

Requiring Oil Majors to Pay

A legal analysis of whether the EU can require the fuel providers to pay for part of the extended Emissions Trading System rather than passing it all to consumers

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About Opportunity Green

Opportunity Green is an NGO working to unlock the opportunities from tackling climate change using law, economics and policy. Opportunity Green helps countries, civil society and business access the solutions that reduce emissions and bring enormous opportunities for economic development, improved health and increased democracy. At Opportunity Green we believe lawyers are obligated to analyse the existing legal systems and regulations to stop climate change. We find pathways within the existing legal structure to facilitate the legislation needed to slash carbon pollution.

Further information

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Executive Summary

The Commission has proposed including the road transport and buildings sectors into the Emissions Trading System from 2026 (known as the “ETS2”). The regulated entities will be the upstream providers of fuel, i.e., the oil majors such as Total, Shell, BP, Eni and Repsol. This legal analysis considers whether the oil majors can be required to absorb part of the ETS2 cost and concludes that there are at least two options the EU could use to do so.

First the EU should impose a requirement for the oil majors to share detailed pricing information with the EU. Following this, as a basis for analysis three similar measures across the EU were considered: the use of corporate governance codes, regulated prices at the pump and a levy on turnover.

One option is the regulation of fuel prices at the pump. The Court of Justice of the EU (CJEU) judgment in Vodafone’s challenge to the EU mobile phone regulations shows that the CJEU will uphold a measure controlling excess profits and regulating retail prices (*Case C-58/08 – Vodafone and others*). Clear reasoning and analysis in the recitals and impact assessment showing the necessity of the EU regulation would be helpful for the CJEU to rely on in any court case.

A levy on turnover is a tool used by several Member States in different sectors. However, as oil majors often have multiple entities across different jurisdictions for tax efficiency reasons, it could be foreseen that designing legislation to assess the turnover of the correct entities could be difficult. Indeed, the oil majors could set up new entities specifically to avoid turnover regulation.

A final option would be the use of corporate governance codes does not bring many advantages and a key issue would be whether all transport fuel providers are listed on the stock exchange. If they are not, this makes this option less viable as several EU countries only have corporate governance codes for listed companies.

The legal base of the measure will be Article 192 on the environment but ensuring that the measure is not seen as “primarily of a fiscal nature” is important to ensure the special legislative procedure (requiring unanimity of all Member States) is not triggered. For this it must be clear the purpose of any measure is indeed climate action and not primarily to raise revenue, and ensuring any levy goes directly to the Social Climate Fund (which has an environmental aim) would be important to proving this.

The analysis concludes that there are two options. Option A is to require oil companies to pay into the Social Climate Fund if they pass through a certain amount of the ETS2 price to consumers. Option B is to simply limit the retail price of road fuel at the pump. However, Option B’s purpose is less clearly related to climate action and Option A is to be preferred.

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1 Introduction

The EU Emissions Trading System is potentially to be expanded to road transport and buildings from 2026 (known as “ETS2”). The regulated entities will be the upstream providers of fuel, i.e., the oil majors such as Total, Shell, BP, Eni and Repsol. This legal analysis considers whether the oil majors can be required to absorb part of the ETS cost, rather than passing it on entirely to EU citizens. To this end, three suggested options have been provided as examples of how this could be done:

1. Inserting provisions into Member State corporate governance codes
2. Using a system similar to the requirement in Belgium that if medicine costs exceed a certain value, that pharmaceutical companies must pay into a social security fund
3. Regulated tariffs as in France for electricity

Each of these options will be assessed from a legal perspective and then a recommendation is provided. In addition, as the options are either pricing or levy based, they raise questions about the legal base to be used and consequently the legislative procedure for adopting any measure will also be analysed.

2 Pricing transparency

Before any regulation can require the oil majors to absorb part of the ETS2 cost, it will be important to know how much of that cost is being passed on. While prices at the pump are set by the market, national taxes and other regulations form a part of that price. Therefore, the first requirement should be that any supplier of fuel for road transport or buildings must provide a breakdown of the costs going into the price at the pump to describe how much of the price is determined by oil exploration and extraction, how much national taxation, how much is the ETS2 price and importantly, how much is profit. Commercial operators have no inherent right to keep this information secret. If the EU passes a law to require them to share the information, then they must do so. The EU already requires this for agriculture products where price information is collected at each stage of the supply chain.¹ Regulation for transport fuels would have to consider that some oil companies are vertically integrated, but the principle is the same. For road transport, the information could be added to the EU oil monitor which is published on a regular basis.²

In addition, it will be important for the EU to analyse fuel prices for road transport and buildings at more macro level, i.e., following national and EU level prices as the sector enters the ETS2 to understand how much of the ETS2 price is being passed on to consumers. However, it would be difficult to tell at any precise moment in time how much was being passed on to consumers as both the ETS2 price and the price at the pump change frequently. Thus, analysis would have to be carried out yearly (or perhaps more often, such as on a quarterly basis) to analyse the pass-through percentage.

