.

- Structural reform of the all-island Single Electricity Market (SEM), is deemed necessary to comply with a recent European initiative for regional market integration. The European Commission aims to harmonise electricity prices as far as possible across Europe by means of more efficient cross-border trading. Proposed changes to the electricity market are of concern to market participants and consumers alike. This has undermined investor confidence in new and existing projects. The emerging new design ('I-SEM') is turning out to involve more radical changes than originally expected. Our members have indicated that this is likely to result in systems set-up costs and working capital costs running into hundreds of millions of euros. Hopefully these will prove to be an enduring investment. Further radical changes may however be necessitated on foot the EU's Energy Union initiative which includes proposals for a new electricity market design template. Ibec members are naturally anxious about unnecessary duplication of systems costs.

- Ireland is in the process of conducting a countrywide commercial and industrial rates revaluation process in accordance with the provisions of the Valuations Act (2001). Revaluation has so far occurred in only six local authority areas. Work is now underway in six further areas, leaving assets in 19 local authority areas remaining to be revalued. Based on current evidence, the revaluation process will ultimately lead to substantial increases in rates payable on existing energy infrastructure. For example, wind farm rates increased by over 300% in one local authority. These additional costs are not able to be reflected in the wholesale price or in the Renewable Energy Feed in

Tariff (REFIT). The resulting adverse impact on operating margins could discourage badly-needed future investment. It is important that local authority charges on strategically important infrastructure assets do not get out of line with other EU member states.

- The Department of Communications, Climate Change and Natural Resources (DCCCNR) will shortly launch, subject to state-aid clearance, a new support scheme for renewable energy, including electricity and heat. We welcome the decision to fund renewable heat incentives through the exchequer, although it remains unclear how the new renewable electricity incentives should be funded. While the initial emphasis on the non-ETS sector is understandable for renewable heat, an expanded scope may well be required if we otherwise risk falling short of our legally-binding 2020 target. According to the Sustainable Energy Authority of Ireland, the state is threatened with EU fines in the region of €100 million to €150 million for each percentage point short of the overall 16% economy-wide target.

- Wind planning guidelines were the subject of lengthy negotiations during the previous Dáil. Ibec notes that onshore wind generation remains by far the most cost-effective source of renewable electricity available today, but that the available resource depends on pragmatic planning guidelines. The recent announcement by DCCCNR of another public consultation on wind planning guidelines, although not unexpected, does create further uncertainty.

- Any further delay in the construction of the long-overdue North South Interconnector will have costly implications for electricity consumers. The Interconnector, currently forecast for delivery in 2019, is a vital step in developing Ireland's energy infrastructure. Ibec predicts Ireland's economy to grow between 3– 4% annually, significantly higher that the EU average. We cannot afford further construction delays if we are to meet our economic potential as well as our EU mandated climate and energy targets. EirGrid has estimated that NSIC could reduce customers' bills by the order of €20m per annum in 2020 rising to between €40m - €60m per annum from 2030. Similarly, the Economic and Social Research Institute has estimated a reduction of €30 million per annum in the running cost of the all-island electricity market. Ibec believes that the economic multiplier effects, arising from improved investor confidence, may result in far larger benefits. Ibec envisages commissioning new research in order to quantify these.

- The all-island electricity market has two electricity interconnectors to Britain. It has been suggested that in the event of a "Brexit", there would be greater incentive to connect directly with a member state of the EU. Given the substantial capital investment this would entail and in order to mitigate cost increases, policymakers must ensure that Irish based consumers receive a net benefit. European market integration should not disproportionately burden either interconnected party from a cost perspective and must be based on a clear business case.

Government should

- Ensure projects are delivered in a socially acceptable, timely and cost effective manner.
- Consider expanding the scope of the Renewable Heat Incentive. The non-EU ETS ('Effort Sharing') sector will be prioritised because it simultaneously contributes to meeting our national renewable energy and greenhouse gas emissions targets. However, the Emissions Trading sector should not be excluded while we risk falling short of our legally-binding renewables target for 2020.
- Enable An Bord Pleanála to focus on strategic national/regional projects by delegating valid appeals on smaller scale projects (e.g. one-off housing) to another appropriate body.
- Avoid any duplication of costs in re-designing the electricity market to meet current and future anticipated EU requirements.
- Base decisions on further electrical interconnection to UK or Europe on independent cost-benefit analysis, which includes the perspectives of generators and end-users.
- Review local authority charges and the methodologies used in valuing key assets so that they are in line with other countries and do not act as a barrier to investment.
- Address the development of an alternative fuel infrastructure (CNG) for road freight.

