EU Decision and Commission Regulation

Centrum für Europäische Politik

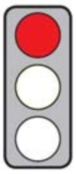
BACKLOADING OF CO_2 EMISSION ALLOWANCES AS OF 2013

cep**Policy Brief** No. 44/2012 of 29 October 2012

KEY ISSUES

Objective of the Decision and of the Regulation: The Commission should be afforded the possibility to change the timetable for auctioning emission allowances in order to be able to temporarily hold back these allowances ("backloading") during the period 2013–2015.

Parties affected: The economy as a whole, in particular energy suppliers and industrial and aviation companies.



Pros: –

Cons: (1) The possibility to change the auctioning rules without there being any concrete requirements leads to planning uncertainty and thus impairs the functioning of the market.

(2) This contradicts the ETS Directive's predictability requirement and infringes the principle of legal certainty based on the rule of law.

(3) The planned temporary scarcity ("backloading") could mark the beginning of a permanent reduction of allowances, which also leads to politically induced uncertainty in the emission allowances market.

CONTENT

Title

Proposal COM(2012) 416 of 25 July 2012 for a **Decision** of the European Parliament and of the Council on amending the Directive 2003/87/EC on **clarifying provisions on the timing of auctions of greenhouse gas allowances** and

Draft Commission Regulation of 25 July 2012 [without number] amending Regulation (EU) No 1031/2010 in particular to determine the volumes of **greenhouse gas emission allowances to be auctioned** in 2013-2020.

Brief Summary

► **Background and objectives**

- EU emission trading system (ETS): The companies of certain sectors may only emit greenhouse gases if they hold the corresponding emission allowances (Art. 12 (2a) and (3) ETS Directive 2003/87/EC; s. CEP Dossier, p. 12 ff., in German only).
- This has applied
  - to certain stationary installations such as plants for producing electricity and heat, for metal production and processing, for paper manufacturing and chemical industrial plants since 2005, and
  - to aviation since 2012.
- Emission allowances for stationary installations will be auctioned as of 2013, unless allocated free of charge (Art. 3d (1–3) and Art. 10 (1) ETS Directive). Emissions allowances for aviation have been auctioned since 2012.
- The procedure and the timing of the auctioning of emission allowances are regulated under the Auctioning Regulation of the Commission (No. 1031/2010, s. CEP Policy Brief).
- Instead of emission allowances, operators can also apply international emission rights acquired as a result of measures to reduce emissions in accordance with the Kyoto protocol (Art. 11a and 11b ETS Directive). Within the period 2008–2011, emission credits equivalent to 549 million tons of CO_2 were used [SWD(2012) 234, p. 7].
- The supply of such international emission credits is expected to "temporarily increase significantly in the short term" [COM(2012) 416, p. 2].
- Due to the poor economic development, the demand for emission allowances in recent years has been less than originally expected. In total, between 2008 and 2011 emission allowances and international emission credits for 8.7 billion tons of CO_2 were faced with actual emissions of 7.8 billion tons of CO_2, so that a "surplus" of emission allowances for almost one billion tons of CO_2 was created, which may also be used by operators in future [SWD(2012) 234, p. 9].
- The Commission wishes to change the auctioning timetable in order to temporarily issue less emission allowances ("backloading") into the market. To this end, the ETS Directive (2003/87/EC) and the Auctioning Regulation (No. 1031/2010) are to be amended.

Authors: Dr. Götz Reichert, LL.M. and Dr. Jan S. Voßwinkel | reichert@cep.eu
CEP | Kaiser-Joseph-Straße 266 | 79098 Freiburg | Germany | Telephone +49 (0)761 38693-105 | www.cep.eu

- **Amendments to the ETS Directive: Commission's power to amend the timing of auctions**
  - According to the Commission, it is "able in exceptional circumstances to adapt the auction timetable".
  - The Commission wishes to clarify this "for the purposes of legal certainty" by means of the following addition to Art. 10 (4) ETS Directive: "The Commission shall, where appropriate, adapt the timetable for each period so as to ensure an orderly functioning of the market." [COM(2012) 416, p. 3, Recital 2 and Art. 1]
- **Amendments to the Auctioning Regulation: Changing the auctioning timetable**
  - "A part" of the volume of allowances to be auctioned in the period 2013-2020 (Art. 10 (2) new sub-para. 3 and 4, new Annex II Auctioning Directive)
    - shall not be auctioned between 2013–2015 ("backloading") and
    - be additionally auctioned in the period 2018–2020.
  - The amendment draft is to serve as a basis for discussion. It does not contain any information as to what extent emission allowances should be reduced in the period 2013-2015.
  - In a working document, the Commission discusses three options: 400 million tons, 900 million tons and 1.2 billion tons [SWD(2012) 234, p. 21–23]. This corresponds to 12.5%, 28.2% or 37.6% of the certificates likely to be auctioned during this period.