¹ Commission Implementing Regulation (EU) 2019/1746 of 1 October 2019 amending Implementing Regulation (EU) 2017/1185 laying down rules for the application of Regulations (EU) No 1307/2013 and (EU) No 1308/2013 of the European Parliament and of the Council as regards notifications to the Commission of information and documents

² See <https://data.europa.eu/data/datasets/eu-oil-bulletin?locale=en>

2.1 Corporate governance codes

Many Member States have corporate governance codes which cover topics such as executive pay and shareholder protection. While in theory the EU could require Member States to place requirements on oil majors into Member State governance codes, there are several considerations which makes this not the most favoured option.

The Belgian Code on Corporate Governance (previously known as the Code Lippens) applies to companies listed on the Belgian stock exchange. There is a separate code for non-listed companies in Belgium, the Code Buysse and this seems to be the pattern in several Member States.³ Meanwhile, other Member States only have corporate governance codes for listed companies. Thus, an issue arises if not all the providers of road transport and buildings fuel are listed on stock exchanges across the EU. A full analysis of whether these fuel providers are listed on stock exchanges is beyond the scope of this paper.

The EU has a choice of instruments when it acts but cannot require Member States to put EU legislation in a particular place in their legislative codes. If the EU chooses to use a Regulation as its instrument, then everything in the Regulation is directly effective in Member State legal systems without any transposition required but this does not place the measures into any particular place in Member State legislative systems. The EU could also put a requirement in a Directive which is an instrument of harmonisation of law across the EU, in which case it will require transposition in EU Member States but as it is an instrument of harmonisation, how the provisions are transposed is left to the individual Member States. Another option is that the EU could issue a recommendation or opinion, but these are non-binding in nature, but this would not be a suitable legal instrument for a requirement involving payments. However, the EU can require certain outcomes, regardless of the legal instrument chosen and to the extent that a Member State not placing a requirement in the governance code meant that the outcome was not achieved, the EU could force compliance. Finally, as fully discussed in the final section of this paper, the most suitable legal base for the measure is environmental which has little link to a corporate governance code and could therefore raise questions around the appropriate legal base.

Therefore, the most important consideration for EU law is the content of the law rather than the placing within the Member State legal order. The rest of this analysis will consider the content of the law which could simply be part of the future ETS2 legislation.

2.2 Regulated tariffs

The French energy system is based on regulated access to gas and electricity with a standard charge for the use of the networks. The charge is determined by the Commission de regulation de l'énergie. This charge accounts for about 40% of the price paid by the final consumer. A similar arrangement for road transport could involve regulating either the price at the pump or the wholesale price of transport fuel.

The EU regulation of mobile phone tariffs provides a useful precedent. The EU put in place several caps on both wholesale and retail charges. This was adopted using the legal base of harmonising the regulation of the internal market (TFEU Article 114), but several mobile phone operators challenged whether the EU

³ For details see for example <https://thelawreviews.co.uk/title/the-corporate-governance-review> which sets out an overview of corporate governance across many countries.

had the authority to issue such price caps and whether, if the EU did, the measure was proportionate (*Case C-58/08 – Vodafone and others*). The challenge failed on both counts.

The challenge to the EU's authority to cap prices came about because under TFEU Article 114, there is a requirement for divergent laws to exist before the EU can step in and regulate. The mobile phone providers argued that there were no divergent laws, just divergent prices but this was dismissed by the Court of Justice of the EU (CJEU) as being manifestly false.

Secondly and more interestingly for the purposes of considering a price cap for road transport, was the argument of whether the regulation from the EU was proportionate to the aim to be achieved. All EU legislation must comply with the principle of proportionality which is that the regulation must only go as far as is necessary to achieve the stated aim. The mobile phone operators claimed that regulating wholesale pricing only would have been a more proportionate measure and regulating retail pricing was beyond the minimum required to meet the aims of the measure.

