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Review Article

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The Evolution of the Emission Trading System in the EU and Italy in the 2030 Climate and Energy Framework. Brief Notes on Climate Change Litigation

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Introduction

The EU Emissions Trading System (EU ETS) is an important tool of the EU's strategy to combat climate change, as it aims to reduce greenhouse gas emissions, according to the "polluter pays" principle. The EU ETS is more effective than environment taxation that has had little application, as it is difficult to determine the amount of tax and how it should be applied to companies and consumers [1].

The ETS also aims to respect the balance between production needs and environmental protection, according to a sustainable development principle. It is the biggest carbon market in the world and covers around 45% greenhouse gasses emissions in UE. It is known as a "cap and trade" system: EU establishes a threshold (cap) of the maximum level of greenhouse gases that can be emitted by power companies, industry and aviation.

Companies receive or buy emission allowances and can also buy international credits from reduction emissions projects. In the event of companies reducing their emissions, they can either trade their spare allowances or use them to cover their future requirements. ETS is one of the flexible mechanisms defined in the framework of the Kyoto Protocol.

Before briefly dealing with such flexible mechanisms, it is best to outline the United Nations Framework Convention on Climate Change.

Brief Notes on The United Nations Framework Convention on Climate Change. Flexible Mechanisms, As Defined Under The Kyoto Protocol

In 1992, the United Nations Framework Convention on Climate Change was concluded, and has since entered into force having been ratified by the majority of the world wide community [2]. According to article 2, the ultimate objective of the Convention "*is to achieve, in accordance with the relevant provisions of the Convention, stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system*".

Under article 3 of the Convention "*The Parties should protect the climate system for the benefit of present and future generations of humankind, on the basis of equity and in accordance with their common but differentiated responsibilities and respective capabilities. Accordingly, the developed country Parties should take the lead in combating climate change and the adverse effects thereof*".

According to the principle of common but differentiated responsibilities of industrialized and developing countries, the former are required to make a greater commitment than the latter in combating climate change given that historically they have produced the greatest amount of greenhouse gas emissions.

A Conference of the Parties – COP - was established, defined, *"as a supreme body of this Convention"*. The Conference of the Parties makes *"the decisions necessary to promote the effective implementation of the Convention*" (article 7 of the Convention).

The Kyoto Protocol was adopted at COP 3. It commits developed nations and those undergoing the process of transition to a market economy to reduce greenhouse gas emissions in the atmosphere, under the principle of "*common but differentiated responsibilities*".

A total amount of emissions in the atmosphere that couldn't be exceeded was established according to the Kyoto Protocol. A total amount corresponding to a quantity of gas that can be emitted was established for each country.

Besides ETS, the other two Kyoto flexible mechanisms are: the clean development mechanism (CDM) and the joint implementation mechanism (JI). Under article 12 of the Protocol, a clean development mechanism (CDM) allows developed Parties listed in Annex I to realize projects aimed at reducing emissions in developing countries. Certified Emission Reduction credits (CER) are issued to member states that implement the afore mentioned reduction emission projects. Each CER is equivalent to a tonne of CO_2, and is considered to meet the obligations of Member States under the Kyoto Protocol.

According to article 6 of the Kyoto Protocol, the joint implementation mechanism (JI) allows any developed country listed in Annex I, "*to transfer to, or acquire from, any other such Party emission reduction units resulting from projects aimed at reducing anthropogenic*

emissions by sources or enhancing anthropogenic removals by sinks of greenhouse gases in any sector of the economy…" These projects earn Emission Reduction Units (ERUs), each equivalent to one tonne of CO2. ERUs can be counted, as well as CER, to fulfil the obligations of Member States under the Kyoto Protocol.

In December 2015, the Paris Agreement was concluded under COP 21 [3]. As is well known, such an Agreement provided for the containment of the increase in temperature well below 2 degrees Celsius compared to pre-industrial levels. The Agreement also provides for the optimal and most ambitious target of 1.5 degrees. The Paris Agreement established a new market mechanism (article 6) [4].

The UE Framework

Directive n. 2003/87/EC introduced ETS to meet the Kyoto targets, as a key tool of its Policy against the climate change, according to the 6th Environmental Action Program [5]. UE ETS was activated in 2005, before Kyoto Protocol's entry into force, in 2008.

Directive n. 2003/87/CE establishes a model *"for greenhouse gas emission allowance trading within the Community (hereinafter referred to as the 'Community scheme') in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner" (article 1)*.

According to article 2*, "This Directive shall apply to emissions from the activities listed in Annex I and greenhouse gases listed in Annex II*".

Annex I lists industrial plants (energy activities, production and processing of ferrous metals, mineral industry), and Annex II includes carbon dioxide (CO_2), methane (CH_4) and other gases.

Under article 3, a), allowance means a permit "*to emit one tonne of carbon dioxide equivalent during a specified period, which shall be valid only for the purposes of meeting the requirements of this Directive and shall be transferable in accordance with the provisions of this Directive*".

Since 2008, member States may apply emission allowance trading to activities and gases not listed in annex I, "*provided that the inclusion of such activities and greenhouse gases is approved by the Commission*" (article 24, Directive 2003/87/EC).

The UE ETS is a step by step process: I phase: from 2005 to 2007; II phase: from 2008 to 2012; III phase: from 2013 to 2020; IV phase: from 2021 to 2030 [6].

According to article 9 of Directive 2003/87, each Member State must develop a national plan stating the total amount of allowances that it intends to allocate for that period and how it proposes to allocate them in phases I and II. The Commission is notified and can reject said proposal on the basis of criteria included in the Directive. This provision (art. 9 of the Directive) was superseded by the Directive n. 2009/29/EC.

