ROCZNIKI NAUK PRAWNYCH
Volume XXVII, No. 1 – 2017
ENGLISH ONLINE VERSION
DOI: http://dx.doi.org/10.18290/rnp.2017.27.1-7en

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REVISION OF THE FUNCTIONING OF THE EU EMISSIONS TRADING SYSTEM

1. PRELIMINARY QUESTIONS

The scheme for greenhouse gas emission allowance trading was launched in 2005 on the basis of the earlier directive 2003/87/EC, which had been adopted by the European Parliament and the Council[1] was intended to be a key instrument of the policy of the European Union [hereafter UE] addressing climate protection.[2] Its

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[1] Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission trading within the Community and amending Council Directive 96/61/EC, OJ L 275/32, 25.10.2003 [hereafter EU ETS]. For more on this directive, see M. Stoczkiewicz, „Dyrektywa w sprawie handlu uprawnieniami do emisji gazów cieplarnianych," in *Implementacja prawa klimatyczno-energetycznego Unii Europejskiej w Polsce*, ed. M. Stoczkiewicz (Warsaw: ClientEarth, 2013), 12–19; F.M. Elżanowski, *Proces inwestycyjny w kontekście pakietu klimatyczno-energetycznego Unii Europejskiej*, in *Energetyka i ochrona środowiska w procesie inwestycyjnym*, ed. M. Cherka et al. (Warsaw: Wolters Kluwer, 2010), 121–34.

[2] On the subject of climate policy, see for example K. Alenka, "EU climate change policies and actions," *Review of Comparative Law* 16 (2011), 51–72; C.T. Szyjko, "Polskie prawo energetyczne wobec polityki klimatycznej Unii Europejskiej," in *Prawo i gospodarka UE*, ed. C.T. Szyjko (Warsaw: Europejskie Centrum Analiz Geopolitycznych, 2013), 83–94. Climate law is regarded as part of commercial law. Climate law brings together environmental law and commercial law by addressing such common issues as, for example, trading in GHG emission allowances; see J. Ciechanowicz-McLean, "O rozwoju prawa ochrony środowiska, czyli od ochrony przyrody, przez «zieloną» gospodarkę do ochrony klimatu," in *Prawo ochrony i zarządzania środowiskiem*, ed. J. Ciechanowicz-McLean (Warsaw: Difin, 2015), 43.

goal was to realise the main goal of this policy, that is reduction of GHG emissions in certain sectors of economy cost-effectively.[3] Essentially, the system was not to induce such reductions but to encourage and promote the search for the lowest cost of achieving a specific amount of reduction.[4] The goal was to be achieved by allocating annual emission allowances to certain businesses rather than imposing rigid emission standards. Such allowances were to reflect a particular permissible quantity of emissions and they could be traded.[5] It was believed that this mechanism would urge companies emitting specific GHGs into the atmosphere to undertake activities enabling them to have surplus allowances which they could use to increase their future production or sell to other businesses which need such allowances to carry on their own production.[6] This unique incentive was intended to motivate emitters, especially those with lower costs of emission reduction, to take measures to reduce their emission below the prescribed levels specified in their allowances to be able to sell the unused allowances to other polluters who incurred higher costs of emission reduction.[7] High hopes were pinned on this mechanism as it was expected to become the most efficient and economically effective form of meeting the emission cap.

At the same time, while the system was being developed, concerns were voiced that it was uncertain whether this mechanism would permit the attainment of the envisaged reduction goals, that is a several per cent decrease in emissions. Mainly,

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[3] In addition, the sub-objectives that the EU ETS should address are in particular, according to the recitals 5 and 7 of the directive, the preservation of economic growth and employment as well as integrity of the internal market and competitiveness. See the judgement of the European Court of Justice of March 29, 2012, case C-505/09 P Commission v Estonia, item 79, accessed August 30, 2016, http://curia.europa.eu/. More on the formation of the ETS: M. Nowacki, *Prawne aspekty bezpieczeństwa energetycznego* (Warsaw: Wolters Kluwer, 2010), 187–96 (chap. 10.1 – *System handlu uprawnieniami do emisji gazów cieplarnianych*); J. Stochlak, „Podstawy prawne gospodarki niskoemisyjnej," in *Polska w Unii Europejskiej. Problemy, wyzwania, nadzieje. Wybrane aspekty prawne, międzynarodowe i społeczno-gospodarcze*, ed. C.T. Szyjko (Warsaw: Wydawnictwo MM Marek Makuliński, 2014), 147–65.

