

## LEGALITY AND PROCEDURE FOR THE UNILATERAL INCLUSION OF EMISSIONS FROM THE TRANSPORT SECTOR WITHIN THE ETS

This briefing explores a series of legal and policy issues related to the unilateral extension of the coverage of the Emissions Trading Scheme (ETS) by a Member State (MS) to include emissions from its transport sector. The specific issues addressed herein are as follows:

1. Is it legally possible for a MS to unilaterally include emissions from its transport sector within the ETS?
2. What is the procedure that must be followed in order for a MS to unilaterally include emissions from its transport sector within the ETS?
3. What is the effect of a MS unilaterally including emissions from its transport sector within the ETS on its national obligations under the “Effort Sharing” decision?

### SUMMARY OF ANALYSIS

- Member States may unilaterally include emissions from the transport sector within the ETS only if the procedural and substantive requirements of the Article 24 of the ETS Directive are met. It is uncertain whether these requirements can ever be met since an analysis would likely reveal that unilateral inclusion violates the principle of direct emissions, creates disincentives to adopt fuel-efficient technologies, increases emissions in the transport sector beyond business-as-usual, and creates imbalances between the ETS and other climate-mitigation measures, among other things.
- Should the unilateral inclusion of emissions from the transport sector be found to comply with the procedural and substantive requirements of Article 24 of the ETS Directive, which is uncertain, the issuance of allowances should be limited to business-as-usual emissions, i.e. those not exceeding what is expected under other Union legislation, otherwise it would increase emissions in the transport sector beyond business-as-usual and therefore diminish the environmental integrity of such unilateral inclusion.
- There are several decisions that would have to be made for the unilateral inclusion of emissions from the transport sector within ETS to proceed, representing a combination of delegated and implementing acts once pre-Lisbon comitology procedures are brought into line with Articles 290 and 291 of the Treaty on the Functioning of the European Union.
- Unilateral inclusion of emissions from the transport sector within the ETS would require a corresponding adjustment of the maximum quantity of emissions covered by the Effort Sharing Decision, which would have the practical effect of placing a higher burden on the sectors covered by the Effort Sharing Decision, such as the agriculture sector, and decreasing flexibility provided to Member States.

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## LEGAL BACKGROUND

### 1. Unilateral Inclusion of Transport Emissions within the ETS

Since 2008, MSs may unilaterally include activities and greenhouse gases (GHGs) not listed in Annex I within ETS. This would include the transport sector, which is not listed in Annex I. To do so, however, the procedural and substantive requirements of Article 24 must be met.

Article 24 of Directive 2003/87/EC (hereinafter the “ETS Directive”) outlines procedures for unilateral inclusion within ETS of an activity or emissions not included in Annex I:

#### Article 24

##### Procedures for Unilateral Inclusion of Additional Activities and Gases

1. From 2008, Member States may apply emission allowance trading in accordance with this Directive to activities and to greenhouse gases which are not listed in Annex I, taking into account all relevant criteria, in particular the effects on the internal market, potential distortions of competition, the environmental integrity of the Community scheme and the reliability of the planned monitoring and reporting system, provided that inclusion of such activities and greenhouse gases is approved by the Commission...

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(b) in accordance with the regulatory procedure with scrutiny... if the inclusion refers to activities and greenhouse gases which are not listed in Annex I....

2. When the inclusion of additional activities and gases is approved, the Commission may at the same time authorise the issue of additional allowances and may authorise other Member States to include such additional activities and gases.
3. On the initiative of the Commission or at the request of a Member State, a regulation may be adopted on the monitoring of, and reporting on, emissions concerning activities, installations and greenhouse gases which are not listed as a combination in Annex I, if that monitoring and reporting can be carried out with sufficient accuracy. That measure... shall be adopted in accordance with the regulatory procedure with scrutiny ...<sup>1</sup>

To date, Article 24 has been invoked for the unilateral inclusion, during the 2008-2012 period, of nitrous oxide (N<sub>2</sub>O) emissions associated with the production of nitric acid. The initial Article 24 application was submitted by the Netherlands and subsequently approved by the Commission with retroactive application.<sup>2</sup> Following the Commission’s approval of the Netherlands application, applications were submitted by Austria,<sup>3</sup> Latvia,<sup>4</sup> Italy,<sup>5</sup> and the United Kingdom<sup>6</sup> – with each receiving Commission

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<sup>1</sup> Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC [as consolidated], Art. 24.

<sup>2</sup> See C(2008) 7867, Commission Decision of 17 December 2008 concerning the unilateral inclusion of additional gases and activities by the Netherlands in the Community emissions trading scheme pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council (Only the Dutch text is authentic).

<sup>3</sup> See C(2009) 3032 Draft, Commission Decision of [...] concerning the unilateral inclusion of additional gases and activities by the Austria in the Community emissions trading scheme pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council (Only the German text is authentic). Unauthenticated draft English version available at:  
[http://www.europarl.europa.eu/RegData/docs\\_autres\\_institutions/commission\\_europeenne/comitologie/droit\\_de\\_r](http://www.europarl.europa.eu/RegData/docs_autres_institutions/commission_europeenne/comitologie/droit_de_r)

approval. It is noteworthy that following the approval of the applications from the Netherlands and Austria, Directive 2009/29/EC (hereinafter the “ETS Expansion Directive”) expanded the scope of ETS to include additional installations, gases and activities in Annex I, including N<sub>2</sub>O emissions associated with the production of nitric acid, from 2013 onwards.<sup>7</sup>

The text of Article 24 of the ETS Directive and the existing precedent make clear that unilateral expansion of the ETS to include activities not listed in Annex I, such as those from the transport sector, is permitted so long as the procedural and substantive requirements of Article 24 are met.