The CJEU dismissed the challenge to proportionality as the retail price cap *“ought to ensure that retail charges for Community-wide roaming services provide a more reasonable reflection of the underlying costs involved in the provision of those services than has been the case.”* Further the CJEU stated, *“reductions in wholesale prices might not be reflected in lower retail prices for roaming owing to the absence of incentives for that to happen...there was no competitive pressure on operators to pass on that reduction.”* The CJEU was upholding the right of the EU to reflect reasonable costs, and in effect not allowing mobile phone providers to receive excessive profits. Reliance was made on the recitals and impact assessment to the mobile phone pricing regulation which set out clearly the objects of the regulation and the analysis showing without regulating retail prices, the desired outcome might not be achieved.

This supplies a direct precedent for the EU to put in place a regulation on excessive profits or a retail price cap on road transport fuels. It would be ideal if the objects of the regulation are set out clearly in the recitals to the legislation, and that there is a robust impact assessment for the CJEU to rely upon if the legislation is challenged. However, the lack of an impact assessment that looks at the question of the oil majors absorbing some of the ETS2 cost or the impact of a retail price cap would not be fatal to any legislation surviving, especially if there are robust recitals explaining the reasoning for the measure and stating that the measure is proportionate to the aim and the minimum required in order for that aim to be achieved.

2.3 Levy on turnover

Belgium has a levy on the turnover of pharmaceutical companies if the State budget for medicines is exceeded. In Italy there is a similar provision where pharmaceutical companies must cover 50% of the overrun if the “direct purchase budget” for medicines is exceeded. A similar provision could be introduced where a levy is placed on the turnover of entities that provide fuels for road transport. Road transport fuel suppliers are highly concentrated with 6 companies covering 75% of sales in Germany and 20 companies covering 99% in the UK⁴. Therefore, there is a relatively modest number of entities which any regulation of turnover would apply to in the road sector though it seems that the buildings sector is less

⁴ https://ftp.zew.de/pub/zew-docs/gutachten/RoadTransport-EU-ETS_ZEW2015.pdf

concentrated due to a wider use of multiple fuel types. However, one of the issues that would be difficult to navigate would be ensuring that the correct entity's turnover was assessed. Each individual oil company will have several company registrations across different countries with different incomings and outgoings booked to different entities for the purpose of tax efficiency.⁵ It could immediately be foreseen that oil majors could set up new companies to limit the amount of turnover that is assessed for any levy. Thus, it could prove complicated to design legislation that takes into account multiple entities to ensure the appropriate turnover is considered.

2.4 Conclusion on potential design options

Based on this analysis, regulating prices at the pump or mandating that if more than a certain percentage of the ETS2 price (or absolute euro value) is passed on to consumers, the oil majors must contribute a certain percentage in addition to the ETS2 price to a fund are options to be preferred. These will be discussed further but first the legal base for any measure must be considered as the EU only has the powers that are given to it in the Treaties and cannot step outside those powers.

3 Legal base

Whatever measure is adopted, the legal base will be important for determining the legislative procedure to be used. The current ETS uses TFEU Article 192 on the protection of the environment as its legal base and the Commission has proposed that the ETS2 will also use TFEU Article 192 as a legal base.⁶ The default legislative procedure for measures using Article 192 is the ordinary legislative procedure which uses qualified majority voting in the Council. But if measures are "primarily of a fiscal nature" or "significantly affecting a Member State's choice between different energy sources and the general structure of its energy supply" then the special legislative procedure, requiring unanimity voting in Council is required. In addition, there is the question of whether a levy should move away from Article 192 entirely and be based on Article 113 on the harmonisation of taxation. The following sections will analyse each of these options in turn.

3.1 Significantly affect energy choice

Poland challenged the ETS Market Stability Reserve (MSR) on the basis that the price of allowances would influence the choice of production technology for future investment and thus impact Poland's electricity production structure which would be a significant impact on Poland's choice of energy source (*C-5/16 Poland v Parliament and Council*). Therefore, Poland claimed that the MSR should have been adopted using the special legislative procedure (in which Poland would have had a veto). But the CJEU rejected this challenge on the basis that a broad interpretation of measures which significantly affect a Member State's energy choice "*would risk having the effect of making recourse to the special legislative procedure, which the TFEU intended as an exception, into the general rule. That conclusion is irreconcilable with the Court's case-law, according to which provisions that are exceptions to principles must be interpreted strictly*".

