



Federal Ministry for the
Environment, Nature Conservation,
Building and Nuclear Safety

EU ETS Legal & Institutional Framework

Chile Study Tour to Germany
Berlin, 11 December 2017

Alexander Handke
Emissions Trading Division
Federal Ministry for the Environment,
Nature Conservation, Building and Nuclear Safety
Germany



- **EU ETS Phase I – III overview**
- **EU Policy Targets**
- **EU ETS Legal Framework**
- **EU ETS Institutional Framework**
- **Challenge: Structural Oversupply**
- **Stakeholder Involvement Germany**
- **EU ETS & Lawsuits**



The European Union

Cultural and Economic Diversity



Member States of the European Union (2013)

Candidate and potential candidate countries

- **member states: 28**
- **official languages: 24**
- **Population:**
507,416,607 (*est. 2014*)
- **GDP (*nominal, est. 2014*):**
EUR 13.464 /
USD 18.451 trillion
- **Currency: Euro**
(in 18 member states)



EU ETS Phase I - III overview

Gases

Initially, the EU ETS focused on CO₂
N₂O and PFCs were added in phase III.

Point of regulation

Downstream

Sectors

Energy: Power and heat generation

Industry: Energy-intensive sectors incl. oil refineries, iron and steel, aluminium, metals, cement, lime, glass, ceramics, pulp, paper, cardboard, acids, and bulk organic chemicals

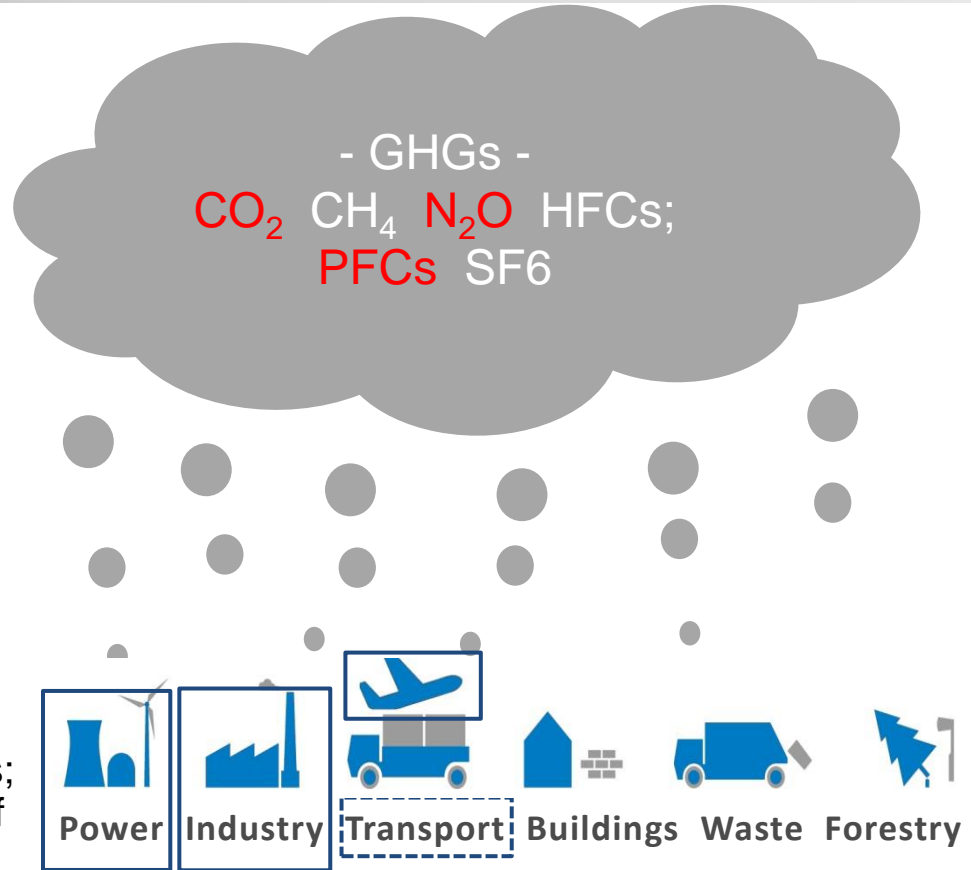
Aviation

Thresholds

Energy: > 20 MW total rated thermal input

Industry: Varying thresholds for different sectors; Small installations with fewer than 25,000 tons of CO₂e may be excluded

Aviation: 10,000t CO₂/year



EU ETS covers ca. 11,000 installations.



EU ETS Phase I - III overview

	No. of installations	Budget Ø* [Mt CO ₂ -eq/a]	% of total emissions	Scope
1st Trading Period: 2005 -2007				
EU	10.600	2.299	43	energy generation, refineries, iron and steel, mineral-processing industries, pulp and paper
Germany	1.850	499	50	
2nd Trading Period: 2008 – 2012				
EU	11.600	2.083	41	+ steel-processing, mineral-smelting, propylene, ethylene and carbon black; aviation (from 2012 on)
Germany	1.650	452	48	
3rd Trading Period: 2013 - 2020				
EU	11.000	1.950	45	+ processing of non-ferrous metals, production of aluminium (+PFC), adipic and nitric acid (+N ₂ O), ammonia
Germany	1.900	-	50	

