Make Big Oil pay
Why and how to oblige fuel suppliers to absorb part of the EU’s new carbon price

April 2022

Summary

In July 2021 the European Commission proposed a new emissions trading system for road transport and buildings (the so-called ‘ETS2’ or ‘ETS BRT’). The scheme is designed to help member states reach their national climate targets more easily, while also generating revenues that can be used to support the lowest incomes in the transition. This social aspect was formalised in a proposal for a new Social Climate Fund (SCF). While scaling up the carbon price signal to reduce demand and ensure the EU’s 2030 climate target is important, Transport & Environment (T&E) thinks that for the climate transition to have any hope of working, the EU should ensure that big polluters pay the bulk of the costs. That means wealthier households, who would not benefit from the revenues redistribution, but also importantly the fuel suppliers. Big Oil has known about the destructive impacts of their business for years, while paying almost no taxes and making nearly 2 trillion in profits in the last 30 years. It’s high time for Big Oil to pay back to society. They should be required to absorb part of the EU’s new carbon price, while we use the remaining price signal to break free from our energy dependence on profit hungry multinationals and oligarchs.

T&E commissioned a legal study that identified a limit on the share of the ETS2 price that can be passed on to end-consumers as the most promising pathway for making the fuel suppliers pay. If they pass on more than the legal limit, they pay a fine into the SCF which is designed to support vulnerable households who might not otherwise be able to move their transport and heating consumption away from fossil fuels. This proposal can be designed in three different ways:

- It could take the shape of an implicit price corridor. A minimum carbon price would be paid solely by the end-consumers. But if the price goes above a certain threshold, fuel suppliers would be required to absorb the entire share of the ETS2 price above that level. This would come down to a price floor and ceiling, though only for end-consumers and not for fuel suppliers. If the carbon price is in between the price floor and ceiling, the fuel suppliers would be required to absorb a significant share of the ETS2 price.

- Alternatively the fuel suppliers could be required to absorb half of the carbon price, regardless of how high it is. Such a set-up could then be accompanied by a price ceiling, to
ensure that member states have predictability in planning their social compensation measures and that middle income households, who don’t benefit (as much) from redistributive measures, don’t experience regressive effects in case of very high carbon prices.

- To reduce the administrative costs of monitoring the cost pass-through, it could also be considered to give fuel suppliers the option not to submit a breakdown of their cost components on the condition of a higher fine into the Social Climate Fund. Also under this option ETS2 prices could potentially reach very high levels (even if they could now be mitigated with a much larger SCF) and could thus be accompanied by a price ceiling.

1. What is the EU’s new carbon price and who should pay?

As part of its Fit for 55 proposals, the European Commission has proposed to include the road transport and buildings sectors into a new carbon market from 2026 (known as the Emissions Trading System ‘ETS2’ or ‘ETS BRT’). Fuel suppliers like Total and Shell would need to buy emissions allowances for each litre of fuel they put on the market. As the market is currently designed, they could then pass this cost on entirely to end-consumers. This could disproportionately impact poorer households driving their cars or heating their homes.

As important as scaling up the carbon price signal is to reduce demand and meet the EU’s 2030 climate target, citizens - and especially low-income households who are often locked into polluting technologies - are not the only polluters and certainly not the biggest ones. If the climate transition has any hope of working, the EU should ensure that big polluters – not the small households – pay the bulk of the costs. While being well aware of the consequences of climate change, causing environmental disasters at large scale and paying almost no taxes, Big Oil made nearly 2 trillion in profits (that’s a 13-digit number) in the last 30 years. It’s high time for Big Oil to pay back to society. They should be required to absorb part of the EU’s new carbon price, while we use the remaining price signal to break free from our energy dependence on profit hungry multinationals and oligarchs.

This proposal can either take the shape of a price ceiling for end-consumers, or act in parallel with such a price limit. While analysis shows that the ETS2 could have a progressive income effect with effective revenue recycling, a degree of uncertainty remains with regard to the effectiveness of the

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1 Profit made by BP, Shell, Chevron and Exxon since 1990. See https://www.theguardian.com/business/2020/feb/12/revealed-big-oil-profits-since-1990-total-nearly-2tn-bp-shell-chevron-exxon

2 See for example Commission services non-paper. (2022) The role of the new ETS for road transport and buildings (ETS2) in achieving the 55% target; IEEP. (2022) Can Polluter Pays policies in the buildings and transport sectors be progressive?; FEST/FÖS. (2022) Assessment of the EU Commission’s Proposal on an EU ETS for buildings & road transport (EU ETS 2) Criteria for an effective and socially just EU ETS 2
redistribution measures designed by the member states. Furthermore, analysis by IEEP indicates that when ETS2 prices are on the higher end of the projections (€100/tCO2), middle income households would see net welfare gains turn into small losses, even with revenue recycling.\(^3\) For those households in income deciles 4-6, a price ceiling could prevent such regressive effects. Lower income households on the other hand would, with revenue recycling, continue to see net welfare gains at high carbon prices. Also for these households a price ceiling could however have added value, as it gives member states more predictability to design their redistribution measures and ensure their effectiveness.