## 2. Procedure for the Unilateral Inclusion of Transport Emissions in the ETS

Article 24 establishes a five-step process to facilitate the unilateral inclusion of transport emissions within the ETS by a MS, which are as follows:

1. (mandatory) MS Application under Article 24(1);
2. (mandatory) Commission approval under Article 24(1)(b);
3. (optional) Commission authorization of additional allowances under Article 24(2);
4. (optional) Commission authorization of other MSs to include the additional activity under Article 24(2); and
5. (optional) Commission adoption of monitoring and reporting requirements under Article 24(3).

These steps dictate, to a large extent, the opportunities for raising objections to the unilateral inclusion of transport emissions within the ETS.

### (a) MS Application under Article 24(1)

A MS must apply for Commission approval under Article 24(1).<sup>8</sup> A review of previous Commission decisions to approve Article 24(1) applications and the information required by the Commission during previous expansions of the ETS at the EU-wide level provide indicators of what information a MS is expected to include with its Article 24(1) application.

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<sup>4</sup> egard/2009/COM-AC\_DR(2009)D004163-02\_EN.doc [hereinafter the “Austria Approval Decision”].  
<sup>4</sup> See C(2009) 9849 Draft, Commission Decision of \_\_\_\_\_ 2009 concerning the unilateral inclusion of additional greenhouse gases and activities by Latvia in the scheme for greenhouse gas emission allowance trading within the Union pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council (English text unavailable).

<sup>5</sup> See C(2011)3798 Draft, Commission Decision of XXX concerning the unilateral inclusion of additional greenhouse gases and activities by the Italy in the scheme for greenhouse gas emission allowance trading within the Union pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council (Only the Italian text is authentic). Unauthenticated draft English version available at: [http://ec.europa.eu/clima/policies/ets/pre2013/nap/docs/decision\\_it\\_en.pdf](http://ec.europa.eu/clima/policies/ets/pre2013/nap/docs/decision_it_en.pdf) [hereinafter the “Italy Approval Decision”].

<sup>6</sup> See C(2011) 3798, Commission Decision of 6 June 2011 concerning the unilateral inclusion of additional greenhouse gases and activities by the United Kingdom in the scheme for greenhouse gas emission allowance trading within the Union pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council.

<sup>7</sup> See Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the community, Art. 1 at ¶30 and Annex I.

<sup>8</sup> See Directive 2003/87/EC, Art. 24(1). The use of the word “approved” to describe the Commission’s role in this process indicates that the process must be initiated by the MS, *i.e.* the MS—and not the Commission—initiates the process by submitting an application for the inclusion of emissions from an activity not currently included in Annex I. By contrast, where the ETS Directive intends that the Commission initiate the expansion of the ETS it has explicitly stated that intention. See *e.g.* Directive 2003/87/EC, Art. 30. Similarly, the ETS also explicitly states when an action can be initiated by either the Commission or a MS. See *e.g.* Directive 2003/87/EC, Art 24(3).

For example, the Netherlands Article 24(1) N<sub>2</sub>O emissions application included, *inter alia*:

- a proposed starting date for the opt-in of the emissions;
- the number of installations to be included and the quantity of historic emissions from those installations;
- a proposed total emissions allocation for the newly regulated activity/installation and a declining benchmark applied to those emissions;
- the source and amount of the reserve allocation for new entrants; and
- a detailed monitoring and reporting system already in use within the MS.<sup>9</sup>

The Article 24(1) N<sub>2</sub>O emissions applications submitted by Austria, Italy and the United Kingdom additionally included, *inter alia*:

- demonstrable consistency with national allocation plans to achieve each MSs emissions reduction target under the Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC);
- provisions excluding the newly covered installations from using Certified Emission Reductions (CERs) or Emission Reduction Units (ERUs); and
- a proposed benchmark applied to emissions and how that benchmark compares to the best performing installations in the Union.<sup>10</sup>

The ETS Expansion Directive extended the coverage of the ETS at the EU-wide level to include additional installations. The ETS Expansion Directive imposed requirements on MSs that wished to allocate allowances to the operators of newly included installations that it brought into the ETS and required MSs to submit an application containing, *inter alia*:

- a list of the installations covered by the application and the amount of allowances to be allocated to each installation in accordance with Commission guidance;
- a national plan in accordance with the ETS Expansion Directive;
- monitoring and enforcement provisions with respect to the intended investments pursuant to the national plan;
- information showing that the allocations do not create undue distortions of competition;
- a list of installations now covered by the ETS Expansion Directive;
- the emission calculations for the newly covered installations; and
- the amount of any free allocations given to each installation.<sup>11</sup>

Directive 2008/101/EC (hereinafter the “Aviation Directive”) expanded the coverage of the ETS at the EU-wide level to include emissions from aviation activities.<sup>12</sup> The Aviation Directive imposed requirements on MSs that wished to allocate allowances to the entities responsible for aviation emissions within their jurisdiction which it brought into the ETS and required MSs to submit an application that, *inter alia*:

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<sup>9</sup> See C(2008) 7867.

<sup>10</sup> See generally C(2011) 3798, p. 2 at ¶18; Austria Approval Decision; Italy Approval Decision.

<sup>11</sup> See Directive 2009/29/EC, Art. 11.

<sup>12</sup> Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community.

- identifies the entities regulated, e.g. the “operators” responsible for aviation emissions, within their jurisdiction;
- establishes baseline historic aviation emissions;
- proposes emissions decreases;
- compares proposed aviation emission levels to “business-as-usual” (BAU) emission levels;
- proposes a method for determining allocations and allowances among regulated entities; and
- proposes methods of monitoring, reporting and verifying emissions.<sup>13</sup>

In addition, in order for the unilateral inclusion of emissions from the transport sector, or any other activity not currently listed in Annex I of the ETS Directive, a MS application and the Commission assessment must take into account “all relevant criteria,” which have been identified as:

- the effects on the internal market;
- potential distortions of competition;
- the environmental integrity of the ETS;
- the reliability of the planned monitoring and reporting system; and
- all other relevant criteria.<sup>14</sup>

Section 4, *infra*, of this briefing discusses how these criteria have been interpreted and applied in both MS Article 24(1) applications and Commission assessments prior to approval of an application, and outlines potential barriers to the unilateral inclusion of transport emissions.