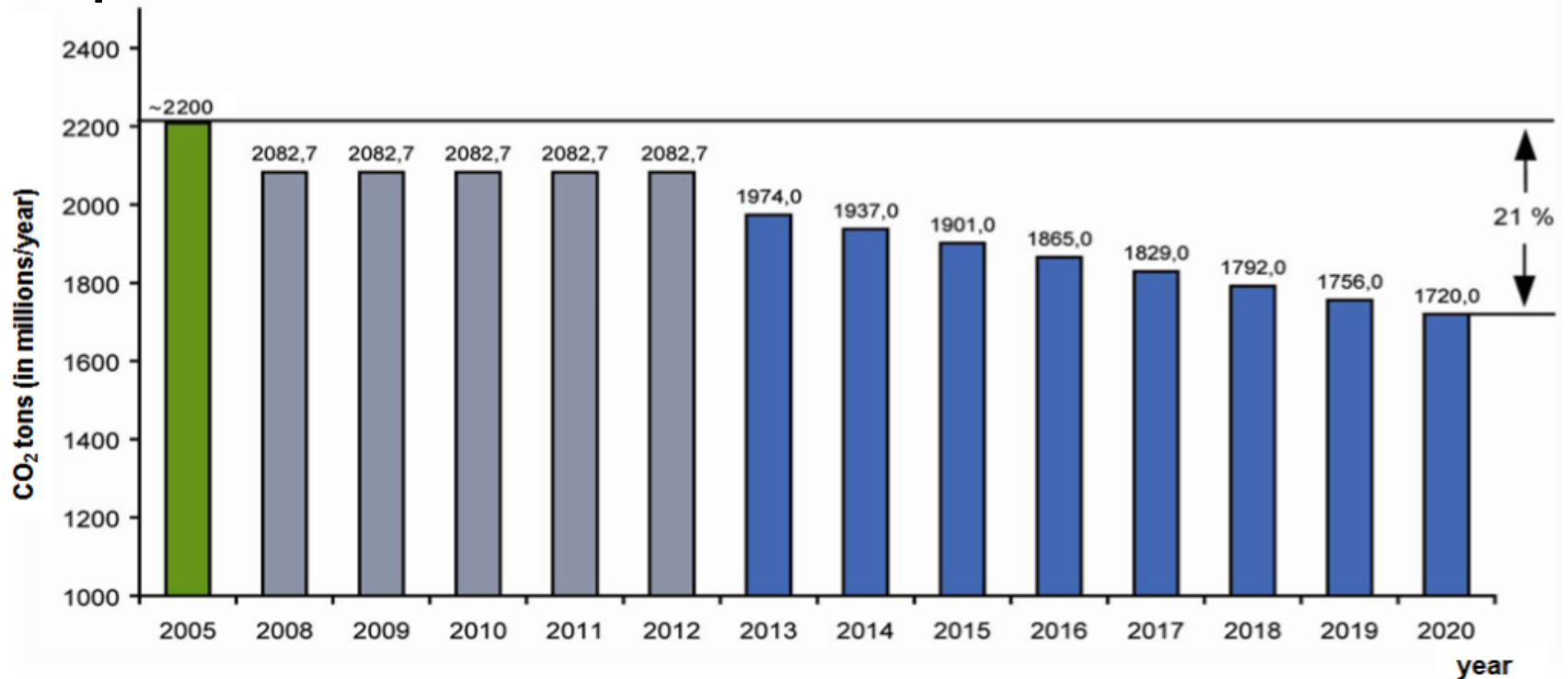
* Without aviation.

Source: EEA, Trends and Projections; in 2016. about 11.000 installations submitted an AER; the cap of Phase III is reduced annually by 1,74 %