[4] Judgement of the European Court of Justice (Grand Chamber) of December 16, 2008, case C-127/07 Arcelor Altantique et Lorraine et al., item 31, accessed September 30, 2016, http://curia.europa.eu. For the concept of the GHG emission trading scheme, see for example: K. Kępa, *Prawnomiędzynarodowe aspekty zmian klimatycznych* (Warsaw: BEL Studio, 2013), 247–51.

[5] K. Marchewska-Bartkowiak, „Wpływy budżetowe ze sprzedaży uprawnień do emisji gazów cieplarnianych w systemie ETS oraz możliwe warianty ich alokacji," *Studia Biura Analiz Sejmowych Kancelarii Sejmu* 29, no. 1 (2012), 140.

[6] M. Górski, „Handel uprawnieniami do emisji gazów cieplarnianych i innych substancji w świetle ustawy z 22 grudnia 2004 r.," in *Prawna ochrona powietrza i handel uprawnieniami emisyjnymi w Polsce i Niemczech*, ed. J. Boć and K. Nowacki (Wrocław: Wydawnictwo Kolonia Limited, 2006), 176.

[7] A. Graczyk, „Ograniczenie i handel emisjami dwutlenku węgla – regulacje europejskie a problemy polskich przedsiębiorstw," in *Procesy reform w Niemczech i Unii Europejskiej*, ed. R. Grzeszczak and M. Piotrowska (Wrocław: Wydawnictwo Uniwersytetu Wrocławskiego, 2009), 129–30.

it was emphasised that this would lead to less competition and slower economic growth, which would hinder the realisation of the environmental goal. In addition, it was stressed that the very idea of trading emission allowances between the member states and their economic operators, its implementation, calculation and verification of the attainment of GHG reduction targets, expansion of administrative control structures at the state, EU or global level is complicated, difficult to coordinate and seems expensive.[8]

In Phases 1 and 2, the EU ETS did not live up to the Commission and ecological organisations' expectations in terms of CO_2 emission reduction. Low prices of carbon emission allowances did not provide adequate return on investments in GHG reduction. The predictions saying that entrepreneurs were going to incur extremely high costs of purchasing carbon allowances did not come true. There were claims that if the average price of a carbon emission allowance was set at 30 €/tCO_2,[9] given the growing popularity of the system leading to an expected drop in the prices of modern low-emission technologies, the cost of purchasing carbon allowances would be high, in other words unprofitable. Additionally, the EU's assumption is that from 2013, the GHG emission cap will decrease every year (by a linear factor of 1.74%), which will involve increased allowance prices and the simultaneous drop in the cost of modern low-emission technologies given their increased availability.[10] There was a conviction that increased carbon emission cost would be sufficient to motivate the private sector to develop relevant technologies.[11] For example, it was estimated by the European Commission that the widespread use of carbon capture and geological storage system (CCS)[12] in power stations would become profitable in about 10–15 years causing that CCS would be an important carbon-reducing technology in around 2020 or slightly later. In reality, though, at the beginning of the phase of

[8] This was already noted at the first conference of DBU at the Branderburg University of Technology in November 2004 devoted to this subject. See Z. Bukowski and K. Nowacki, „Prawnomiędzynarodowa ochrona klimatu i jej zastosowanie w prawie krajowym," in *Prawna ochrona powietrza i handel uprawnieniami emisyjnymi*, 153.

[9] Source: a study conducted by the Ministry of the Environment "Implementation of elements of the Energy and Climate Package" (2009).

[10] Source: a report commissioned by the Polish Confederation of Private Employers "Carbon capture and storage (CCS) as a method to mitigate climate change" (2009).

[11] Resolution of the European Parliament of January 14, 2014, on implementation report 2013: developing and applying carbon capture and storage technology in Europe (2013/2079(INI)), OJ C 482/9, 23.12.2016.