Essential Changes to the Status quo

- Until now, the ETS Directive has not provided the Commission with the explicit right to change the timetable for auctioning emission allowances so as to ensure the "orderly functioning of the market".
- To date, the Auctioning Regulation has not provided for the backloading of emission allowances and their subsequent auctioning.

Statement on Subsidiarity by the Commission

The Commission does not address the issue of subsidiarity.

Policy Context

As of 2013, the EU emission trading system (ETS Directive 2003/87/EC) will become increasingly important for EU climate policy due to the amendments stipulated under the Climate Package of 23 April 2009 (Directive 2009/29/EC, s. CEP Dossier, p. 11 et sqq.): whereas today each Member State sets its own national ceiling for available certificates, as of 2013 an EU-wide total amount ("EU-Cap") – 2013: 1,926,876,368 allowances to the equivalent of one ton of CO_2 each – will be issued annually, which between then and 2020 will gradually be reduced by 21% of 2005 levels [Art. 9 ETS Directive; Commission Decision C(2010) 4658]. Accordingly, the distribution of emission allowances carried out by Member States during the first two ETS trading periods (2005-2007 and 2008-2012) within the framework of "National Allocation Plans" (NAP) will be harmonised throughout the EU as of the third trading period (2013-2020). The system of free allocation will be gradually converted to auctioning, so that as of 2013, at least 50% and as of 2027 almost all certificates will be auctioned. By way of exception, energy-intensive sectors with a "substantial risk" of moving to non-EU States ("carbon leakage") will also receive cost-free emission allowances after 2013 (Art. 10a (12)).

Legislative Procedure

Amendment of Directive 2003/87/EC

25 July 2012	Adoption by the Commission
Open	Adoption by the European Parliament and the Council, publication in the Official Journal of the European Union, entry into force

Amendment of the Commission Regulation No. 1031/2010

Open	Submission by the Commission, consent of the Committee of national experts on climate change and forwarding of the Regulation Draft to the Council and the European Parliament; adoption by the Commission provided the European Parliament and the Council do not raise objections within a period of three months following the forwarding.

Options for Influencing the Political Process

Leading Directorate General:	DG Climate Action
Committees of the European Parliament:	Environmental Issues, Public Health and Food Safety (in charge), rapporteur: Matthias Groote (S&D Group, DE);
Committees of the German Bundestag:	Environment, Nature and Nuclear Safety (in charge);
Decision mode in the Council:	Qualified majority (objection with 91 of 345 votes; Germany: 29 votes)

Formalities

Legal competence:	Art. 192 TFEU (Environment)
Form of legislative competence:	Shared competence (Art. 4 (2) TFEU)
Legislative procedure:	Art. 294 TFEU (ordinary legislative procedure)

ASSESSMENT

Economic Impact Assessment

Ordoliberal Assessment

The current price of 7-8 Euros for emission allowances is lower than expected by politicians and several market participants during the introduction of ETS. Therefore, this price creates only a very low incentive to invest in climate-friendly technologies. This is the major argument in favour of the planned holding back of emission allowances. However a closer inspection reveals that it is inconclusive. It is particularly wrong with regard to the statement that the "orderly functioning" of the market for emission allowances is not ensured. Rather does emission trading ensure even in this situation that the cap of permitted CO_2 emissions is altogether being complied with by operators of the affected fixed premises and air carriers.

The low price is not a result of dysfunctional markets, but rather to very simple economic issues and the existing energy and climate protection policy of the EU and Member States: emissions have declined as a result of the economic crisis. Moreover, emissions are decreasing due to the development of renewable energies being pushed through by governments and as a result of higher, politically induced energy efficiency [Communication on the reduction of greenhouse gas emissions by more than 20% COM(2010) 265, s. CEP Policy Brief; Impact Assessment SEC(2011) 779 on the proposal for an Energy Efficiency Directive COM(2011) 370, p. 29 et sqq., 75 et sqq.; s. CEP Analysis].

By way of these measures, politicians decided how CO_2 emissions should be avoided and thus reduced the steering function of emissions trading to a large degree.

Irrespective of this fundamental criticism, the following applies:

The Commission's right to backload emission allowances has not been attached to concrete requirements regarding under which circumstances and for which purpose this may "where appropriate" be exercised. The "orderly functioning of the market" leaves considerable room for interpretation and is not substantiated at all. Thus it remains unclear in which cases and which adjustments can be expected in future. **This leads to planning uncertainty** on the part of market participants **and thus impairs precisely the "orderly functioning of the markets"**.