#### **(b) Commission Approval under Article 24(1)(b)**

The Commission must approve a MS Article 24(1) application in accordance with the regulatory procedure with scrutiny (RPS) where, as here, it attempts to unilaterally include activities and emissions not listed in Annex I.<sup>15</sup> While the RPS currently applies when the Commission exercises powers under Article 24(1)(b), it almost certainly *will not apply* at the time the Commission takes any decision in relation to a MS’s Article 24(1) application to include emissions from its transport sector within the ETS. Rather, the regulatory procedure for “Delegated Acts” set forth in Article 290 of the Treaty on the Functioning of the European Union (TFEU) will likely apply.<sup>16</sup>

Like all other legal acts, the ETS Directive will be adapted to Articles 290 and 291 of the TFEU, and the Commission has pledged to Parliament to replace the RPS with the procedures set forth in Article 290 or 291 in all legislative instruments by the end of 2014.<sup>17</sup> Further, the Commission has already submitted a proposed regulation which specifically proposes to adapt the RPS procedures for the exercising of powers under Article 24(1)(b) of the ETS Directive to the Delegated Acts procedure of Article 290 of the TFEU.<sup>18</sup> The only exception is for pending procedures in which an opinion has already been delivered by a

<sup>13</sup> See generally Directive 2008/101/EC.

<sup>14</sup> Directive 2003/87/EC, Art. 24(1).

<sup>15</sup> Directive 2003/87/EC, Art. 24(1)(b). The procedure referenced in Article 23(3) and applied to Commission decision making under Article 24(1)(b) is the procedure set forth in Article 5a(1) – (4) of Decision 1999/468/EC. See Directive 2003/87/EC, Art. 23(3).

<sup>16</sup> See *Consolidated Version of the Treaty on the Functioning of the European Union*, (26 Oct. 2012) [hereinafter “TFEU”], Art. 290, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:12012E/TXT&from=EN>.

<sup>17</sup> See EIPA, *Delegated & Implementing Acts The New Comitology*, (Sept. 2013), p. 15, available at: [http://www.eipa.eu/files/repository/product/20130904094203\\_Comitology\\_Brochure5EN\\_web.pdf](http://www.eipa.eu/files/repository/product/20130904094203_Comitology_Brochure5EN_web.pdf).

<sup>18</sup> See Council of the European Union, *Common Understanding on delegated acts*, (4 Apr. 2011) [hereinafter “Article 290 Common Understanding”], p. 2; 2013/0365 (COD), *Proposal for a Regulation of the European Parliament and of the Council adapting to Article 290 and 291 of the Treat on the Functioning of the European Union a number of legal acts*

committee in accordance with the RPS.<sup>19</sup> Therefore, unless a MS submits an application and the committee delivers its opinion before the end of 2014, the Delegated Acts procedure must be followed by the Commission when it approves a MS's application under Article 24(1)(b).

While Article 290 of the TFEU sets forth a broad framework within which the Commission exercises its powers under Delegated Acts,<sup>20</sup> the precise contours of the Delegated Acts procedure under Article 290 are determined on a case-by-case basis. A "Communication from the Commission to the Parliament and the Council,"<sup>21</sup> an agreed upon "Common Understanding" of Article 290 between the Commission, Parliament and Council<sup>22</sup> and a proposed regulation adapting Article 290 and 291 to legal acts providing for the use of the RPS (the "Article 290 Proposed Regulation")<sup>23</sup> have clarified how the Delegated Acts procedure will operate in the context of decision making under the ETS Directive, and specifically Article 24(b)(1). The Delegated Acts procedure is outlined in Annex I of this briefing.

During its consideration of a MS Article 24(1) application, the Commission will take into account "all relevant criteria" listed in Article 24(1). In addition, when considering the Article 24(1) application from the Netherlands to include certain N<sub>2</sub>O emissions within ETS, the Commission assessment considered, *inter alia*, issues raised by a study commissioned by the Commission on technological possibilities to reduce N<sub>2</sub>O emissions from nitric acid plants and the economic effects such reductions would have should the installations be included in ETS.<sup>24</sup> In the context of approving any Article 24(1) application to unilaterally include transport within ETS, it should be expected that the Commission would similarly consider the issues raised by several studies commissioned by Union institutions, including one commissioned by the European Parliament considering the feasibility and implications of including emissions from the transport sector within the ETS (hereinafter the "Future Elements Study").<sup>25</sup> The policy issues raised in that report are considered in Section 4, *infra*, of this briefing.

### (c) Authorization of Additional Allowances under Article 24(2)

Under Article 24(2), "[w]hen the inclusion of additional activities and gases is approved, the Commission may at the same time authorise the issue of additional allowances" for the newly included activity.<sup>26</sup> There are no specified criteria for the authorisation of additional allowances and no procedural process is stated. In the absence of a specific provision setting forth the procedure to be followed when the Commission exercises its powers under Article 24(2), the ETS Directive states: "measures necessary for the implementation of [the ETS] Directive should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers

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*providing for the use of the regulatory procedure with scrutiny*, (30 Oct. 2013) [hereinafter "Article 290 Proposed Regulation"], Annex I.

<sup>19</sup> See Article 290 Proposed Regulation, p. 7.

<sup>20</sup> See TFEU, Art. 290 ("1. A legislative act may delegate to the Commission the power to adopt non-legislative acts of general application to supplement or amend certain non-essential elements of the legislative act. The objectives, content, scope and duration of the delegation of power shall be explicitly defined in the legislative acts. The essential elements of an area shall be reserved for the legislative act and accordingly shall not be the subject of a delegation of power. 2. Legislative acts shall explicitly lay down the conditions to which the delegation is subject; these conditions may be as follows: (a) the European Parliament or the Council may decide to revoke the delegation; (b) the delegated act may enter into force only if no objection has been expressed by the European Parliament or the Council within a period set by the legislative act. For the purposes of (a) and (b), the European Parliament shall act by a majority of its component members, and the Council by a qualified majority. ...").