EU ETS Phase I - III overview

Caps from Phase I to Phase III





EU ETS Phase I - III overview

2005 – 2007

**EU ETS
1st Phase**

Pilot phase:
learning by doing

2008 – 2012

**EU ETS
2nd Phase**

Stabilisation:
first commitment
period under the
Kyoto Protocol

2013 – 2020

**EU ETS
3rd Phase**

European
harmonization &
consolidation

2021
and beyond

**EU ETS
4th Phase**

Structural
reform, further
development

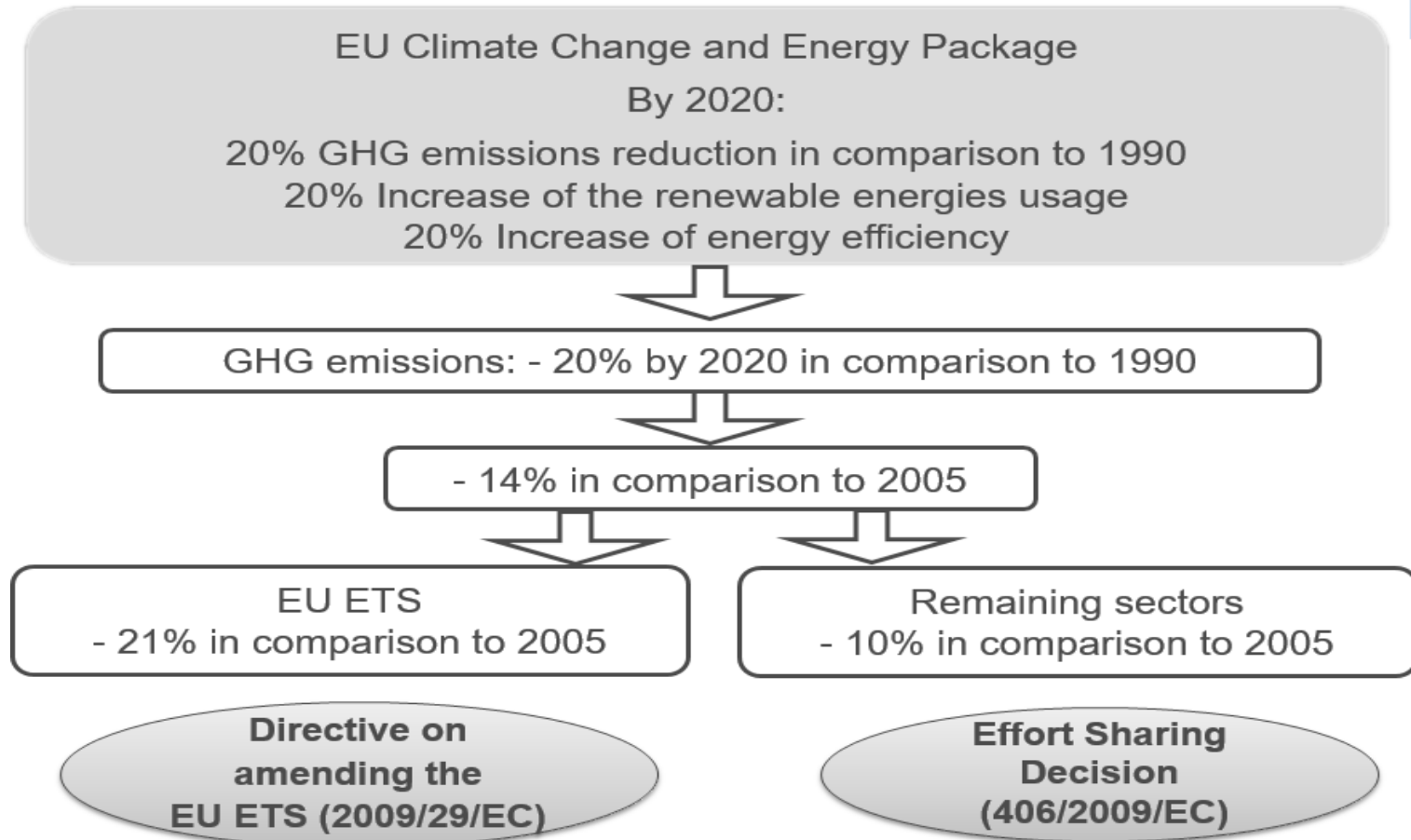


Outline

- EU ETS Phase I – III overview
- **EU Policy Targets**
- EU ETS Legal Framework
- EU ETS Institutional Framework
- Challenge: Structural Oversupply
- Stakeholder Involvement Germany
- EU ETS & Lawsuits



EU Policy Targets I





EU Policy Targets II

- **EU Climate and Energy Framework 2030 – at least...**
 - 40 % cuts in GHG emissions
 - 27 % share for renewable energy
 - 27 % improvement of energy efficiency
- **ETS sectors** will have to cut emissions by **43 % => Linear Reduction Factor for the Cap needs to be more stringent (2.2 % instead of 1.74 %)**
- **No admission of offsets after 2020** (EU domestic action only)



- EU ETS Phase I – III overview
- EU Policy Targets
- **EU ETS Legal Framework**
- EU ETS Institutional Framework
- Challenge: Structural Oversupply
- Stakeholder Involvement Germany
- EU ETS & Lawsuits