[12] For the legal aspects of CCS, see for example A. Lipiński, „Z problematyki prawnej podziemnego składowania dwutlenku węgla," in *Zmiany klimatu a społeczeństwo*, ed. L. Karski and I. Grochowska (Warsaw: C.H. Beck, 2010), 387–95.

2008–2012, the market prices of allowances were within a range of a dozen Euros or so. In the final stage of that phase the prices dropped to several euros.[13] The economic slowdown (caused by the economic crisis) in addition to enhanced energetic efficiency and increased share of clean fuels all led to a large surplus of carbon emission allowances in 2013 (which is predicted to grow in the years to come) and that in turn led to a large drop in prices. Low prices mean that entrepreneurs do not find it profitable to switch to cleaner fuels or invest in low-emission technologies. Low prices of CO_2 emission allowances available in the market resulted not only in weaker incentives to invest in GHG reduction but also in decreased revenues of the member countries from auctioning the allowances, which in turn builds up pressure on public finances and limits other potential sources of public funding to counteract the climate change.[14]

The fall in prices of carbon emission allowances has triggered an avalanche of legislative initiatives at the EU level, especially from the European Commission, both those of a temporary character (aiming mainly at changing the auction schedule) and long-term schemes (structural reforms), which were intended to revise the arrangements of the Energy and Climate Package.[15] With a view to resolving the issue of cheap emission allowances and accelerated growth of their supply, the Commission made efforts to change this system already before Phase 3 commenced. On November 14, 2012, the Commission published a report on the state of the European carbon market, where it was postulated that actions were needed in order to mitigate the structural imbalance between supply and demand. According to the report, in the years to come, the surplus was going to increase beyond the cap of 2 billion surplus allowances, which would make the EU ETS scheme no longer provide incentives for investing in carbon reduction cost-effectively and stimulate innovativeness in the area of low-emission technologies which would contribute to economic growth

[13] Cf. changes in carbon allowance prices (EEX exchange, spot transactions).

[14] See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2010) 265 final, *Analysis of options to move beyond 20% greenhouse gas emission reductions and assessing the risk of carbon leakage*. For the notion and causes of climate change, see for example A. Przyborowska-Klimczak, „Zagrożenia związane ze zmianami klimatycznymi i przeciwdziałanie ich negatywnym skutkom na forum międzynarodowym", in *Świat wobec współczesnych wyzwań i zagrożeń*, ed. J. Symonides (Warsaw: Wydawnictwo Naukowe SCHOLAR, 2010), 433–36; Kępa, *Prawnomiędzynarodowe aspekty*, 16–20.

[15] The most important ones were: *A roadmap for moving to a competitive low carbon economy in 2050*, COM(2011) 112; Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, COM(2011) 885 final, *Energy Roadmap 2050*; Green Paper of 27 March 2013, COM(2013) 169, final, *A 2030 framework for climate and energy policies*.

and the creation of workplaces.[16] As a conclusion, the Commission proposed several further structural reforms, which in its opinion should contribute to improved functioning of this market[17] (e.g. further increase of the carbon reduction target, extension of the EU ETS coverage into other sectors of economy, changing the reduction factor for the quantity of free allowances, limited possibility of using CDM and Joint Implementation units, suspension of auctioning of some allowances, reduction in the quantity of auctioned ETS allowances in the years 2013–2015, permanent withdrawal of some allowances in Phase 3 or the EU ETS). The Commission also instituted (albeit ineffectively) a legislative procedure to realise these postulates.

Further activities of the Commission and other EU institutions, aiming at the creation of short supply of emission allowances by lowering the EU ETS cap, proposing scheduling changes in allowance auctioning, and by introducing a minimum auction price on the primary EU ETS market, were undertaken several times afterwards (in April, July and September of 2013). Finally, on December 10, 2013, with a view to counteracting the lower-than-expected prices of carbon emission allowances, upon the initiative of the EU Commission, the European Parliament adopted an amendment to art. 10 para. 4 of the directive 2003/87/EC concerning the auctioning of greenhouse gas emission allowances, which involved postponing 900 million allowances (the so-called *backloading*).[18] The amended art. 10(4) of Directive 2003/87/EC provides as follows: "Where and assessment shows for the individual industrial sectors that no significant impact on sectors or subsectors exposed to a significant risk of carbon leakage is to be expected, the Commission may, in exceptional circumstances, adapt the timetable for the period referred to in art. 13(1) beginning on 1 January 2013 so as to ensure the orderly functioning of the market. The Commission shall make no more than one such adaptation for a maximum number of 900 million allowances." On December 16, 2013, the EU Council gave ultimate consent to the above-mentioned amendment of Directive 2003/87/EC.[19] As a result, the Commission launched the so-called *backloading*

[16] Recital 5 of the preamble for the Decision of the European Parliament and of the Council of 6 October 2015, concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC, OJ L 264/1, 9.10.2015.

