

## EU renewables plan: investor confidence boosted, but further clarity needed

Renewable energy has been one of hottest investment themes for the past two or three years. There are two reasons for this. The first is climate change, driven by the strengthening scientific evidence of its physical impacts and the growing awareness of its potentially huge economic consequences (as outlined in the Stern report). The second is the rising cost of fossil fuels, in particular oil, and the related issue of energy security.

These concerns about climate change, fuel prices and energy security have led governments around the world to actively support the development of alternative sources of energy. Many countries have adopted policies (subsidy regimes, feed-in tariffs, mandatory renewable targets, etc.) directed at promoting the development of renewable energies. Companies involved in this area have directly benefited, and funds with significant exposure to this area have had correspondingly strong returns.

Despite high oil prices, the reality is that, without government support, most renewable energy sources are uneconomic compared to more 'conventional' fuel sources. The reliance of renewable energy on government support has been an ongoing concern for investors. One of the critical issues in this regard has been that, while the overall direction of EU policy in this area seems clear, questions remain around the specific details of the scale and duration of government support for renewable energy.

### 20/20/20 by 2020

On 23 January 2007, the EU announced a package of proposals designed to deliver on its commitments to combating climate change and promoting renewable energy and energy security – commonly referred to

as '20/20/20 by 2020'. This commitment, which was endorsed by the European Parliament and EU leaders in March 2007, comprises the following targets:

- 20% reduction in greenhouse gases by 2020
- 20% share of renewable energy in overall EU energy consumption by 2020, including a 10% biofuels in transport target
- 20% increase in energy efficiency by 2020

While these targets set the broad direction for renewable energy and climate change policy, they did not provide much detail on how they would be implemented. On 23 January 2008, the European Commission published a draft Renewables Directive (discussed further below), as well as a series of related measures, including an amended EU Emissions Trading Directive (EU ETS); expanding greenhouse gas emissions reduction efforts to include sectors not covered by the EU ETS (transport, buildings, services, smaller industrial installations, agriculture and waste); a legal framework for carbon capture and storage; and new guidelines regarding environmental state aid.

These proposals are likely to be adopted by the European Council and EU leaders within the coming months. Member States' National Action Plans (which describe how the EU legislation will be transposed into national legislation) are due by early 2010.

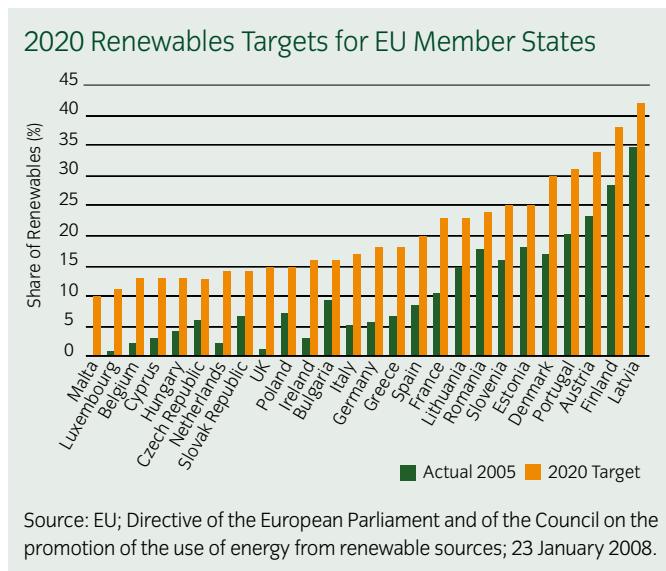
### The Renewables Directive

The proposed Renewables Directive seeks to significantly increase the amount of energy derived from renewable sources – defined as wind, solar, geothermal, wave, tidal, hydropower, biomass, landfill gas, sewage treatment plant gas and biogas

- throughout the EU. Even though the Directive bolsters the case for investing in these areas, it remains unclear precisely how the EU will meet its goals. A closer look at the specifics of the Directive provides a better appreciation of the scale of the challenge and the potential opportunities for investors.

First, the proposed Directive sets differentiated national targets for the share of renewable energy in each Member State's total energy consumption. These targets are extremely ambitious as only 8.5% of the energy that the EU currently consumes is derived from renewable sources.

The national targets vary significantly (see the chart below). Each Member State is expected to increase its renewables share by at least 5.5% (from 2005). The remaining expected effort has been calculated on the basis of gross domestic product per capita, which reflects each Member State's wealth. Generally, 'richer' countries have received proportionally tougher targets. For example, the UK, despite having derived only 1.3% of its power from renewables in 2005, is expected to produce 15% of it from them by 2020, while Romania is only expected to increase its use of renewables from 17.8% to 24% (a proportionally less demanding target). Denmark, France, Germany and Ireland are among those with the most challenging targets. Member State governments have been given complete freedom (with the exception of the biofuels target discussed below) to decide on how to achieve their respective targets.



Secondly, the EC has proposed a voluntary cross-border trading scheme to help Member States reach their renewables targets in, theoretically, the most cost-effective manner. After meeting interim targets, Member States will be able to buy 'guarantees of origin' (certificates proving the renewable origin of energy) from other Member States where the development of renewable energy is cheaper. The proposed scheme has been praised for offering flexibility to Member States, but it is also proving to be controversial. Some are concerned that the scheme will undermine domestic support programmes such as those of Spain and Germany, which provide substantial feed-in tariffs for energy derived from wind and solar sources.

Thirdly, the proposed Renewables Directive includes a specific 10% target for the use of biofuels in transport fuel for each Member State. In an attempt to address concerns about the sustainability of biofuels production and to ensure that the EU's other environmental goals are not compromised, the Directive sets out sustainability criteria for biofuels. In order to qualify towards the target, biofuels must achieve a minimum level of greenhouse gas savings (35%) and meet sustainability-related requirements. Specifically, qualifying biofuels will not be able to be derived from feedstocks grown on certain types of land including old forest, highly biodiverse grasslands, wetlands or 'pristine' peatlands. The EU's insistence on maintaining a biofuels component of its renewables target in the face of significant global food inflation has been the subject of intense debate and criticism.

### Concluding comments

The proposed Renewables Directive offers investors increased certainty regarding the important role that renewables will play in the EU's future energy strategy and should go some way to strengthen confidence in the sector. However, there is some way to go; the proposals need to be formally adopted, and Member States need to establish their national programmes for the delivery of the targets specified in the Directive. Therefore, investors will need to continue to closely monitor the development of national policies and ensure that their investment strategies reflect the details of the specific measures that are adopted.

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