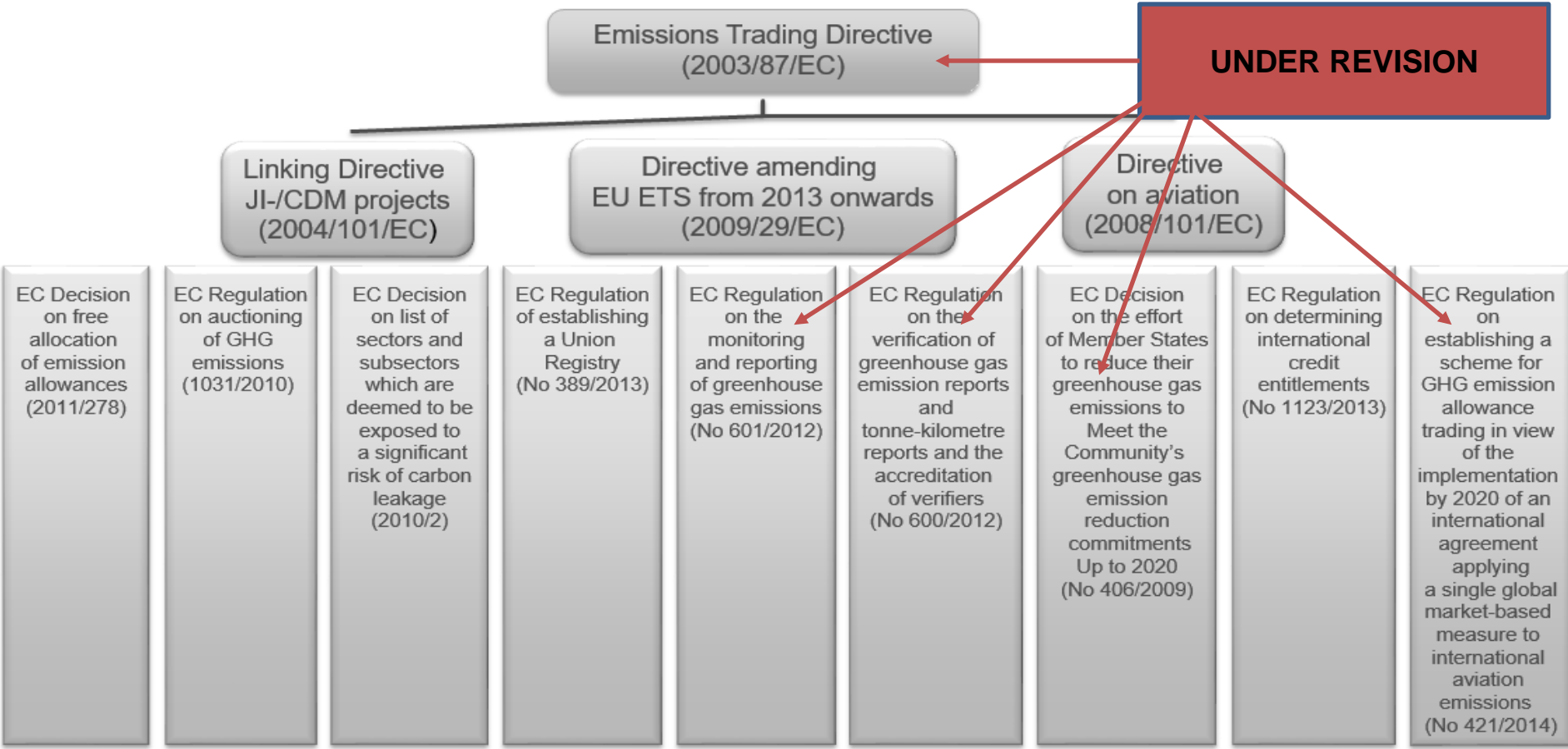


EU ETS Legal Framework





EU ETS Legal Framework





EU ETS Legal Framework



EU Law

Emissions Trading Directive (2003/87/EC)

Linking Directive
JI-/CDM projects
(2004/101/EC)

The Regulation on International
Credit Entitlements (RICE) (No
1123/2013)

Directive
on aviation
(2008/101/EC)

EC Regulation (No 600/2012)
on the verification of reports
and accreditation of verifiers

EC Registry Regulation
(No 389/2013)

Directive amending EU ETS
from 2013 onwards
(2009/29/EC)

Auctioning Regulation
(No 1031/2012)

EC Regulation (No 601/2012)
on the monitoring and reporting
of greenhouse gas emissions

Effort Sharing Decision
(406/2009/EC)

EC Decision on free allocation
of emission Allowances
(2011/278/EU)

Carbon Leakage
Decision (No 2010/2)

EC Regulation on aviation
(No 421/2014)



German Federal Law

Greenhouse Gas
Emission Allowance
Trading Act
(TEHG 2004 & 2011)

Project
Mechanisms Act
(ProMechG 2005)

Auction Ordinance 2012
(EHV 2012)

Allocation Ordinance
2020
(ZuV 2020)

Emissions Trading
Ordinance 2020 (EHV
2020)

Project Mechanisms Act
Fee Ordinance
(ProMechGebV 2007)

Data Collection
Ordinance 2020 (DEV
2020)



EU ETS Legal Framework 2013-2020 Harmonized System

DIRECTIVE 2009/29/EC establishes:

Level playing field between Member states

- a **community-wide cap** with a **linear reduction factor of 1.74% per year**
- general provisions on the **allocation** and **auctioning of allowances**
- **harmonized** Monitoring, Reporting and Verification (**MRV**) rules
- **Union Registry**



EU ETS Legal Framework 2013-2020 Harmonized System

EU Level

Member State (MS) Level

Cap setting

Cap is set on European level – no national targets within ETS-sectors

Allocation

Harmonized allocation rules

Implementation

Cost free

Common rules based on European Benchmarks
Commission consolidates data, determines cross sectoral correction factor and approves NIMs

Collect and approve applications of national installations and submit data and allocation proposal (National Implementation Measures – NIMs) to EU Commission

Auctioning

MS have auctioning budgets
Exchange (EEX) conducts auctions of allowances on a common platform for most Member States

MS receive revenues
Germany and UK have own auctioning platforms subject to the same rules as common platform



EU ETS Legal Framework 2013-2020 Harmonized System

	EU Level	Member State (MS) Level
MRV including Accreditation	Harmonized rules	Implementation of rules, accreditation of verifiers, peer-to-peer review of accreditation bodies
Registry	Unified Union Registry	National implementation – “face to the customer”
Market Oversight	Regulated in other general legislation on European level	Implementation
Sanctions	Sets level of penalty	Implementation and additional fines