Implement energy efficiency more effectively

Energy efficiency is a fundamental part of our overall energy policy. Benefits include reduced costs, security of supply and increased productivity. This presents a genuine opportunity for businesses of all sizes. The recent softness of international energy prices should not deflect firms from focusing on how much they are consuming. If demand is falling due to technological and other factors, then the real impact of any future increase in per-unit bills will be softened.

> The **Energy Efficiency Directive** imposes a legal obligation on member states to reduce energy demand. This entails new savings each year from 1 January 2014 to 31 December 2020 of 1.5% of the annual energy sales to final customers of all energy distributors and all retail energy sales companies by volume, averaged over the most recent three-year period prior to 1 January 2013.

The Irish government, along with 12 other member states, opted to meet the energy efficiency target by a combination of an Energy Efficiency Supplier Obligation scheme and other policy measures. Obligated parties include all types of energy suppliers. Their reduction targets are allocated according to their proportion of retail market sales volume which is then broken down into three sub-targets: 75% non-residential, 20% residential and 5% energy poverty residential. The third category is far more expensive to address, but confers valuable social welfare benefits. Ibec has long argued that it is inappropriate to ask energy suppliers (or their industrial consumers) to pay for social policy objectives. There are already substantial taxes and levies impacting on the competitiveness of our energy users.

Energy efficiency is at the core of industrial productivity and in many cases is vital for Irish sectors exposed to global competition. However, productivity is also tied to management practices. Failure to tackle barriers such as the lack of specialist sectoral knowledge puts Ireland at a real risk of failing to meet our energy efficiency targets. It would represent a missed opportunity for many firms that could benefit from great levels of efficiency and higher productivity.

SEAI therefore needs to be adequately resourced. In recent years its remit has expanded to include ensuring that non-SMEs undertake energy audits as required by the Energy Efficiency Directive. SEAI has a proven track record and the White Paper confirmed SEAI's role as the provider of expert advice on energy efficiency. SEAI's Large Industry Energy Network, which includes 160 companies with an energy spend of over €1 million each, reportedly achieved an estimated 770GWh of energy savings in 2013 through the implementation of specific energy saving measures. The most recent report estimates €36 million in avoided energy.

While knowledge-sharing represents an important tool in achieving efficiency within industry, better financing instruments are also required. In 2013, the government set up the National Energy Efficiency Fund with €35 million of seed capital for investment in energy efficiency projects. The fund's objective is to finance energy efficiency projects in public and private organisations. The uptake so far has been rather disappointing. New energy efficiency finance schemes and instruments should be made available, with a variety of payback periods and varying scale of investment, targeted to company-size and activity. Ibec members have cited numerous barriers in terms of accessing finance for energy efficiency investments, including high levels of administrative burden or long, complicated processes for requesting financial support. They also report that the level of financial support on offer is inadequate to ensure an attractive return on investment.

Government should

- Avoid costs being passed onto consumers by revisiting the policy of making energy suppliers responsible for meeting not only the energy efficiency target but also sectoral sub-targets. The supplier obligation on energy efficiency should complement, not replace, exchequer support.
- Allow the Sustainable Energy Authority of Ireland to fulfill its expanded remit by having adequate funding and resources in place.
- Review the functioning of the Energy Efficiency Fund to align its operation with the practical needs of industry.

Maintain a competitive industrial base

Clean energy should underpin rather than undermine our industrial base. The EU has set its 28 member states on a trajectory built firmly on sustainable energy practices. Arguably, European companies operate under stricter environmental legislation than their non-EU counterparts. The intended outcome is a cleaner, more sustainable energy future but it does come at a cost. In particular, the obligation to comply with stringent climate change legislation as well the EU's Target Model for cross-border electricity trading will put upward pressure on retail energy prices.

Irish-based companies, particularly those that are trade-exposed and energy-intensive therefore face long term challenges to their competitiveness. Over the past year, Irish industrial electricity prices have been converging towards the EU average, driven largely by falling international gas prices. However previous experience tells us that those gas prices will rise again at some point, and that our electricity prices will end up well above the EU average. Reform of the EU Emissions Trading Scheme will have a compounding effect.

> The **Emissions Trading Scheme** places a limit on the total amount of certain greenhouse gases that can be emitted by qualifying installations. The cap is reduced over time so emissions fall.

In looking to our EU neighbours, qualifying energy-intensive industries in Germany are in direct receipt of compensation packages in the form of exemptions from certain renewable energy policy costs. The British government last year signaled its intention to continue an exemption for energy-intensive industries from the policy costs associated with renewable energy subsidies. These are just two examples of numerous measures across the EU to protect energy-intensive industries from policy-driven price rises. There is no such scheme in place to protect Irish-based industries that are similarly exposed. In the absence of a harmonized EU-wide framework, the Irish government should now explore the merits of an exchequer-funded scheme to prevent carbon or investment leakage when electricity costs increase. Such a scheme would allow Ireland to continue to attract and retain inward investment and it would give foreign direct investment an important assurance that they will not be priced out of global markets due to prohibitive operating costs. Arguably the net long-run cost to the economy would be small or even negative.