<sup>21</sup> See COM (2009) 673, *Communication from the Commission to the European Parliament and Council: Implementation of Article 290 of the Treaty on the Functioning of the European Union*, (9 Dec. 2009) [hereinafter "Article 290 Communication"].

<sup>22</sup> See Article 290 Common Understanding.

<sup>23</sup> See Article 290 Proposed Regulation.

<sup>24</sup> See C/2008 7867, p. 3 n.2.

<sup>25</sup> See European Parliament Policy Department – Economic and Scientific Policy, *The future elements of the EU Emission Trading Scheme* (Feb. 2008) [hereinafter "Future Elements Study"], pp. 41-59.

<sup>26</sup> Directive 2003/87/EC, Art. 24(2).

conferred on the Commission.”<sup>27</sup> The referenced implementing powers were adapted to Article 291 of the TFEU through Regulation (EU) 182/2011.<sup>28</sup> Article 2(2) of Regulation (EU) 182/2011 stipulates that “the examination procedure applies, in particular, for the adoption of... other implementing acts relating to... the environment.”<sup>29</sup> Thus, under Regulation (EU) 182/2011, the powers conferred by Article 24(2) should be exercised by the Commission following the examination procedure set forth for implementing acts under Article 291 of the TFEU and Regulation (EU) 182/2011.

In the past, the amount of additional allowances is calculated based on the historic emissions of the newly covered activity during a select year or select years and reduced by an annual percentage applied to that amount in order to support the MS’s ETS targets.<sup>30</sup> There is no precise formula for determining the amount of additional allowances issued to a MS for its emissions from the newly covered activity and each application is considered on a case-by-case basis.

Nevertheless, additional allowances should not exceed the amount of emissions that would have occurred under a BAU scenario taking into account existing obligations under other domestic, Union or international law. This ceiling was applied by the Commission when it exercised its Article 24(2) powers to issue additional allowances following its approval of the Netherlands application to include N<sub>2</sub>O emissions from nitric acid production within the ETS,<sup>31</sup> and it should be equally applied here. At a bare minimum, this would mean that allowances allocated to the transport sector must be less than the maximum allowed or expected emissions from that sector under Decision 406/2009/EC (hereinafter the “Effort Sharing Decision”).<sup>32</sup> This issue is discussed further in the “Environmental Integrity” portion of Section 4, *infra*, of this briefing.

#### **(d) Authorization of Other MSs to Include the Activity**

Under Article 24(2), “[w]hen the inclusion of additional activities and gases is approved, the Commission... may authorise other Member States to include such additional activities and gases.”<sup>33</sup> As discussed above, in the absence of a specified procedure, the Commission exercises its powers under Article 24(2) of the ETS Directive according to the “examination procedure” set forth in the Regulation (EU) 182/2011.<sup>34</sup>

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<sup>27</sup> Directive 2003/87/EC, Recital ¶ 28. Additionally, Article 24 was added to the ETS Directive via the ETS Expansion Directive. The ETS Expansion Directive also states that “[t]he measures necessary for the implementation of [the ETS Expansion Directive] should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission.” See Directive 2009/29/EC, Recital ¶44.

<sup>28</sup> See Regulation (EU) 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general provisions concerning mechanisms for control by Member States of the Commission’s exercise of implementing powers.

<sup>29</sup> Regulation (EU) 182/2011, Art. 2(2)(b)(iii).

<sup>30</sup> See *e.g.* C(2008) 7867, pp. 2-4 (Netherlands Article 24 application); C(2011) 3798, pp. 1-2 (UK Article 24 application); Directive 2003/87/EC, Art. 3c (adjusting allowances to include the aviation sector). Like previous expansions of the coverage of the ETS, a corresponding adjustment must also be made to the Community-wide quantity of allowances through 2020 equal to the amount of additional allowances authorized by the Commission. See *e.g.* Directive 2009/29/EC, Recital ¶ 14 (“Adjustments should be made to the Community-wide quantity in relation to installations which are included in, or excluded from, the Community scheme during the period from 2008 to 2012 or from 2013 onwards.”); 2010/634/EU, Commission Decision of 22 October 2010 adjusting the Union-wide quantity of allowances to be issued under the Union Scheme for 2013 and repealing Decision 2010/384/EU (adjusting the total amount of Union-wide allowances in response the unilateral inclusion under Article 24 of emissions from activities not listed in Annex I).

<sup>31</sup> See C(2008) 7867, p. 3 at ¶4.

<sup>32</sup> Decision 406/2009/EC of the European Parliament and of the Council of 23 April 2009 on the effort of Member States to reduce their greenhouse gas emissions to meet the Community’s greenhouse gas emissions reduction commitments up to 2020.

<sup>33</sup> Directive 2003/87/EC, Art. 24(2).

<sup>34</sup> See Regulation (EU) 182/2011, Art. 2(2)(b)(iii).

The leaked conclusions of the European Council include the following statement: “12. The Commission, in collaboration with interested Member States, will swiftly explore modalities to facilitate the unilateral inclusion of fuels used in the transport sector by a Member State into the EU ETS in line with modalities foreseen in the EU ETS.”<sup>35</sup> In practice, following an initial application by a MS under Article 24(1), the Commission can exercise its powers under Article 24(2) to establish modalities that streamline the process of including transport within the ETS for other MSs, including identifying the appropriate historic baseline, benchmark or other method for decreasing the allowances over time as well as identifying or adopting monitoring and reporting systems.