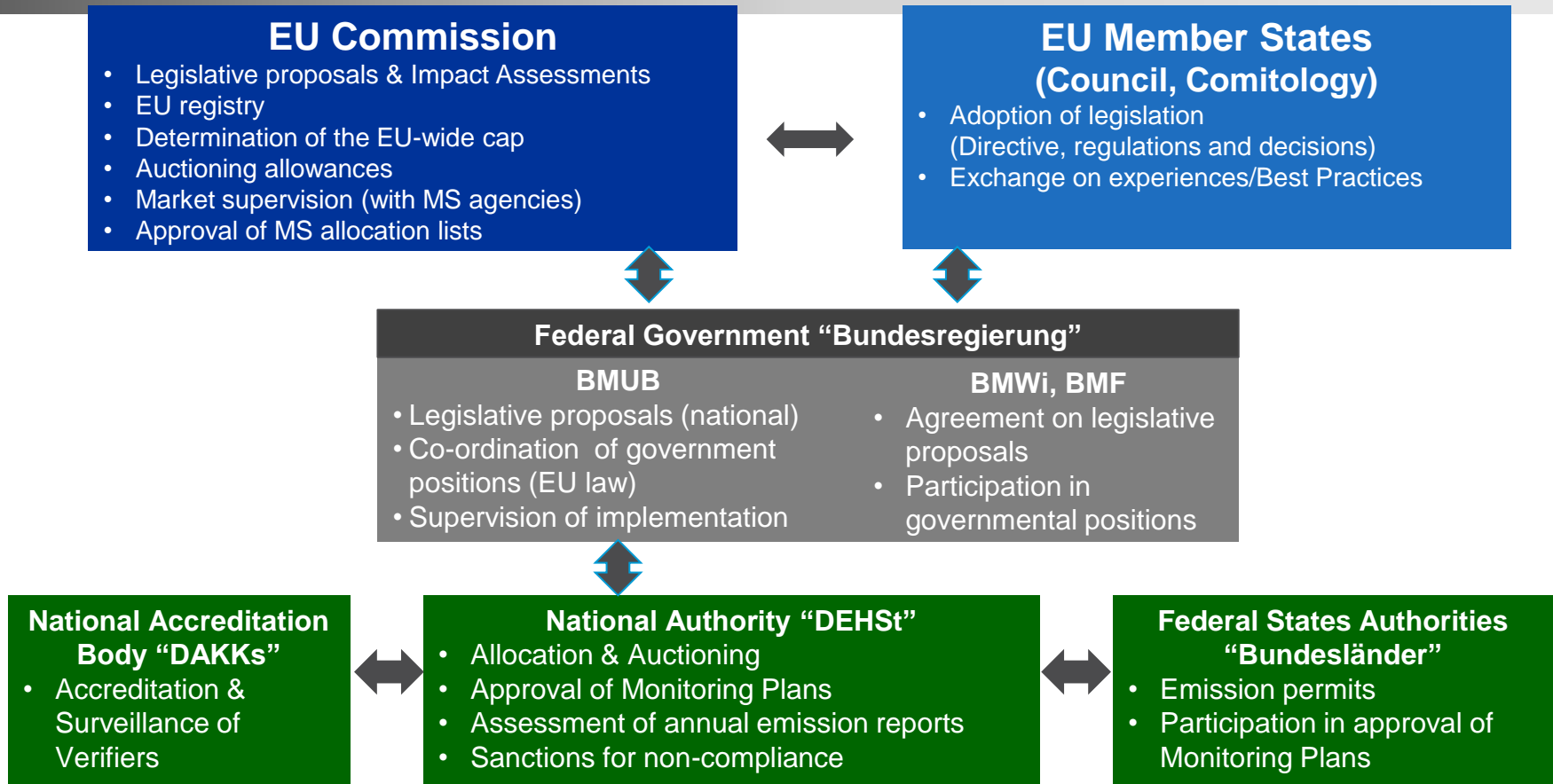


Outline

- EU ETS Phase I – III overview
- EU Policy Targets
- EU ETS Legal Framework
- **EU ETS Institutional Framework**
- Challenge: Structural Oversupply
- Stakeholder Involvement Germany
- EU ETS & Lawsuits



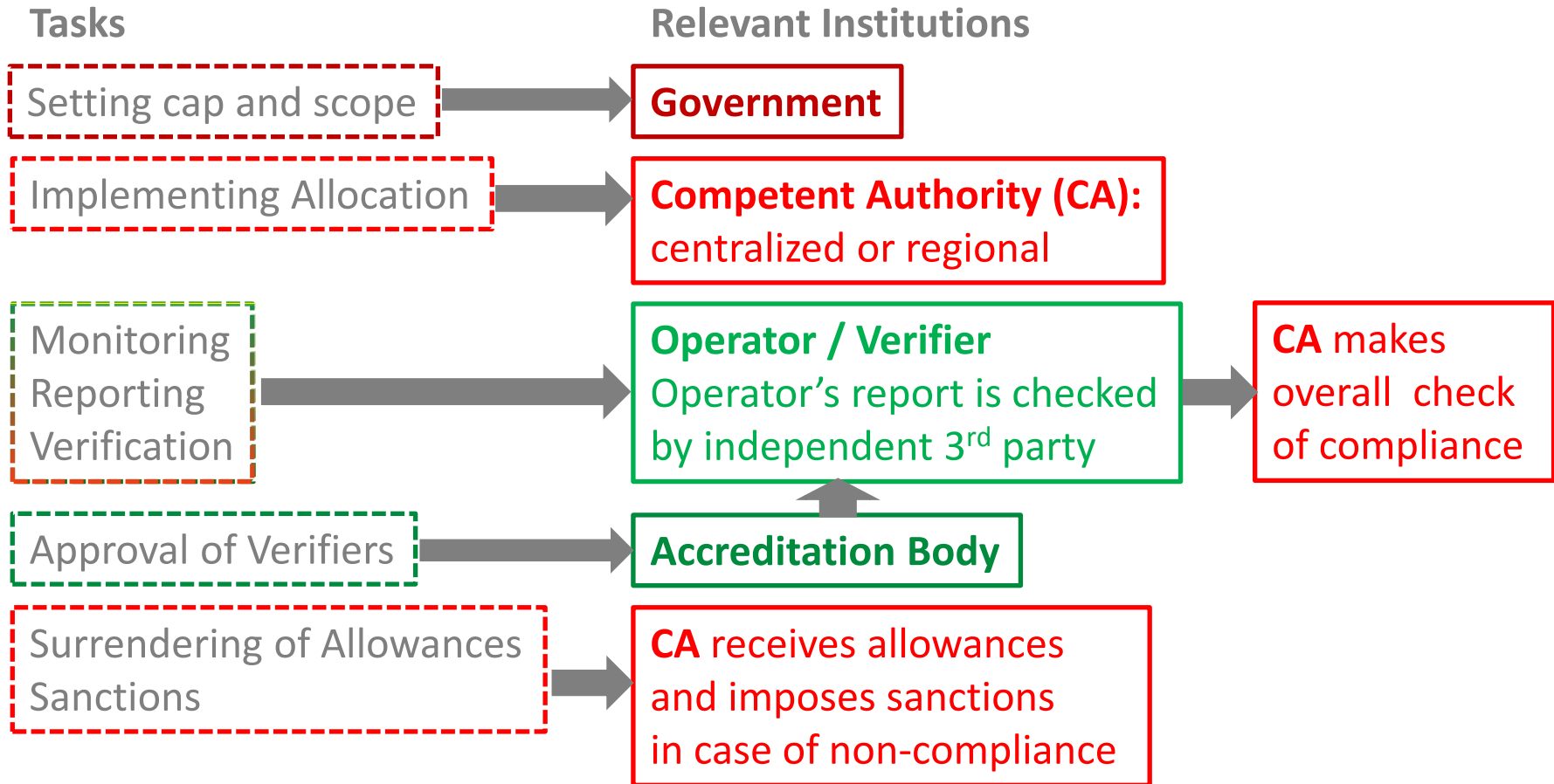
EU ETS Institutional Framework





Institutional Framework

Institutional Capacity Needs for an ETS





EU ETS

Institutional Framework

Federal Ministry of Environment

Political oversight

- Formulation of laws and regulations
- Coordination with other Ministries
- Cooperation with interest groups and stakeholders
- Communication with the EU COM and participation in EU Working Groups and Climate Change Committee
- Supervising the Competent Authority
- International cooperation to build up national and regional ETS