Impact on Efficiency and Individual Freedom of Choice

As the Commission itself states, market participants in emission allowances trading take account of long-term developments [SWD(2012) 234, p. 12 et sqq.]. It is therefore questionable whether or not it will really lead to a substantial price-increasing effect if market participants anticipate that the certificates being backloaded as of 2013 are going to become available again from 2018. As at the moment the Commission has only specimen calculations in a working paper but no concrete proposals as to the volume of the emission allowances to be backloaded, what impact "backloading" will have on the efficiency of emissions trading is currently not assessable. The specimen calculations in the working paper demonstrate, however, that the Commission is not only considering smaller amendments.

A lasting price-increasing effect could only be achieved if the allowances were withdrawn from the market definitively. Therefore, **"backloading" could mark the beginning of a permanent reduction of allowances**. Speaking in the European Parliament, Commissioner Günther Oettinger addressed the question of whether or not to waive issuing allowances onto the market until 2020, in other words reduce the number emission allowances in general (…)" (plenary debate of the European Parliament on the Energy Efficiency Directive on 11 September 2012 in Strasbourg). **A permanent reduction of allowances would represent a tightening of EU climate protection targets**. However, until now the Commission has argued against a tightening of EU climate protection targets by 2020 [Communication on the reduction of greenhouse gas emissions by more than 20% COM(2010) 265, s. CEP-Policy Brief]. If a tightened EU climate protection target, also with regard to the long-term EU climate protection targets for 2030 and 2050, is supposed to be politically intended, then the issue of the related reduction of allowances must stand at the end of the debate process, rather than being implicitly anticipated at the beginning by "backloading".

As long as the question of whether or not to fully withdraw backloaded certificates from the market exists, there will be politically induced uncertainty in the market, which might lead to speculative trading. By prematurely introducing a political issue that has not yet been clarified into the emission allowances market, the "orderly functioning" of this market is disrupted rather than safeguarded .

Impact on Growth and Employment

Higher prices for emission allowances increase production costs in Europe and have a negative impact on growth and employment.

Impact on Europe as a Business Location

Higher prices for emission allowances increase production costs in Europe and have a negative impact on Europe as a business location.

Legal Assessment

Legal Competence

Unproblematic. The EU is entitled to adopt environmental policy measures to protect the climate (Art. 192 TFEU).

Subsidiarity

Unproblematic.

Proportionality

Unproblematic.

Compatibility with EU Law

The proposed **Commission's right to change the auctioning rules substantially is not in line with the** corresponding **provisions stipulated under the ETS Directive**. Although in principle the Commission was empowered to "regulate" the timing, administration and other aspects of the auctioning of emission allowances for stationary installations within a Regulation (Art. 10 (4) ETS Directive 2003/87/EC; Auctioning Regulation No.1031/2010), this did not empower them to *amend* the auctioning rules independently once they were stipulated. On the contrary, the ETS Directive explicitly determines that the auctioning procedure defined by the Commission should be "predictable, in particular as regards the timing and sequencing of auctions and the estimated volumes of allowances to be made available" (Art. 10 (4) Sentence 2 ETS Directive). This predictability requirement is not compatible with the comprehensive power to change the auctioning rules that is now being proposed. This holds all the more true as the circumstances under which "if necessary" the "orderly functioning of the market" is no longer ensured **and** consequently intervention by the Commission is permitted, are still undefined. Hence, the amendment power **infringes the principle of legal certainty based on the principle of the rule of law** (Art. 2 TEC; cp. ECJ, Case 169/80, No. 17 – *Gondrand Freres*).

Compatibility with German Law

Unproblematic.

Possible Future EU Action

The currently proposed **"temporary" backloading of emission allowances could be converted into a final reduction,** for instance by not implementing the second part of the project, namely releasing the backloaded certificates onto the market as of 2018. This is to be expected **particularly if** the **politically desired substantial price increase** hoped for through backloading **does not take place** or is not permanent.

Conclusion

The Commission's right to backload emission allowances, which is not connected to any concrete requirements, leads to planning uncertainty among market participants and thus impairs the "orderly functioning of the markets". Moreover, it contradicts the predictability requirement of the ETS Directive and infringes the principle of legal certainty based on the rule of law. Backloading could mark the beginning of a permanent reduction of allowances. This would create a tightening of the EU climate protection targets. However, as long as it remains unclear whether or not the certificates retained by temporary backloading will turn out to be set aside permanently, politically induced uncertainty is created in the emission allowances market. Therefore, the project proposal should be withdrawn.