As the CJEU dismissed the claim by Poland that the MSR significantly affected its choice of energy sources and importantly ruled that any exemption be interpreted strictly, it is extremely unlikely that a measure

⁵ <https://www.reuters.com/article/global-oil-tax-havens-idUSKBN28J11K>

⁶ Impact Assessment stepping up Europe's climate ambition to 2030

to ensure that oil majors absorb a portion of the ETS2 would be found to significantly affect a Member State's choice between different energy sources. While putting a cap on road transport and more importantly on building emissions, could be said to affect a Member State's choice between different energy sources, this is inherent to the ETS2 itself and not the addition of any provisions requiring oil companies to absorb some of the ETS2 costs.

3.2 Primarily of a fiscal nature

It is further unlikely that the addition of a measure requiring the absorption of ETS2 costs by the oil companies could be seen as being "primarily of a fiscal nature" if the clear aim of the measure is reducing climate impacts. The primary aim of the ETS2 is to reduce emissions, not to raise government revenue. The addition of a measure ensuring oil companies absorb some of the ETS2 cost would not alter that primary aim but simply be an addition to assist in achieving that goal. The ETS2 could directly affect consumers if the full allowance price were passed through. While this should aid with moving consumers towards lowering their use of fossil fuels for transport and building heating, vulnerable consumers do not have the available capital to buy an electric car or retrofit their home (as examples). The Commission recognise this and have stated they will create the Social Climate Fund alongside the ETS2 to tackle this issue. Ensuring the oil companies either absorb some of the cost and/or contribute to the Social Climate Fund would aid poorer households in moving to options for transport and heating that have lower climate impacts as these would be financed by the Social Climate Fund or if the oil companies absorbed some of the cost, this would leave poorer households with more capital they could invest in measures to reduce emissions. Ensuring that the aims of the ETS2 are more likely to be achieved.

3.3 Harmonisation of taxation

A provision to ensure oil majors absorb most of the ETS2 price would be a fully integrated part of the ETS2, there is no reason to believe that such a provision should be based on a separate TFEU Article. However, it is possible that the claim could be made that any requirement for the oil companies to pay additional amounts is akin to a tax and thus its legal base should be that of Article 113 TFEU on the harmonisation of taxes (note the mobile phone tariff case discussed above related to Article 114 on internal market harmonisation, not 113). Using Article 113 as the legal base would mean any resulting measure must be enacted via unanimity in the Council. However, it is unlikely any such claim could succeed.

As discussed above, as long as the levy on the oil majors primarily aimed at the protection of the environment, rather than the harmonisation of taxation across the EU, the use of Article 192 is more appropriate. The Court has held in *C-45/86 Commission v Council* that a specific legal base precludes the possibility of using a more general legal base. Between a legal base of primarily environmental action or taxation harmonisation for a levy on oil majors, the environmental base is to be preferred. Though such a measure would in a limited way harmonise taxation across the EU, it would be regulating the price due to a sought-after environmental impact rather than as a taxation matter per se. This is important as the CJEU has held in the past that the legal basis for a legislative act, "*must rest on objective factors amenable to judicial review, which include in particular the aim and the content of the measure.*" (*Case C-211/01 Commission v Council*) In addition, the CJEU has stated that, "*if the examination of a Community measure reveals that it pursues a twofold purpose or that it has a twofold component and if one of these is identifiable as the main or predominant purpose or component whereas the other is merely incidental, the*

act must be based on a single legal basis, namely that required by the main or predominant purpose or component." (Case C-155/91 Commission v Council; Case C-36/98 Spain v Council) As the EU would be regulating based on environmental concerns, Article 192 TFEU should be the legal base.

3.4 Tackling social exclusion

Part of the aim of the Social Climate Fund and any measure to have the oil majors absorb some of the ETS2 cost is to protect vulnerable consumers. However, this in and of itself cannot be the basis for any EU legislation as there is no legal base in the TFEU which could be relied on. Tackling poverty and social exclusion is one of the specific policy goals of the EU but Article 153 TFEU calls for it to be achieved solely by non-legislative cooperation. Therefore, any aim of relieving poverty or protecting vulnerable consumers must always be secondary to achieving the climate goals of the legislation if it is to have the best possible chance of being adopted and surviving any potential legal challenge.