[17] Report from the Commission to the European Parliament and the Council *The state of the European carbon market in 2012*.

[18] As regards doubts concerning the compliance of the amendment of Directive 2003/87/EC and a draft amendment of Regulation no. 1031/2010 with the procedural and material provisions of the EU law, especially Art. 290(1) of the Treaty on the Functioning of the European Union (OJ C 83/47, 30.03.2010), in P. Czembor, "Backloading – zmiana zasad aukcji uprawnień do emisji," *Przegląd Prawa Ochrony Środowiska* 3 (2013), 104ff.

[19] Session report of the European Parliament no. 124/2013, Strasbourg, December 9–12, 2013.

scheme, which in effect froze auctioning for 900 million emission allowances for the years 2014–2016 and postponed their use for the following period, issuing a regulation amending Regulation (EU) 1031/2010 in particular to determine the volumes of greenhouse gas emission allowances to be auctioned in 2013–2020.[20] The instrument was one-off, however, and it constituted a temporary solution to the problem of low-priced allowances caused by a large surplus of these allowances on the market, a situation which in fact discouraged industry from investing in modern low-emission technologies.

The passage of more than a decade since the system was introduced and 3 years since the beginning of the third trading period has coincided with a period of aggravating crisis (referred to even as a breakdown), recurring doubts as to whether the system is capable of achieving the desired goal or perhaps it should be replaced with another instrument. However, no concept of such an instrument has been proposed yet, which would enable harmful emissions to be reduced efficiently and cost-effectively instead of the current EU ETS. Ten years after the launch of the system and three years into Phase 3, intensive work began on a structural reform of the EU ETS. The aim of this article is to give account of the state of research in the reform, present the principal directions and objectives, and to make an attempt at evaluation. Due to the fact that the proposed draft of the EU climate and energy policy until 2030, and in particular the proposed changes to the EU ETS, have been published fairly recently, no analysis has been provided yet. The existing publications address only the current rules of the EU ETS functioning as well as its operation in the first and second trading period.[21] It should be noted that the presented article also touches upon some other side issues but since the scope of the study is restricted they cannot be presented in full (some of them might be analysed in more detail in an independent study).

[20] Regulation of the European Commission 176/2914 of February 25, 2014, amending Regulation (EU) no. 1031/2010 in particular to determine the volumes of greenhouse gas emission allowances to be auctioned in 2013–2020, OJ L 56/11, 26.02.2014.

[21] J. Dyduch, „Unijny system handlu uprawnieniami do emisji gazów cieplarnianych" in *Handel uprawnieniami do emisji zanieczyszczeń powietrza* (Warsaw: Polskie Wydawnictwo Ekonomiczne, 2013), 119–71; J. Baran, A. Janik, and A. Ryszko, „Unijny system handlu uprawnieniami do emisji gazów cieplarnianych," in J. Baran, A. Janik, and A. Ryszko, *Handel emisjami w teorii i praktyce* (Warsaw: CeDeWu, 2011); J. Ciechanowicz-McLean, „Handel uprawnieniami do emisji gazów cieplarnianych*," Gdańskie Studia Prawnicze* 14 (2005), 705–14.