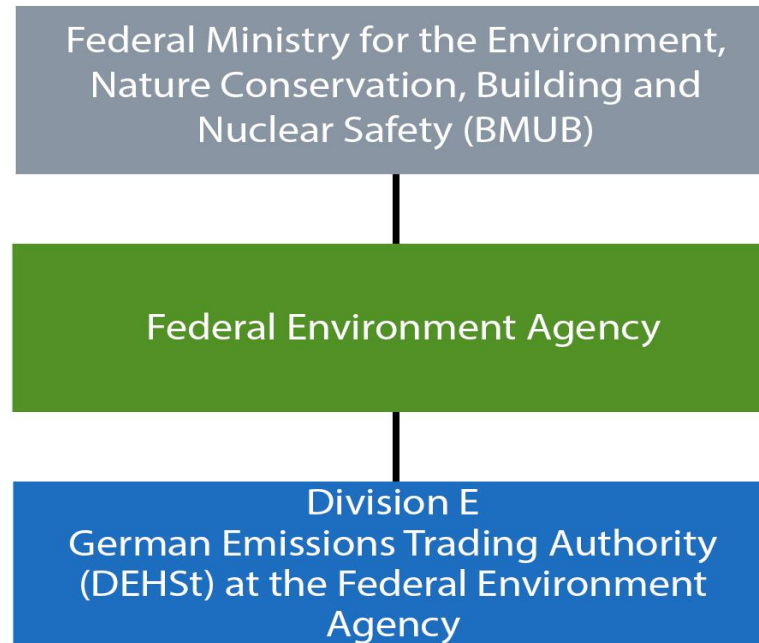
Competent Authority (DEHSt)

Technical ETS implementation in Germany

- Allocation and issuance of emission allowances
- Approval of monitoring plans
- Assessment of emission reports, imposing of sanctions where applicable
- Management of national installations and trading accounts
- Supervision of auctioning
- Approval and review of CDM and JI projects



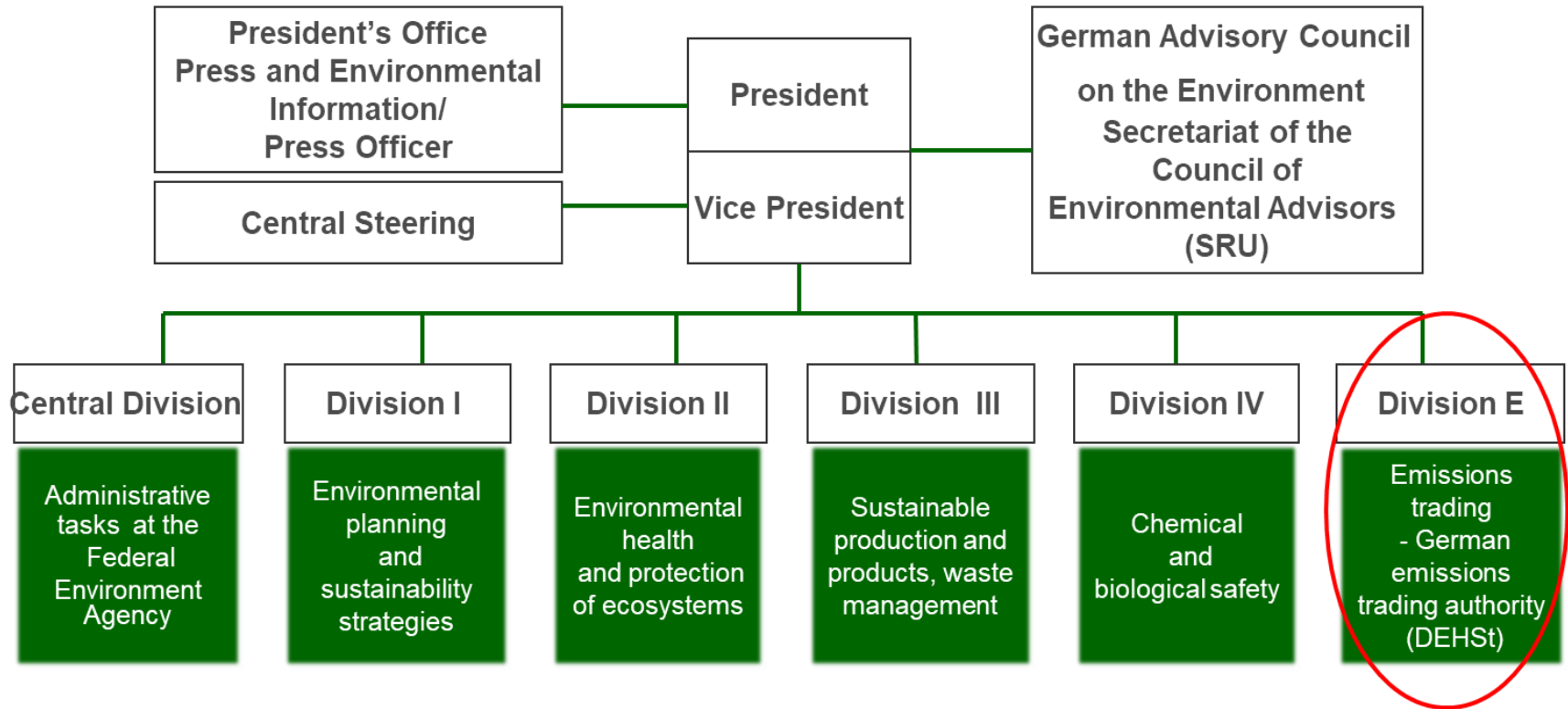
Structure of the German administration on the federal level