An alternative legal base would be the protection of consumers in Article 169 which aims at promoting *"the interests of consumers and to ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information"*. There are two options for enacting legislation under this article – one is for *"measures which support, supplement and monitor the policy pursued by the Member States"*. Requiring the oil majors to absorb some of the ETS2 cost would not be supporting policy pursued by Member States and so this option could not be used. The other option uses Article 114 on the harmonisation of the internal market which allows for measures to be adopted using the ordinary legislative procedure. However, there is no additional benefit to using this article compared to using Article 192 on the environment. Indeed, separating the legal base for oil majors to absorb some of the ETS2 cost from the legal base for the rest of the ETS2 would make the measures more akin to a separate tax or levy. Thus, the recommendation is to leave the legal base as Article 192 and ensure that the protection of the environment is the main aim of the final measure.

4 Proposed regulation

Two options stand out as having the best potential, either regulating prices at the pump or placing a requirement that if more than a certain percentage of the ETS2 price (or absolute euro value) is passed on to consumers, the oil majors must contribute a certain percentage in addition to the ETS2 price to the proposed Social Climate Fund.

4.1 Option A: Contribution to Social Climate Fund

The Social Climate Fund has two aims: (1) to finance direct income support for vulnerable households, including through the reduction of electricity taxes and levies and (2) to support measures and investments that reduce emissions in the road transport and buildings sectors and as a result reduce fossil fuel costs for vulnerable households, micro-enterprises and transport users. These aims are important in ensuring any regulation is not primarily of a fiscal nature as they are clearly stated to be environmental.

As an example of how this regulation could work, if the EU determines that more than 50% of the ETS cost is being passed onto consumers (via the price transparency information they have collected), then the entities in the road transport sector of the ETS2 must pay the average allowance cost for the ETS2 from

the previous year for 20% the entities' emissions responsibility. An example is below using very simplified numbers for illustration purposes, an economic analysis should be carried out to decide the appropriate metrics:

- Fictional oil company Totell surrenders 1000 EUAs in 2027 for its 2026 road transport emissions
- Based on information provided by Totell and its own analysis, the Commission considers that Totell passed on 65% of the cost of the EUAs to the consumer
- The average cost of an EUA during 2026 was €100
- As the 65% passthrough is larger than the 50% cap, Totell must pay, in addition to the EUAs already purchased, 20% of 1000 = 200, multiplied by the average EUA price of €100 = €20,000 into the Social Climate Fund
- A sliding scale could be set with larger penalties as larger proportions are passed on to the consumer.

This could even be simplified by requiring Totell to pay the same amount that Totell passed on in excess of the passthrough-cap into the Social Climate Fund. This would work the same as in the above example but as Totell passed 65% through to consumers, which is larger than the 50% cap, Totell would then be required to pay an amount equivalent to the 15% excess passthrough into the Social Climate Fund.

4.2 Option B: Cap on retail prices

Another option would be for the EU to directly regulate retail prices of road transport fuel. By doing so, the EU would essentially require the oil majors to absorb a certain amount of the ETS2 price as they would not necessarily (depending on prices) be able to pass it on. The Commission could set the cap by considering the information provided by the pricing transparency requirements discussed at the start of this analysis on a quarterly or more frequent basis. This would further the environmental aim of the ETS2 because it would reduce the amount that more vulnerable customers (and everyone else) pays so that they could more easily save up the capital required to install a heat pump or buy an electric vehicle (as examples). However, the environmental purpose (important to ensure the legal base is not seen as “primarily of a fiscal nature”) is less clear-cut as the consumers who save money due to the retail price cap would not necessarily invest this money in measures that reduce climate change. Further, it does reduce the climate signal sent to all other consumers. The recitals to the legislation would be key to ensuring a clear environmental benefit to this measure is articulated, which could be relied upon later in the case of any challenge to the regulation.

5 Conclusion

Multiple legal options are available to the EU in ensuring that the ETS2 cost is absorbed by the fuel providers. This piece considered using corporate governance codes, regulated pricing and a levy on turnover. The final conclusion presents two options. Option A is a hybrid that is mainly modelled on the turnover levy but considers the passthrough from the oil companies to the consumers and the ETS2 price for the penalty. Importantly, the penalty should go to the Social Climate Fund because it is designed to reinforce the aims of the ETS2 by supporting vulnerable households who might not otherwise be able to move their transport and heating consumption away from fossil fuels. Option B would be for the EU to directly regulate the retail price of road fuel. Both of these options primary aim at the protection of the environment, rather than having a financial aim, avoiding a requirement to use the special legislative

procedure. However, Option A provides a clearer environmental benefit and thus it will be extra important if Option B is adopted to ensure that there is clear reasoning set out in the recitals to the legislation that could be relied upon in any subsequent challenge to the legislation.