2. How would the mechanism work?

T&E commissioned a legal analysis that looked into different options for requiring fuel suppliers to absorb part of the ETS2 cost.\(^4\) The preferred option from both a legal and social point of view would be to limit the share of the ETS2 price that fuel suppliers can pass through to end-consumers. Such a requirement can either serve as an alternative to a price corridor or be implemented in parallel with a price ceiling (see three options under section 2.2.).

2.1. Price setting transparency and systems already set up

If the ETS directive is to require the fuel suppliers to absorb part of the ETS2 cost, it will be important to monitor how much of that cost is being passed on. Any supplier of fuel for road transport or buildings would thus need to provide the EU with a breakdown of the costs going into the price at the pump to describe how much of that price is determined by oil exploration and extraction, how much is 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 requiring them to share this information, then they must do so.

The monitoring should already start before the ETS2 auctions start, for example from 1 January 2024 onwards. The information should be shared on a regular basis, in order for the EU to be able to track if any of the cost categories changes by a significant amount (e.g. more than 5%) compared to the last reporting period. This could be an indication of fuel suppliers inflating another cost category to evade the limit on cost pass-through of the ETS2 price component. For road transport the information could for example be added to the EU oil monitor which is published on a regular basis.\(^5\)

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\(^3\) IEEP. (2022) Can Polluter Pays policies in the buildings and transport sectors be progressive?

\(^4\) Opportunity Green. (2022) Requiring Oil Majors to Pay

\(^5\) See https://data.europa.eu/data/datasets/eu-oil-bulletin?locale=en
Such a price setting transparency requirement would not be a first. The EU already requires this for agriculture products where price information is collected at each stage of the supply chain. Regulation for transport fuels would have to consider that some oil companies are vertically integrated, but the principle is the same. At national level, Italy has recently put in place a monitoring mechanism of the monthly energy price in the framework of their one-off windfall tax that was introduced in March 2022. The tax captures the extra profits made by energy producers, importers and suppliers because of the surge in energy prices while the mechanism avoids the tax being passed-on to consumers. At the end of each month, energy companies must communicate the average purchase, production and sale price of energy to the Italian Antitrust Authority. The Authority is then to calculate what the monthly profit margin of each company is and compare that to the standard margin made by each entity in a previous period of reference. If the difference exceeds a predefined level, the Authority would further investigate the reasons behind such deviation. In this process, energy companies are not required to communicate the price components right away, but the result does not change: if the profits have increased excessively compared to the reference period, further controls on what led to this increase would be triggered. This allows the Antitrust Authority to keep track of price components fluctuations and avoid cost pass-through.

2.2. A legal limit on pass-through and price cap for end-consumers

The next step would be to place a requirement on the fuel suppliers that if more than a certain percentage of the ETS2 price or absolute euro value is passed on to end-consumers, they must pay a fine into the proposed Social Climate Fund. That Fund is designed to support vulnerable households who might not otherwise be able to move their transport and heating consumption away from fossil fuels.

There are three implementation options to achieve this, each of which represents a slightly different variant of a price corridor or ceiling for the end-consumers:

**Option 1:** The ETS2 cost is split evenly between the fuel suppliers and end-consumers, meaning each actor pays 50% of the ETS2 price. This would ensure the social fairness of the scheme, while also preserving the price signal for the end-consumers, steering them towards demand reduction. To ensure that ETS2 prices don’t go too high, this option should be combined with a price ceiling. Analysis by Vivid Economics indicates that a price ceiling of €50/tCO2 that annually increases by €10/tCO2

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8 This is the mode of operation described by the head of the Italian Antitrust Authority. See [https://www.senato.it/application/xmanager/projects/leg18/attachments/documento_evento_procedura_commissione/files/000/423/577/Audizione_di_AGCM - Autorit%20Garante_Concorrenza_e_Mercato.pdf](https://www.senato.it/application/xmanager/projects/leg18/attachments/documento_evento_procedura_commissione/files/000/423/577/Audizione_di_AGCM - Autorit%20Garante_Concorrenza_e_Mercato.pdf)
would still allow the EU to reach its emissions target for 2030 for road transport and buildings (764 Mt), as well as the cumulative emissions budget for 2026-30 for those sectors (4.31 Gt). This would mean prices could theoretically go up to €90/tCO2 by 2030. A price ceiling of €50/tCO2 that annually increases by €5/tCO2 would also largely deliver the emissions reductions needed, missing the 2030 target by only 4 Mt and still landing within the cumulative emissions budget for the decade. Prices could then go up to €70/tCO2 by 2030. Note that within this system of making the fuel suppliers pay half of the ETS2 price, the price ceiling would need to be more towards the double of that, as only half of it is passed on to end-consumers and driving behavioural change.