The recently revised European Commission Energy and Environment Aid Guidelines introduced new criteria for allowing state aid to energy-intensive industries exposed to international competition. It provides different lists of eligible sectors for relief from the costs of funding renewable energy deployment and to offset the indirect costs associated with carbon taxation. Ibec is in the process of devising a scheme in line with the new criteria, and will seek to engage with policymakers on it.

According to the **Energy and Environment Aid Guidelines**, qualifying companies must demonstrate prescribed levels of energy and trade intensity:

- Electricity costs would have to account for at least 20% of output minus non-wage inputs (gross value added threshold)
- 4% of trade is with countries outside the EU (trade intensity threshold)

Government should

- Support the idea of harmonised EU rules for protection against investment leakage in exposed sectors.
- Consider following the example of other EU member states that exempt eligible energy and trade-intensive industries from a portion of the costs associated with renewable energy in the meantime.

Getting the best from European Energy Union

European industry is facing unprecedented environmental and economic challenges in the pursuit of Energy Union. The European Commission Energy Union Strategy, initially unveiled in February 2015, outlines the EU's vision to decarbonise the economy, integrate national energy markets and secure Europe's energy supply. Over the next few years the European Commission aims to revise and introduce legislation across 15 areas. Although in principle this could benefit Irish-based industry, getting to such an outcome is conditional upon the design and implementation of new policies. Ibec has responded to a series of European Commission consultations to inform the completion of Energy Union, including reviews of the renewable energy and energy efficiency directives and electricity market designs. To illustrate this, we briefly outline the potential impact of impending reforms to the EU Emissions Trading Scheme (ETS).

The European Commission recently published a proposal to revise the EU ETS from 2021 onward and is awaiting the necessary input from the European Parliament and the Council to take the proposal forward to the next stage. It will impact mainly on the power sector and large industrial plants. The EU ETS ensures economic efficiency through trading of the EU Allowances. Analysts are forecasting that the proposed reforms will drive prices to more than three times the current level, thereby making a somewhat wider range of low carbon technologies commercially attractive. In order to protect certain sectors deemed to be at risk from non-EU competition, a proportion of Allowances will continue to be allocated free of charge to eligible installations, albeit by a different methodology.

In the revision of this Directive, it is important to ensure that Irish based industry exposed to international competition continues to receive the appropriate level of protection. Policies aimed at reducing carbon emissions are going to impact industrial consumers. It will result in an increase to the wholesale electricity price and therefore increasing retail electricity prices. This will have the greatest effect on those industries that use the most electricity, leading to a risk that investment is lost – known as carbon leakage. As outlined in the previous section, certain other member states compensate those businesses most at risk of carbon leakage. With this in mind, the

Irish government should consider providing support for the next phase of the EU ETS, possibly funded from the auction of EU allowances.

While the ETS delivers a common marginal cost (Euros per avoided tonne) for greenhouse gas emissions, the same is absolutely not the case for greenhouse gas emissions reduction in the non-ETS sector. Our national target for 2020 is arguably the toughest in the entire EU, although we are not expected to do all of it thorough domestic action. Ireland's unique emissions profile and the low mitigation potential of agricultural and transport emissions mean that we will have to co-operate with other member states.

Government should

- Consider providing support for manufacturing industries operating in the ETS to offset increased electricity costs stemming from the higher costs of allowances.
- Explore the most cost-effective way to meet our non-ETS targets Ireland's mix between domestic action and the purchase of surplus credits from other member states.

Conclusion

Ibec welcomes the integration of energy and climate policy under a single government department, and looks forward to contributing to the forthcoming national dialogue. Our members are committed to playing a constructive role in the sustainable energy transition. Our members urge the government to make the right choices on renewables, energy efficiency investment and to quickly begin the process of dramatically reducing domestic emissions out to 2050. It demands a long term strategy, not a short term political fix.

www.ibec.ie/policy

About Ibec

Ibec is the national voice of business in Ireland. The organisation and its sector associations, work with government and policy makers nationally and internationally, to shape business conditions and drive economic growth.

From the dynamic, modern manufacturing of the high-tech, life sciences and food sectors to the vanguard of quality services provision, including financial, software, retail and tourism; from companies operating in small villages to those serving a global customer base, and those doing both at the same time; from those managing 5 employees, to those managing 50,000. Ibec's strength lies in our diversity.

We offer our members a range of professional services and training on human resource management, occupational health and safety, employee relations and employment law.

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