### **(e) Adoption of Monitoring and Reporting Requirements**

Under Article 24(3), “[o]n the initiative of the Commission or at the request of a Member State, a regulation may be adopted on the monitoring of, and reporting on, emissions concerning activities, installations and greenhouse gases which are not listed as a combination in Annex I, if that monitoring and reporting can be carried out with sufficient accuracy...”<sup>36</sup>

Similar to Commission powers exercised under Article 24(1)(b), the ETS Directive states that the Commission must act in accordance with the RPS when exercising its powers under Article 24(3).<sup>37</sup> And, similar to Article 24(1)(b), the Commission listed Article 24(3) among those provisions that will be subject to the Delegated Acts procedure of Article 290 of the TFEU in the Article 290 Proposed Regulation, which is outlined in Annex I of this briefing.<sup>38</sup>

To date, the required standard for monitoring and reporting of new sources of emissions under the ETS has been high. The ETS Expansion Directive states that expansion “should be extended to other installations the emissions of which are capable of being monitored, reported and verified *with the same level of accuracy*” as requirements for installations currently covered by the ETS.<sup>39</sup> And where a new activity that differs substantially from previously covered sources of emissions, *e.g.* aviation, is included in the ETS, the monitoring, reporting and verifying provisions should account for the particular character of the emissions and be stated with sufficient detail.<sup>40</sup> Among other distinctions, emissions from the transport sector are transient in nature and there is the potential that regulated entities will not be directly responsible for emissions, *e.g.* if, as suggested by the leaked Danish proposal, fuel suppliers are the regulated entity. These issues and others, discussed in Section 4, *infra*, of this briefing, should be addressed in any regulation adopted for the monitoring, reporting and verification of emissions from the transport sector and scrutinized under the Delegated Acts procedure.

### **3. Effect of Unilateral Inclusion of Transport Emissions in the ETS on MS Obligations under the Effort Sharing Decision**

Under the Effort Sharing Decision, MSs are required to limit their GHG emissions covered by the Effort Sharing Decision between 2013 and 2020 by meeting binding annual limits set according to a linear path. The scope of the GHG emissions covered by the Effort Sharing Decision is defined by their exclusion from the ETS.<sup>41</sup> Emissions from transport, with the exception of aviation and international maritime shipping, are covered under the Effort Sharing Decision. The annual targets, known as annual emission allocations

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<sup>35</sup> Leaked 2030 European Council Conclusions, ¶ 12 (sent to Defense Terre with assignment). This is supported by other language in the Leaked 2030 European Council Conclusions: “In order to ensure cost-effectiveness of the collective EU effort, flexibility in achieving the targets in the non-ETS sector will be significantly enhanced ...” *Id.*, ¶16.

<sup>36</sup> Directive 2003/87/EC, Art. 24(3).

<sup>37</sup> See Directive 2003/87/EC, Art. 24(3).

<sup>38</sup> See Article 290 Proposed Regulation, Annex I(B)(5).

<sup>39</sup> Directive 2009/29/EC, Recital ¶10; see also Aviation Directive, Recital ¶31 (stating that “the provisions of the [ETS Directive] relating to monitoring, reporting and verifying emissions ... applicable to operators should also apply to aircraft operators.”).

<sup>40</sup> See *e.g.* 2003/87/EC, Annex IV Part B and Annex V Part B.

<sup>41</sup> See Decision 406/2009/EC, Art. 1(1).

(AEAs), follow a straight line between a defined starting point in 2013 and the target for 2020. A percentage variation up or down from the linear path is permitted to be carried over from year-to-year.

The Effort Sharing Decision mandates that “[a]ny adjustments in the coverage of [the ETS Directive] should be matched by a corresponding adjustment in the maximum quantity of greenhouse gas emissions covered by this Decision.”<sup>42</sup> Article 10 of the Effort Sharing Decision specifically addresses the impact an expansion of the coverage of the ETS Directive will have on an MS’s obligations under the Effort Sharing Decision.

**Article 10**  
**Changes in the Scope of Directive 2003/87/EC and Application of Article 24 Thereof**

The maximum quantity of emissions for each Member State under Article 3 of this Decision shall be adjusted in accordance with the quantity of...

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- (b) allowances or credits issued pursuant to Articles 24 [of the ETS Directive] in respect of emission reductions in a Member State covered by this Decision...

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The Commission shall publish the figures resulting from that adjustment.<sup>43</sup>

This adjustment will not affect a MS’s obligation to reduce its emissions from the remaining covered sectors by the percentage specified in Annex II of the Effort Sharing Decision. Only the total amount of AEAs is reduced by the amount attributable to the sector now covered by the ETS Directive and the percentage reduction in Annex II is applied to the new baseline amount of emissions to create a new AEA target in 2020. The linear reduction in emissions required to achieve the targets in Annex II must still be met by the MS.<sup>44</sup> The following hypothetical example illustrates the impact of a MS unilaterally including emissions from its transport within the ETS would have on its obligations under the Effort Sharing Decision:

- *Assumption 1:* The MS’s total baseline AEAs in 2013, based on the 2008-2010 emissions of the sectors covered by the Effort Sharing Decision, is 100.
- *Assumption 2:* Transport represents 40% of the total 2008-2010 emissions covered under the Effort Sharing Decision.
- *Assumption 3:* The MS’s Effort Sharing Decision GHG emissions limit in 2020 is a 10% reduction.

Before including transport within the ETS, the MS’s obligations under the Effort Sharing Decision would be: 100 AEAs x .9 (representing a 10% reduction) = 90 AEAs in 2020. The MS would be expected to follow a linear path from 2013 to 2020 to achieve this reduction.

After including transport within the ETS the MS’s obligations under the Effort Sharing Decision would be: 60 AEAs x .9 (representing a 10% reduction) = 54 AEAs in 2020. The MS would still be expected to follow a linear path from 2013 to 2020 to achieve this reduction.

Including transport within the ETS will, however, decrease the flexibility the MS enjoys in choosing when and in which sectors to reduce emissions to meet its target under the Effort Sharing Decision. Under

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<sup>42</sup> Decision 406/2009/EC, Recital ¶25.