2. THE ROLE OF THE EU EMISSION TRADING SCHEME IN THE REALISATION OF 2030 FRAMEWORK FOR CLIMATE AND ENERGY POLICY

During the session of the European Council held on October 23–24, 2014, the 2030 Framework for climate and energy policies was agreed. The objective of the 2030 EU climate and energy policy envisages a reduction of domestic GHG emissions by at least 40% relative to 1190. The Council agreed that the set objective would be realised jointly by the EU countries in the most cost-effective manner while ensuring a reduction of emissions by 2030 in both the sectors which were covered by EU ETS and those which were not, 43% and 30% respectively relative to 2005. The European Council also decided that all the member countries would participate in those efforts, maintaining a balance between considerations of justice and solidarity In line with the conclusions formulated by the European Council, agreed upon during the session on October 23–24, 2014, the well-functioning, reformed EU ETS in combination with a market-stabilising instrument will be the main European mechanism used to achieve the GHG 40% reduction objective. The reformed EU ETS was acknowledged to be a key instrument in the realisation of the EU climate and energy policy after the year 2020.

The European Council also established a framework for the EU ETS for the 2030 perspective. The annual reduction factor for the cap on the quantity of permitted emissions is going to be increased from 1.74% to 2.2% starting in 2021. In addition, exceptions and privileges in respect of free emission allowances have been envisaged as well as funds to be allocated to investments. In the Conclusions, the Council stated that "free allocation will not expire; existing measures will continue after 2020 to prevent the risk of carbon leakage due to climate policy, as long as no comparable efforts are undertaken in other major economies", while "Member States with a GDP per capita below 60% of the EU average may opt to continue to give free allowances to the energy sector up to 2030", but "the maximum amount handed out for free after 2020 should be no more than 40% of the allowances." Moreover, "a new reserve of 2% of the EU ETS allowances will be set aside to address particularly high additional investment needs in low income Member States" and "10% of the EU ETS allowances to be auctioned by the Member States will be distributed among those countries whose GDP per capita did not exceed 90% of the EU average (in 2013)" while "the rest of allowances will be distributed among all Member States on the basis of verified emissions, without reducing the share of allowances to be auctioned."[22]

[22] *2030 climate & energy framework*, adopted in the European Council session of October 23–24, 2014, accessed August 30, 2016, http://data.consilium.europa.eu/doc/document/ST-169-2014-INIT/pl/pdf.

It is to be noted that the 2030 climate and energy framework, outlined in the conclusions, point to extensive and systemic connections with other instruments that make up the so-called climate & energy package, including regulations concerning renewable sources of energy, efficient energy use, the technology of capturing and geological storage of carbon dioxide (CCS). These instruments enhance the effectiveness of the EU ETS in respect of environmental protection. The conclusions of the European Council also tally with the resolutions of the Paris Agreement of December 12, 2015, concerning UN framework convention on climate change.[23] The agreement is as much concerned about measures aiming at carbon emission reduction by, for example, introducing new technologies or increasing the share of renewable energy sources in the energetic balance as it is about absorption of carbon, for example by forests, which is expected to counteract the effects of global problems such as human migration, food safety, access to clean water and air, or protection of biodiversity. In accordance with the provisions of item 2.14 of the Conclusions, adopted during the session of October 23, 2014: "The European Council invites the Commission to examine the best means of encouraging the sustainable intensification of food production, while optimising the sector's contribution to greenhouse gas mitigation and sequestration, including through afforestation. Policy on how to include Land Use, Land Use Change and Forestry into the 2030 greenhouse gas mitigation framework will be established as soon as technical conditions allow and in any case before 2020."

Importantly, the conclusions adopted by the European Council on October 23, 2014, are of general nature and their role is to provide a framework for future legislative measures. The submission of this document initiated a discussion of the shape of the new EU regulations implementing the 2030 climate & energy policy as well as the EU market for carbon allowances auctioning (the EU ETS) after 2020.

[23] Paris agreement on the Framework Convention on Climate Change, which forms an attachment to the decision of the Conference of the Parties dated of December 12, 2015, FCCC/CP/2015/L.9/Rev.1, accessed August 30, 2016, http://unfccc.int/resource/docs/2015/cop21/eng/l09r01.pdf. For more on the UN convention on climate changes see, for example, Przyborowska-Klimczak, *Zagrożenia związane ze zmianami*, 439–40; Kępa, *Prawnomiędzynarodowe aspekty*, 153–208; J. Ciechanowicz-McLean, "Odpowiedzialność prawna w konwencji klimatycznej," *Gdańskie Studia Prawnicze* 25 (2011), 493–505; Idem, "Globalne ocieplenie i zmiany klimatyczne: przegląd międzynarodowych działań prawnych," *Prawo i Środowisko* 3 (2001), 85–87.