EU ETS Institutional Framework

Organisational Structure of the Federal Environment Agency





Outline

- EU ETS Phase I – III overview
- EU Policy Targets
- EU ETS Legal Framework
- EU ETS Institutional Framework
- **Challenge: Structural Oversupply**
- Stakeholder Involvement Germany
- EU ETS & Lawsuits



EU ETS

Challenges: Oversupply

- Accumulated surplus of approx. **2 billion allowances** and decline of CO2 allowance prices
- **Surplus caused by ...**
 - Financial and economic crisis 2008/2009 – resulted in reduction of output and emissions
 - Prognosis of emissions had not foreseen depth of economical crisis
 - Considerable proportion of credits from project-based mechanisms
- Generally **positive countercyclical effect of ETS**
- Scarcity needs to be upheld to give **incentives for long-term investments**



Structural reform through quantity control

Market Stability Reserve (MSR)

- If **surplus** is over certain threshold a defined number of allowances is **not auctioned but shifted to MSR**
- In case of **scarcity** a defined number of allowances is **returned to the market**
- The **MSR has the following effects:**
 - reduces surplus stepwise
 - prevents extreme burden in times of scarcity
 - is rule based and transparent for market participants
 - is quantity driven and leaves price discovery to market
 - improves the stability of the ETS and the price signal
- **The environmental integrity of the cap is not compromised**



Outline

- EU ETS Phase I – III overview
- EU Policy Targets
- EU ETS Legal Framework
- EU ETS Institutional Framework
- Challenge: Structural Oversupply
- **Stakeholder Involvement Germany**
- EU ETS & Lawsuits



Germany

Formal Stakeholder Involvement

- **First step: Draft legislative proposals** of the government are subject to **hearings of experts/ stakeholders concerned**, e.g.
 - Federal States
 - Business associations
 - Unions
 - (Environmental) NGOs
- **Second step: Inter-ministerial consultations** before the Federal Government adopts proposal
- **Third step:** Proposal is submitted to the **legislative bodies** (Bundesrat, Bundestag); committees **conduct public hearings of experts/stakeholders**



Germany

Informal Stakeholder Involvement

„Working Group on Emissions Trading“ (AG Emissionshandel)

- **Established** by the Federal Government in **2000**; **145th** meeting in December 2017
- **Permanent stakeholder consultation** concerning questions of emissions trading & national, european & international climate related policies
- **About 70 members** – representatives of companies, business/trade associations, environmental NGOs, trade unions, parliamentary fractions of political parties, federal states and agencies
- Financed by the Ministry for the Environment and Members
- **Sub groups** on economic, legal, administrative and international questions



Outline

- EU ETS Phase I – III overview
- EU Policy Targets
- EU ETS Legal Framework
- EU ETS Institutional Framework
- Challenge: Structural Oversupply
- Stakeholder Involvement Germany
- **EU ETS & Lawsuits**



EU-ETS and Lawsuits

- **High willingness for litigation**, especially in Germany
- Possible reasons:
 - “Continuation of policy-making with other means“
 - Distributional conflict, individual justice and equality: specific allocation rules might lead to different treatment between operators
 - Duty to go to court is often obligatory because of management liability rules
- Contribution to the evolution of the EU ETS



Court Decisions EU-ETS (I)

Legality of the ETS

BVerwG (Federal Administrative Court) 2005

Implementation of the **ETS and its obligations do not constitute a violation of fundamental rights** of operators of incumbent installations

Company claimed:

- a **permit** (under Immission Control Act) **to operate** the installation and to emit CO₂ **was obtained** before => **legitimate expectation**
- New **ETS obligations infringe fundamental rights** (e.g. property)

BVerwG:

- **ETS-obligations** have to be seen **separately**
- **existing permit** refers to non-GHG emissions and **doesn't grant a right to unlimited emissions**; operators' **obligations** are **“dynamic”**



Court Decisions EU-ETS (II)

Scope

ECJ (European Court of Justice) 2008

The Emissions Trading Directives' approach to **exempt certain sectors from the scope does not violate the principle of equal treatment.**

Company claimed:

- **Aluminium and Chemical** (plastics) industries are **excluded** from the ETS **although** producing **possible substitutes** to steel
- **distortion of competition** & breach of the principle that comparable situations must not be treated differently without justification

ECJ:

- In general, all **relevant competitors have to be covered** by ETS to **avoid unjust market distortions**
- However, a **“step-by-step approach“** to enlarge the ETS scope is **reasonable and justified**



Court Decisions EU-ETS (III)

Auctioning

BVerwG (Federal Administrative Court) 2012

Phasing-in into auctioning of allowances for electricity producers is proportionate and therefore justified.