<sup>43</sup> Decision 406/2009/EC, Art. 10; *see also e.g.* 2013/634/EU, Commission Implementing Decision of 31 October 2013 on the adjustments to Member States’ annual emissions allocations for the period 2013 to 2020 pursuant to Decision 406/2009/EC of the European Parliament and of the Council.

<sup>44</sup> *See* Decision 406/2009/EC, Art. 3(1) and Annex II.

a BAU scenario, existing measures affecting transport emissions are anticipated to significantly reduce these emissions through 2020 and beyond. As a result, the sectors remaining under the Effort Sharing Decision may be required to increase their emission reductions burden to allow the MS to meet its Effort Sharing target in the 2013-2020 period.

The Effort Sharing Decision also states: “[t]he measures necessary for the implementation of this Decision should be adopted in accordance with Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission.”<sup>45</sup> Under Article 2(2)(b)(iii) of Regulation (EU) No. 281/2011, the examination procedure will apply when the Commission exercises its powers of adjustment under Article 10 of the Effort Sharing Decision.

#### **4. Potential Barriers to the Unilateral Inclusion of Transport Emissions in the ETS**

As set forth in Sections 1 and 2, *infra*, so long as the MS and Commission adhere to the procedural and substantive requirements of Article 24, the unilateral inclusion is lawful. Leaving aside any potential procedural objections—unknown at the moment—several potential barriers against the unilateral expansion of ETS to include transport emissions exist. These barriers are based on the criteria set forth in Article 24(1), namely the effects on the internal market, potential distortions of competition, the environmental integrity of the ETS, the reliability of the planned reporting and monitoring system and/or other relevant criteria.

##### **(a) Effects on the Internal Market**

The Commission must consider the potential impact that allowing certain MSs to include transport emissions in the ETS will have on the internal market. If, as has been suggested,<sup>46</sup> fuel suppliers are the regulated entity and those fuel suppliers operate across MS borders, including emissions from transport within the ETS may cause additional disruption to the free movement of fuel within the Union. In this regard, the interplay between the price of carbon credits within the ETS and tax measures imposed on fuel by MSs will be determinative of the extent of the disruption.

##### **(b) Potential Distortions of Competition**

The transient nature of transport emissions and the ability to purchase fuel in one MS for use in another creates potential distortions of competition during unilateral inclusion of transport emissions within the ETS. In particular, it raises the specter of “fuel shelters” being created on the borders between MSs that have unilaterally included transport emissions and those that have not. This issue was highlighted in the Future Elements Study:

Clearly, in relation to intra-EU competitiveness, any potential adverse impact would be reduced if the scheme [to include emissions from transport] is EU-wide, rather than simply national. In a national [cap-and-trade] scheme, vehicle drivers near border areas could buy fuel from across the border, but for an EU-wide scheme, these risks would be reduced.<sup>47</sup>

At present, the only transport-related emissions currently included in the ETS are those from aviation activities. The Aviation Directive imposed Union-wide obligations rather than allowing unilateral inclusion of aviation emissions by MSs to avoid distortions of competition recognizing that the transient nature of the emissions would create competition distortions within the Community unless the obligations were harmonized.<sup>48</sup> The piecemeal, unilateral inclusion of transport emissions by certain MSs would pose a

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<sup>45</sup> Decision 406/2009/EC, Recital ¶132.

<sup>46</sup> Fuel suppliers are the preferred regulated entity under the leaked Danish proposal (submitted with this assignment) and the Future Elements Study. See Future Elements Study, pp. 41-59.

<sup>47</sup> See Future Elements Study, p. 49.

<sup>48</sup> See Directive 2008/101/EC, Recital ¶16 (emphasis added)(“In order to avoid distortions of competition and improve

similar potential for distortions of competition within the Union.

### (c) Environmental Integrity of the ETS

The Commission has stated that:

Environmental integrity requires most importantly that the inclusion in the EU ETS of an additional gas and activity should result in a *real reduction of emissions compared to business as usual* and the number of allowances created by inclusion in the EU ETS *should not exceed emission levels that can be expected pursuant to other environmental legislation...*<sup>49</sup>

This is, in essence, an “additionality” requirement for newly included non-Annex I activities. For example, in approving the Netherlands application under Article 24(1), the Commission determined that the benchmark applied to the historical emissions of the installations to be included was below the maximum emissions values imposed by the application of all existing legislation, *i.e.* including the emissions “will create an incentive for the ... installations to invest and apply abatement measures which will significantly reduce emissions below the level that results from the application of [other existing measures] alone.”<sup>50</sup>

Emissions from the transport sector are included within the Effort Sharing Decision. Each MS is responsible for reducing emissions across the covered sectors from 2008-2010 levels by 2020 by the percentage specified in Annex II.<sup>51</sup> These reduction targets, along with any formal sector-specific national plans submitted by the MS,<sup>52</sup> should form the ceiling for the amount of allowances allocated to the transport sector under Article 24(2). This ceiling may be further lowered by existing Union legislation, of which at least three are relevant. First, Article 7a of Directive 2009/30/EC—the Fuel Quality Directive—requires fuel suppliers to reduce lifecycle GHG emissions in their fuel and energy supplied by 6% by 2020.<sup>53</sup> This may not only be met through upstream emission reductions but also through the use of biofuels and electric vehicles. Article 7a also contains indicative targets of up to 4% that would need to be accounted for. Second, Directive 2009/28/EC—the Renewable Energy Directive—contains volume targets to achieve 10% renewable energy in the transport sector.<sup>54</sup> National renewable energy action plans (NREAPs) outline how Member States intend to meet these obligations and would therefore need to be accounted for, and ongoing legislative activities seeking to amend the Renewable Energy Directive upon adoption are also relevant. Third, Regulation (EC) No 443/2009, which reduces carbon-dioxide (CO<sub>2</sub>) emissions in cars, is also relevant as it reduces the use of fuel in transport and, hence, GHG emissions.<sup>55</sup> In addition to Union legislation, taxes and regulations at the MS level will also impact the BAU emissions scenario for the transport sector. Therefore, in order to be “additional,” Commission approval of the issuance of allowances for emissions from the transport sector would have to adequately account for the cumulative impact of these and other existing measures that will reduce emissions from the transport sector. The Commission’s ultimate determination on the number of allowances to be issued must maintain the environmental integrity of the ETS by ensuring that allowances issued do not exceed levels that can be expected under other Union and national legislation.