3. THE DECISION TO ESTABLISH A MARKET STABILITY RESERVE

The process of streamlining the EU ETS was triggered by the introduction of the so-called stability reserves. "In order to address that problem and to make the EU ETS more resilient in relation to supply-demand imbalances, so as to enable the EU ETS to function in an orderly market,"[24] by virtue of Decision (EU) 2015/1814 of the European Parliament and of the Council of October 6, 2015, as part of the EU ETS, a market stability reserve will be created in 2018, but allowances will be placed in this reserve from January 1, 2019 (art. 1(1)). The said decision of the European Parliament and of the Council lays down the rules of placement and release of allowances in and from the reserve. According to the requirements contained in the decision, the Commission will publish the total number of allowances in circulation each year, by May 15 of the subsequent year (starting on May 15, 2017). Starting in 2019, "each year, a number of allowances equal to 12% of the total number of allowances in circulation, as set out in the most recent publication as referred to in paragraph 4 of this article, shall be deducted from the volume of allowances to be auctioned by the Member States under art. 10(2) of Directive 2003/87/EC and shall be placed in the reserve over a period of 12 months beginning on 1 September of that year, unless the number of allowances to be placed in the reserve would be less than 100 million" (art. 1(5)). Further, if in any year "he total number of allowances in circulation is less than 400 million, 100 million allowances shall be released from the reserve and added to the volume of allowances to be auctioned by the Member States." If, on the other hand, the reserve holds fewer than 100 million allowances, all allowances in the reserve shall be released under this paragraph" (Art. 1(6)). Additionally, the decision of the European Parliament and of the Council (EU) 2015/1814 provides that allowances which are not allocated to new installations until 2020 and those which remain unallocated due to discontinuation of economic activity fully or in part will also be placed in the market stability reserve. Furthermore, the Decision provides that the quantity of 900 million allowances deducted from auctioning volumes during the period 2014–2016 (*backloading*), but in accordance with earlier arrangements were to have been added to the volumes for auctioning in 2019 and 2020, be placed in the reserve (art. 1(1) and (2)).

It is worth pointing out that Poland, under art. 263 of the Treaty on the functioning of the European Union, lodged a complaint with the European Court of Justice seeking the annulment of the decision of the European Parliament and of

[24] Recital 5 of the preamble to the decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015.

the Council (EU) 2015/1814. The position of the Polish government was that the 2019 market stability reserve is going to start operation within the current trading period of EU ETS (2013–2020), which "significantly alters the legal framework originally defined for the 2020 perspective."[25] "This will trigger changes in the EU ETS, which were not anticipated by the participants of the system when planning for business operation and investments."[26] According to the Polish government, the European Parliament and the Council violated, among others, the "principle of loyal cooperation by adopting measures that are contrary to the conclusions of the European Council drawn in 2014."[27] Also, "the principle of legal certainty and the principle of legitimate expectation" were breached through the use of "measures interfering with the emission trading scheme during a trading period" as was the "principle of proportionality" by the adoption of measures which will lead to the attainment of reduction targets that are higher than stipulated in the international EU commitments."[28]

4. DRAFT AMENDMENT OF DIRECTIVE 2003/87/EC

In July 2015, the European Commission presented a draft amendment of Directive 2003/87/EC with a view to adapting the directive to the targets set for 2021–2030, in line with the conclusions of the European Council adopted during the session of October 23–24, 2014.[29] This document retains the overall structure of the Directive and the EU ETS while incorporating the changes defined in the Conclusions. According to the said document, the auctioning of allowances remains as a general rule with a proviso that 57% of the allowances will be sold by way of auction while 43% will be allocated freely. What will be changed, though, is the linear reduction factor, which will be 2.2% as of the beginning of 2021. Therefore the total number of allowances ("the cap") will decreae at a faster annual rate, leading to a general reduction of emissions in the sectors covered by the EU ETS by 43% until 2030.[30]

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[25] Source: https://www.premier.gov.pl/wydarzenia/decyzje-rzadu/zgoda-na-zlozenie-przez-rzeczypospolita-polska-skargi-o-stwierdzenie.html, accessed August 30, 2016.