- In 2008 DE started auctioning of 40 Mio t CO₂e (8,8 % of the Cap). Allocation for power producers was reduced correspondingly (15 %).
- **Power producers claimed: State may not auction the “use of air/atmosphere“ & violates fundamental rights of electricity producers**

BVerwG:

- ETS aims at putting a price on CO₂; auctioning is an efficient way
- **Fundamental rights** of operators have to be taken into account **phasing out free allocation**, but **operators who pass through CO₂ costs do not need an allocation free of costs**



Court Decisions EU-ETS (IV)

Sanctions

ECJ (European Court of Justice) 2013 & 2015

1. The “**excess emissions penalty**” regarding the failure to surrender allowances to cover the emission of the preceding year is **justified, irrespective of the reason for the non-surrender.**
 2. The “**excess emissions penalty**” is **precluded** if the allowances surrendered **equal the verified emissions** of the reporting period.
- **Operators challenged** the penalty for **various reasons**

ECJ:

- Highlighted the **key role** of the **allowance surrender process**; only “*force majeure*” has to be **recognised**
 - Imposing the penalty is limited to cases that **no or less allowances than reported & verified** are surrendered
- Special penalty/fine for “underreporting” is required



Thank you for your attention

Alexander Handke

Emissions Trading Division

**Federal Ministry for the Environment, Nature
Conservation, Building and Nuclear**

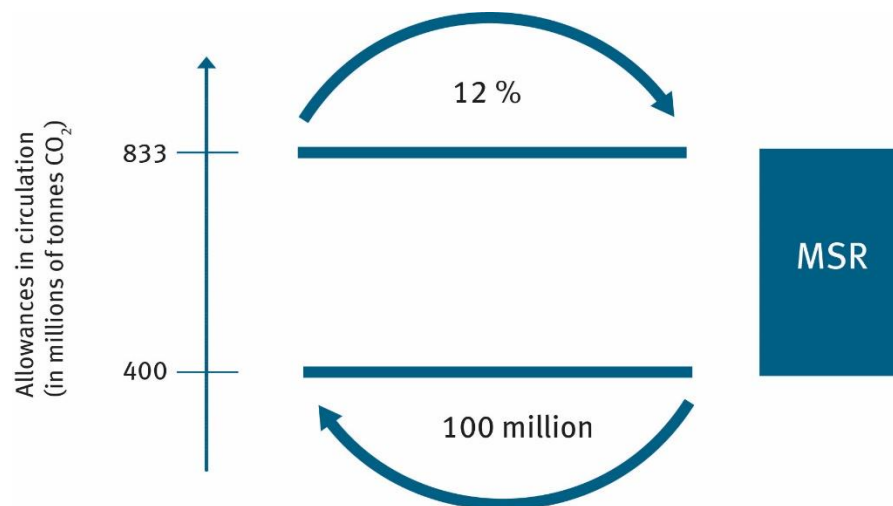
Alexander.Handke@bmub.bund.de



How the Market Stability Reserve Works

- **Start Date:**
 - First publication of Allowances in circulation in 2017
 - **First transfer of allowances into the MSR in 2019**
- **Backloading:**
 - To be directly transferred to MSR
- **Unallocated Allowances:**
 - To be directly transferred to MSR at the end of 3rd trading period
- **Solidarity:**
 - Auctioning amounts of poorest MS are reduced less than of richer MS until 2025

$$\begin{aligned} &\text{Allowances Issued} \\ &\text{minus Verified Emissions} \\ &= \text{Allowances in Circulation} \\ &\quad (\text{Surplus}) \end{aligned}$$





The Federal Ministry
for the Environment,
Nature Conservation
and Nuclear Safety

BACKUP



EU ETS – 2005 to 2012

European Framework

- DIRECTIVE 2003/87/EC established the EU ETS and determined:
 - greenhouse gases and activities/thresholds covered
 - duration of compliance periods and time of review
 - criteria for allocation (at least 95% / 90% of allowances for free)
Commission reviews national allocation plans
→ significant reductions in 2. trading period
- Member States:
 - determined liable installations according to criteria of directive
 - formulated national cap and allocation rules
 - laid down rules on competent authorities, penalties, and registries
 - determined national MRV-rules according to guidelines laid down by COM



EU ETS – 2005 to 2012

National Implementation in Germany

Legal and institutional basis in Germany:

- Transposition of directive and national rules:
Greenhouse Gas Emissions Trading Act (TEHG)
- Formulation of **National Allocation Plans**: Transposition into **Allocation laws** 2007 and 2012, complemented by allocation ordinances
- Monitoring, Reporting and Verification (MRV) rules:
Germany declared the European Guidelines to be legally binding
- Designation and establishment of a national **Competent Authority**:
German Emissions Trading Authority (DEHSt)
in the Federal Environment Agency
- Establishment of a **national registry**



Establishing an ETS

Key Design Features

- **Coverage**
Which sectors should participate in the ETS?
- **Cap**
What is the contribution of the covered sectors to the national GHG target?
- **Allocation**
Will allowances be auctioned
How much are given for free and how?
- **Monitoring, Reporting and Verification (MRV)**
How will be ensured that a tonne is a tonne?
- **Compliance**
How to cover emissions by allowances?
Which **Sanctions** ensure compliance?
- **Registry**
Which electronic infrastructure will be used to track trading and ensure security?



Establishing an ETS

Steps to implement the ETS

- **Define key design features**

What kind of system suits best regarding your **national circumstances**?

How to ensure the ETS will be **compatible with** systems you envision **linking** with or being part in the future?

- Will existing **data** suffice for your decisions or do you need to collect additional data?

- **Legal Basis**

Establish legal basis needed for the key design elements

- **Institutional Basis**

Define or create institutions responsible for implementing the ETS



Establishing an ETS

Pilot Phase - Learning by Doing

Learning is possible only in a “real” system

- **“Hard” Framework**

- Duties of covered installations and sanctions need to **ensure compliance**
- **Verified data** ensure information basis for subsequent more ambitious trading periods

- **Soft Start**

- Generous cap providing for **manageable reduction efforts**
- **Cost free allocation & Phasing-in Auctioning**
- **Additional policies** can reconcile economic impacts (e.g. by developing renewable energy, improving energy efficiency, solutions for carbon leakage)