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environmental effectiveness, emissions from all flights arriving at and departing from Community aerodromes should be included from 2012.”<sup>48</sup>).

<sup>49</sup> C(2008) 7867, p. 3 at ¶14.

<sup>50</sup> C(2008) 8767, pp. 3-4 at ¶¶8-9.

<sup>51</sup> See Decision 406/2009/EC, Annex II.

<sup>52</sup> In contrast to sectors in the ETS, which are regulated at EU level, it is the responsibility of MSs to define and implement national policies and measures to limit emissions from the sectors covered by the Effort Sharing Decision.

<sup>53</sup> Directive 2009/30/EC.

<sup>54</sup> Directive 2009/28/EC.

<sup>55</sup> Regulation (EC) No 443/2009.

#### (d) Reliability of Monitoring and Reporting Systems

The Commission should also apply the same standard it has applied to all other ETS expansions, *i.e.* the ETS should only be extended to include activities “the emissions of which are capable of being monitored, reported and verified with the same level of accuracy” as those emissions already included within the ETS.<sup>56</sup> For example, when the Commission approved the Netherlands Article 24(1) application, it simultaneously published a decision amending Decision 2007/589/EC—establishing the monitoring and reporting requirements of the ETS Directive—to include N<sub>2</sub>O emissions from nitric acid production thereby subjecting the N<sub>2</sub>O emissions at issue to the same rigorous monitoring and reporting requirements as all other ETS emissions.<sup>57</sup>

While emissions from the transport sector can be monitored, reported and verified more accurately than certain non-ETS sectors, *e.g.* agriculture, it is debatable whether these emissions can ever be monitored, reported and verified to the same degree of reliability as other emissions covered by the ETS. Unlike N<sub>2</sub>O emissions from nitric acid production, there are no readily available or adopted uniform systems for the monitoring and reporting of actual emissions from the transport sector. The complexities and costs of measuring actual emissions from the road transport sector downstream, *i.e.* at the point of emission, are the principal reasons why Union-wide efforts to mitigate transport emissions have, to date, focused on upstream factors such as fuel efficiency and fuel quality. Further, if “fuel shelters” are created on the borders of MSs that have unilaterally included emissions from their transport sectors within the ETS, a monitoring and reporting system based on information supplied by fuel suppliers from within that MS will underestimate the transport sector emissions occurring within its borders. Therefore, it could be that transport sector must be kept out of the ETS to safeguard the integrity of the ETS’s monitoring, reporting and verification systems – as has been Parliament, Council and Commission policy to date.

#### (e) Other Relevant Criteria

Other “relevant criteria” include any other environmental or economic issues bearing on whether the Commission should approve the application for unilateral inclusion by a MS of emissions from its transport sector under Article 24(1). The following are examples of issues the Commission or other Union institutions have deemed relevant when considering whether to expand the coverage of the ETS.

- **Consistency with Other Climate Goals:** Previous Article 24(1) applications have been assessed for their consistency with the MS’s national allocation plan and whether approval would assist the MS to achieve its emissions reduction target under the Kyoto Protocol to the UNFCCC.<sup>58</sup>
- **Incentive or Disincentives to Adopt Fuel-Efficient Technologies:** The ETS Directive is intended to “encourage the use of more energy-efficient technologies ...”<sup>59</sup> And the ETS Expansion Directive was adopted, in part, to “trigger the necessary investment by offering new abatement opportunities” in the newly covered installations.<sup>60</sup> However, the Future Elements Study has predicted, at least “in the short term, it is likely that the inclusion of transport in the EU ETS would lead to transport buying EU ETS allowances and using JI and CDM, as the cost of abatement in the transport sector is higher than in other sectors.<sup>61</sup> It is only “[i]n the longer-term [that] investment in fuel efficiency

<sup>56</sup> Directive 2009/29/EC, Recital ¶10.

<sup>57</sup> C(2008) 8767, p. 4 at ¶13 (citing C(2008) 8040, Commission decision of 17 December 2008 amending Decision 2007/589/EC as regards the inclusion of monitoring and reporting guidelines for emissions of nitrous oxide and finding that the system employed by the Netherlands complied with that criterion).

<sup>58</sup> See *e.g.* C(2011) 3798 Final, Commission Decision of 6 June 2011 concerning the unilateral inclusion of additional gases and activities by the United Kingdom in the scheme for greenhouse gas emission allowance trading within the Union pursuant to Article 24 of Directive 2003/87/EC of the European Parliament and of the Council, p. 2 at ¶18.

<sup>59</sup> See Directive 2003/87/EC, Recital ¶20.

<sup>60</sup> See Directive 2009/29/EC, Recital ¶18.

<sup>61</sup> See Future Elements Study, p. 49.

technology might be stimulated, as the price of carbon rises under more stringent caps, or even by rising oil prices ...”<sup>62</sup> Further, the proposed regulated entity—the fuel suppliers—would have no incentive to invest in fuel-efficient technologies. Only by indirectly passing on the cost of emission allowances to consumers, who may then overtime choose to buy more fuel-efficient vehicles, will there be any indirect encouragement to vehicle manufacturers to develop fuel-efficient vehicles. Thus, as far as the transport sector is concerned, inclusion in the ETS will result in less investment in and use of more energy-efficient technologies.