[26] Ibid.

[27] Ibid.

[28] Ibid.

[29] Directive of the European Parliament and of the Council amending Directive 2003/87/EC in order to enhance cost-effective emission reductions and low-carbon investments – motion, COM(2015) 337 final, 2015/148 (COD).

[30] Amendments of art. 9 of Directive 2003/87/EC; in the years 2013–2020 the cap for power stations and other fixed installations is decreased by 1.74% each year.

As regards those allowances which can be auctioned by the member states, 10% of them will be allocated to benefit some of the less wealthy member states to promote solidarity, growth and interconnections, while the remaining allowances will be distributed among all of the member states.[31] As before, the income from the sales of allowances is intended to provide the member states with funding which can be used to finance various activities, such as implementation of RES programmes, increasing energy efficiency or supporting developing countries in their transition to low-carbon economy.

The presented draft amendment of Directive 2003/87/EC also envisages modification of the mechanism of free allocation of allowances conducted by the member state governments. The said proposals provide for the free allocation benchmarks to be updated to account for technological progress achieved in particular sectors. To this end, a standard factor will be used, which may be changed if the actual technological growth factor in a sector is radically different from the assumed standard factor. Accordingly, 100% of fee carbon emission allowances will be granted to those operators whose efficiency complies with a given benchmark as determined by the principle of utilising the best available technology.

The allocation of free allowances is to be focused on the sectors which are the most vulnerable to the so-called carbon leakage, that is relocation of production outside the EU. Sectors which are deemed prone to carbon leakage will receive larger allowances relative to other sectors which have a greater potential to reflect certain costs in the prices of their products. What is going to be changed is the method of determining the sectors and subsectors exposed to the real risk of carbon leakage; it will rely on two connected criteria: the volume of emissions and trade intensity.

According to the provisions of the draft amendment of Directive 2003/87/EC, due to a considerable increase in production, allowances for new installations will be transferred from a special reserve. The reserve for new installations will be created using the 250 million unallocated allowances placed in the market stability reserve and supplemented with allowances which remain unallocated due to an installation closure or substantial changes in production in the period starting from 2021. The reserve for new installations will also include unallocated free allowances, which originate in the industrial sector and have not been placed in the market stability reserve until 2020.

The draft amendment of Directive 2003/87/EC provides for the institution of a modernisation fund for the years 2021–2030, whose role will be to provide support to investments in modernisation of energy systems and improvements in energy

[31] Changes to art. 10 of Directive 2003/87/EC.

efficiency in member states with a GDP per capita below 60% of the Union average in 2013.[32] The fund is going to be financed with the sales of 2% of the total number of allowances for the period of 2021–2030, in accordance with the provisions of the regulation concerning auctioning under the EU ETS, in order to create necessary funds for projects which are to be carried out. The fund is to be managed by an investment board and a management committee, composed of representatives of the beneficiary member states, the Commission, the European Investment Bank and three representatives elected by the other member states for a period of 5 years.[33] Investments which should gain the financial support of the fund will be nominated directly by member states. The candidates will be assessed by the European Investment Bank. If the EIB recommends not financing an investment and provides reasons for this recommendation, a decision can be adopted if it is accepted by a majority of two-thirds of all votes. The member states in which the investments will take place as well as the EIB are not entitled to vote in this regard.

Moreover, in order to support innovation in the area of low-carbon technologies and processes in industrial sectors and to stimulate the construction and operation of commercial demonstration projects intended to capture that aim at the environmentally safe capture and geological storage of carbon dioxide (CCS) as well as demonstration projects of innovative renewable energy technologies in the territory of the EU. 400 million allowances will be earmarked for that.[34] Added to that will be 50 million allowances which will not have been used in the years 2013–2020 and which otherwise would be transferred to the market stability reserve in 2020.