**Option 2:** Another option would be to set a minimum ETS2 price floor from which point onwards the fuel suppliers start contributing and a ceiling price for end-consumers. The percentage of the contribution from the fuel suppliers would then be adapted to the ETS2 price level, with the these firms not contributing at all below that minimum ETS2 price, being required to absorb an >50% share of the ETS2 price between the price floor and ceiling and having to absorb the entire ETS2 price for the share above the price ceiling. Table 1 below shows how this would play out if one would want to limit the price signal for end-consumers to €50/tCO2, assuming a 70% absorption share for the fuel suppliers between the price floor and ceiling and a 100% absorption share above the price ceiling.

*Table 1 - share of ETS2 price paid by end-consumers and fuel suppliers when implementing a €50/tCO2 implicit price ceiling for end-consumers*

<table>
<thead>
<tr>
<th>ETS price</th>
<th>Price paid by the end-consumer</th>
<th>Price paid by the fuel suppliers</th>
</tr>
</thead>
<tbody>
<tr>
<td>€0 - €35</td>
<td>- slice 1 (100%): between €0 - 35</td>
<td>- slice 1 (0%): €0</td>
</tr>
<tr>
<td>€35 - €85</td>
<td>- slice 1 (100%): €35 - slice 2 (30%): between €0 - 15 &gt;&gt; max. total = €50</td>
<td>- slice 1 (0%): €0 - slice 2 (70%): €0 - 35</td>
</tr>
<tr>
<td>&gt; €85</td>
<td>- slice 1: €35 - slice 2: €15 - slice 3: €0 &gt;&gt; max. total = €50</td>
<td>- slice 1 (0%): €0 - slice 2 (70%): €0 - 35 - slice 3 (100%): €35 - as high as needed</td>
</tr>
</tbody>
</table>

**Option 3:** To reduce the administrative costs of monitoring the cost pass-through, it could also be considered to give fuel suppliers the option not to submit a breakdown of their cost components on the condition of a higher fine into the Social Climate Fund. For example, if the legal limit is set at 50% cost pass-through, the fine could be 80% of the ETS2 price in case they don’t submit price transparency data to the EU. Firms would then have the choice between sacrificing a larger part of

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9 Vivid Economics (2021). ETS2 price model developed for Transport & Environment
their profit margin but keeping their price setting secret, or complying with the obligation and absorbing only the legal limit of the ETS2 price. If they opt for the former, the Social Climate Fund would grow considerably. While under this option there would be more revenues available in the Social Climate Fund to support the most vulnerable consumers compared to option 1, it would still mean that ETS2 prices could potentially reach very high levels. Therefore also this option should be accompanied by a price ceiling.

Under each of these above designs, the level of the absorption requirement could be modified depending on the oil and gas commodity prices, to ensure that fuel suppliers contribute fairly at times when oil and gas prices are very high and when these companies are making record profits.

2.3. The legal basis

The current ETS uses TFEU Article 192 on the protection of the environment as its legal base. The Commission has proposed that the ETS2 will also use TFEU Article 192 as a legal base, as the primary aim of the ETS2 is to reduce emissions. 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.

It is therefore important that any change to the Commission’s ETS2 proposal is not potentially seen as ‘primarily of a fiscal nature’ to ensure the special legislative procedure is not triggered. For this it must be clear the purpose of any measure is indeed climate action and not primarily to raise revenue. The addition of a measure ensuring fuel suppliers absorb some of the ETS2 cost would not alter that primary environmental 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 often do not have the available capital to buy an electric car or retrofit their home. The Commission recognises this and created 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. Thereby ensuring that the aims of the ETS2 are more likely to be achieved.

3. Impact on fuel suppliers and end-consumers
Fuel suppliers could cope with the cost pass-through limit either by complying with the regulation and balancing the extra cost of doing business within their profit margin, or by violating the limit and paying the subsequent fine into the SCF (under option 3 in section 2.2., that would be a compliance option). **Fuel suppliers certainly have the margin to cope with this small operational cost increase.** Europe’s five biggest oil majors (BP, Eni, Repsol, Shell, and TotalEnergies) pocketed €47 billion - mostly in profit for shareholders and management - in 2021.10

While there might be some potential for fuel suppliers to reduce their emissions as a response to this provision, rather than buffering it all through their profit margin, it is unlikely that they would be able to reduce their emissions by an extent equal to 50% of the ETS2 price signal. Therefore there would be a feedback effect on the ETS2 auction price, which would go up slightly in order to ensure the needed emissions reductions are still achieved. For example, if the original ETS2 auctioning price is €50/tCO2 (± 12cts/L) and it is split evenly between fuel suppliers and end-consumers, each actor would pay €25/tCO2 (± 6cts/L). While end-consumers would as a response reduce their demand (± -1% in the short term and -2% in the long term), fuel suppliers would be unable to do so by the same extent. As a result, the ETS2 auctioning price would slightly increase, for example to €70/tCO2.11 This would then again be evenly split between both actors, meaning end-consumers pay €35/tCO2 (± 8-9cts/L instead of the original 12cts/L). To prevent this feedback effect from negatively affecting middle income households, a price ceiling could be introduced in parallel to this provision to make fuel suppliers pay part of the ETS2 price (see section 2.2.).

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**Further information**

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11 Note that this example is for illustrative purposes only and not based on actual modelling of the ETS2 market.