- ***Creates Imbalance between the ETS and Other Climate-Mitigation Measures:*** “[T]he European Union strategy for climate-change mitigation should be built on a balance between the [ETS] and other types of Community, domestic and international action” as recognized in the ETS Directive.<sup>63</sup> If the Commission approved the applications of several MSs to include emissions from fossil-fuel use in transport within ETS, the ETS would quickly expand to cover approximately 60-70% of all GHG emissions within the EU. This imbalance between ETS and other types of climate-mitigation measures runs counter to Union climate policy to date.
- ***Violates the Principal of Direct Emissions:*** ETS was adopted “in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.”<sup>64</sup> To date, this has been given effect within ETS by adherence to the principal of direct emissions, namely that the regulated entity is the one directly responsible for and with the most control over the emissions.<sup>65</sup> However, proposals to include the transport sector within the ETS have thus far identified fuel suppliers as the regulated entity for reasons of administrative practicability.<sup>66</sup> However, as the Future Elements Study observed, “the choice of fuel supplier as the trading entity would not be consistent with the principle of direct emissions that is currently applied in the EU ETS, so consideration would need to be given to the implications for the EU ETS more widely, if this option were chosen.”<sup>67</sup>

In addition to the broader philosophical concerns for the principles underpinning the ETS, the practical implications are that “fuel suppliers have limited access to direct emissions reductions, although they could use biofuels and may be able to transfer the costs of emission allowances to end-users via the price of the fuel ... who may respond to the increased cost by driving less, driving more efficiently or buying an alternative vehicle.”<sup>68</sup> But “if the trading entity were fuel suppliers, then all costs may not necessarily be passed on to drivers.”<sup>69</sup> Additionally, fuel suppliers cannot directly impact vehicle fuel efficiency—a primary driver of emissions reductions in the transport sector.

- ***Including the Transport Sector within the ETS Will Not Reduce Transport Emissions:*** The purpose of expanding the ETS is to include the transport sector should be to reduce emissions in the transport sector. However, the Future Elements Study predicts that “[a] closed scheme for transport, i.e. one that did not allow trading with other sectors, is likely to encourage emissions reduction in the road transport sector, whereas in an open scheme [like the ETS] emissions reductions would probably occur in other sectors.”<sup>70</sup>

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<sup>62</sup> See Future Elements Study, p. 49.

<sup>63</sup> See Directive 2003/87/EC, Recital ¶ 26.

<sup>64</sup> See Directive 2003/87/EC, Art. 1.

<sup>65</sup> See e.g. Directive 2008/101/EC, Recital ¶15 (setting forth the reasons for imposing obligations on “aircraft operators” because they were the entities with the most direct control over the amount of emissions resulting from aviation activities).

<sup>66</sup> See Future Elements Study, p. 45.

<sup>67</sup> See Future Elements Study, p. 46.

<sup>68</sup> See Future Elements Study, p. 48.

<sup>69</sup> See Future Elements Study, p. 48.

<sup>70</sup> See Future Elements Study, p. 59.

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## Annex I

### Delegated Acts Procedure for Exercising Powers under Article 24(1)(b) and 24(3)

The following procedure will be followed by the Commission when exercising powers delegated to it under Article 24(1)(b) and 24(3).

**Step 1:** The legislative act must meet the criteria of a Delegated Act under Article 290(1), in particular: (i) the objectives, content, scope and duration of the delegation; and (ii) the conditions to which the delegation is subject. The Article 290 Proposed Regulation states that decisions under Article 24(1)(b) and 24(3) of the ETS Directive meet these criteria.<sup>71</sup>

**Step 2:** The Commission undertakes preparatory work for the adoption of the Delegated Act. During this process, no formal opinion of a committee is needed – *there is no comitology committee*. However, the Commission intends to consult experts from national authorities of MSs and may form an “expert group” for this purpose.<sup>72</sup> While the experts will have a consultative rather than an institutional role in the decision-making process, this arrangement will serve as an early-warning system for the Parliament and Council to exercise their prerogatives following the adoption of a Delegated Act.<sup>73</sup> Additionally, the Commission will ensure all relevant documents are submitted to the Parliament and Council in a timely manner throughout the process.<sup>74</sup>

**Step 3:** The Delegated Act will then be adopted and presented to Parliament and the Council. At this stage, the Parliament and Council can take one of three actions: (1) object to the delegated act; (2) not object to the delegated act; or (3) revoke the delegation.

Either Parliament (by absolute majority) or the Council (by qualified majority) can *object to the Delegated Act on any grounds whatsoever* – there is no longer any need to rely on one of the three legal justifications under the RPS. The time period for objection is two months following notification to the Parliament and Council or if before the expiry of that period the Parliament and Council both inform the Commission that they will not object. The objection period shall be extended by two months at the initiative of either the Parliament or Council.<sup>75</sup>

If a delegated act is objected to by either Parliament or the Council, the Commission can either: (1) adopt a new delegated act; (2) amend the delegated act where necessary to take account of the objections expressed; (3) present a legislative proposal under the Treaties (if the objections were based on its having overstepped the powers delegated; or (4) nothing at all.<sup>76</sup>

If neither the Parliament (by absolute majority) nor the Council (by qualified majority) object, *the delegated act enters into force*.<sup>77</sup>

Alternatively, and at the same time, either the Parliament (by absolute majority) or the Council (by qualified majority) can revoke the power of delegation in which case the

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<sup>71</sup> See Article 290 Proposed Regulation, Annex I(B)(5).

<sup>72</sup> See Article 290 Proposed Regulation, p. 5.

<sup>73</sup> See Article 290 Communication, p. 6-7.

<sup>74</sup> See Article 290 Common Understanding, p. 1; Article 290 Proposed Regulation, p. 5.

<sup>75</sup> See Article 290 Proposed Regulation, p. 6-7.

<sup>76</sup> See Article 290 Communication, p. 10.

<sup>77</sup> See Article 290 Proposed Regulation, p. 6-7.

Delegated Act is repealed and the Commission is stripped of its power to act under the legislation and no further action can be taken by the Commission on this issue.