5. SUMMARY

In practice, the implementation and smooth operation of the EU ETS has always given rise to many complications. The functioning of the EU ETS is disrupted by both domestic and external factors (the lack of global agreement in the area of GHG emission reduction). The greatest problem hindering the achievement of the EU ETS objectives, such as the provision of necessary incentives for cost-effective investments in carbon emission reduction as well as promotion of innovation in low carbon technologies, which is conducive to economic growth and the creation of workplaces, is the low price of allowances resulting from their large surplus on the market. The

[32] See art. 10d(1) of the draft amendment of Directive 2003/87/EC.
[33] See art. 10d(4) of the draft amendment of Directive 2003/87/EC.
[34] See art. 10a(8) of the draft amendment of Directive 2003/87/EC.

agreement on the 2030 climate & energy framework policy, achieved by the European Council on October 23–24, 2014, and the submission by the European Commission of a draft amendment of Directive 2003/87/EC with a view to adapting it to the objectives set for 2021–2030 as postulated in the conclusions of the European Council, provoked discussion about the shape of the new EU regulations implementing the 2030 climate & energy policy as well as the European emission trading system (EU ETS) after 2020. In line with the conclusions adopted by the European Council during the session on October 23–24, 2014, the well-functioning, reformed EU ETS in combination with a market-stabilising instrument will be the main European mechanism used to achieve the objectives of the climate & energy policy after 2020, namely reduction of greenhouse gas emission. Amendments of Directive 2003/87/EC, proposed by the European Commission, contain many provisions that are essential to smooth functioning of the EU ETS. Of major importance are the provisions which envisage establishment of a modernisation fund as well as an innovation fund, which are to be financed by the sales of emission allowances. The institution of these funds reflects the systemic approach to the implementation of the climate & energy policy; it emphasises extensive functional and systemic connections between the EU ETS and other instruments which are part of the so-called climate and energy package, including regulations concerning RE sources, energy efficiency, and the use of carbon capture and storage technology (CCS). However, many proposals with regard to the amendment of Directive 2003/87/EC requires further development and complementation. Doubts may arise with respect to insufficient consideration of the question of diversification (the so-called energy mix) in the context of allocation of free emission allowances, which is vital for Poland, the impossibility to use extra allowances from the stability reserve should production increase radically, or the attribution of a key role to the European Investment Bank in the assessment of enterprises which can receive funding from the Modernisation Fund. Moreover, the ambiguity of many formulations put forward by the Commission is pointed out.[35] A wise implementation of this systemic reform of the EU ETS before the commencement of the next trading period is of crucial importance; therefore clear and stable regulations are required for the years 2021–2030. The Commission's attempts to interfere with the established rules of the functioning of the EU ETS during a particular trading period (as it

[35] See Resolution no. 5 of employee and employer delegates of the Social Dialogue Council dated February 16, 2016, concerning the EU climate and energy policy and the EU ETS in the context of the draft amendment of Directive 2003/87/EC of the European Parliament and of the European Council establishing a scheme for greenhouse gas emission allowance trading within the Community in the period 2021–2030 and amending Directive 96/61/EC.

happened during Phase 3) were met with justified opposition of the participating parties. Such conduct provokes disapproval and aversion to the very idea of the ETS; it violates the fundamental principles of the EU law, especially the one of loyal cooperation. A change of rules "during the game" has a negative impact mainly on the possibility of long-term planning with respect to the development of enterprises, especially those in the energy sector.

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REVISION OF THE FUNCTIONING OF THE EU EMISSIONS TRADING SYSTEM

Summary

The passage of more than a decade since the system was introduced and 3 years since the beginning of the third trading period (Phase 3) has coincided with a period of aggravating crisis (referred to even as a breakdown) and recurring doubts as to whether the system is capable of achieving the desired goal or perhaps it should be replaced with another instrument. However, no concept of such an instrument has been proposed yet, which would enable harmful emissions to be reduced efficiently and cost-effectively instead of the current EU ETS. Ten years after the launch of the system and three years into Phase 3, intensive work started on a structural reform of the EU ETS. The aim of this article is to give account of the state of research in the reform, present the principal directions and objectives, and to provide an evaluation.

Key words: climate & energy policy, environmental law, emission reduction, greenhouse gases, GHG.

Translated by Tomasz Pałkowski

The preparation of the English version of *Roczniki Nauk Prawnych* (*Annals of Juridical Sciences*) no. 1 and its publication in electronic databases was financed under contract no. 753/P–DUN/2017 from the resources of the Minister of Science and Higher Education for the popularization of science.