In the 2008 – 2012 period, companies subject to ETS received their allowances for free. Under Directive n. 2008/101/EC, that amended Directive n. 2003/87/EC, the aviation sector was included in EU ETS.

The main amendments Directive 2009/29/EC introduces to Directive n. 2003/87/EC relate to the following points:

a) The extension of the application of ETS to other activities and gases;
b) The cap of allowances issued every year from 2013 to 2020 that is reduced annually by 1.74%; and
c) According to Directive n. 2009/29/EC, since 2013 (phase III of ETS), only some sectors receive allowances free of charge (e.g., manufacturing industry), while in other sectors allowances are auctioned.

According to EU 1031/2010 Regulation, the percentage of allowances free will decrease by 30% in 2020; free allocation of allowances will cease in 2027.

Since 2013, the cap of the maximum level of emittable greenhouse gases is set by UE, on the basis of the total emission allowances issued by the State in phase II (2008 – 2012).

According to article 4, of the 2003/87 Directive, from 2005 "*no installation carries out any activity listed in Annex I resulting in emissions specified in relation to that activity unless its operator holds a permit issued by a competent authority*".

In UE ETS, the UE plays a key role in regulating and planning, while administration remains under the remit of the States. Until 2020, operators will be able to use international credits from CDM and JI to meet part of their obligations under EU ETS, according to Directive n. 2003/87/EU. The Paris Agreement established a new market mechanism that will replace CDM and JI after 2020.

The EU Commission observed that from 2013, "*the EU ETS was characterized by a large imbalance between the demand and supply of allowances, resulting in surplus of 2.1 billion in 2013" (EU Commission, Report on the functioning of the European carbon market, COM (2017) p.23)*. The emission allowance surplus was partly due to the economic crisis. Consequently, the price of allowances dropped, decreasing the efficiency of the ETS [7].

The EU initially introduced some strategies such as back-loading and market stability reserve to solve this problem. Back loading is a temporary solution, according to EU Regulation 176/2014, that consists in postponing the auctioning of 900 million allowances, to be transferred into the reserve. The market stability reserve is a long term solution. It aims to withdraw a percentage of EU ETS allowances from the market, if the total number of allowances exceeds a given threshold. In the opposite case, allowances are returned to the market. The market stability reserve operates from January 2019.

In October 2014, the European Council adopted the 2030 Climate and Energy Framework. The targets for 2030 are: at least 40% cuts in greenhouse gas emissions, from 1990 levels; at least 32% share for renewable energy; at least 32.5% improvement in energy efficiency. To reach the target reduction in greenhouse gas emissions, Directive n. 2018/410/EU revised previous Directive n. 2003/87/EC. Phase IV of ETS (from 2021 to 2030) begins with Directive n. 2018/410/EU.

Pursuant the Provisions of this Directive:

1. From 2021 onwards the cap set by EU is reduced annually by 2.2%, reflecting the EU's new 2030 target for greenhouse gas

emission reductions;
2. Allowances to industrial installations exposed to risks of carbon leakage are allocated free of charge. Carbon leakage refers industrial sectors exposed to the risk of relocation; and
3. Assistance to industry and energy sector for a transition to a low – carbon economy through various financing mechanisms.

Directive n. 2018/410/EU had to be transposed by 9 October 2019. However, in order to achieve climate neutrality by 2050, according to Paris Agreement and as discussed in the EU, 2030 EU targets will be revised, as well as the targets of the ETS reduction of greenhouse gases.

ETS in Italy

In Italy, Legislative Decree n. 216/2006 first transposed the Directive n. 2003/87, and then Legislative Decree n. 30/2013 transposed Directive n. 2009/29/EC. In Italy, the ETS covers more than 1,000 plants, 70 % of the manufacturing industry and 30 airlines.

A National Committee for the implementation of Directive n. 2003/87, headquartered at the Ministry of Environment is the national competent authority. It consists of a Governing Council of 9 members appointed for 4 years (8 of them are appointed by Ministries) and of a technical secretariat of 22 members, all highly qualified professionals.

The National Committee issues permits for greenhouse gas emissions. It also reviews the permits every 5 years and withdraws the authorization if the activity has been discontinued. After each year, by April 30th, companies must surrender sufficient allowances to cover all their emissions from that installation during the preceding calendar year as verified by the Competent Authority, and will otherwise incur in heavy penalties.

The Committee does not draft the national plan of allocation of allowances; in fact, as mentioned, it is the UE that now establishes the cap of allowance emissions. The Committee makes the list of the plants included in the ETS. The National Committee has many tasks. At present, the Committee receives administrative support from the staff of the Ministry of Environment. However, a better organization of this Committee would require a dedicated organization and staff.

Operations on allowances are registered in a European electronic structure (the UE Register), that houses emission allowances and through which operators fulfil their emission–off obligations by surrendering the allowances themselves. ISPRA (the Italian Higher Institute for Environmental Protection and Research) is the administrator of the Italian section of the UE Register.

It is possible to identify some critical issues in the sanctioning system. According to afore mentioned article 4, of 2003/87 Directive, from 2005, "*no installation carries out any activity listed in Annex I resulting in emissions specified in relation to that activity unless its operator holds a permit issued by a competent authority*".

If the provision is infringed, under article 36, paragraph 1 of Legislative Decree n. 30/2013, the penalty is set from a minimum of 25,000 Euros to a maximum of 250,000 plus 100 Euros for each tonne of carbon dioxide equivalent emitted, if the operator does not hold a permit for it. Article 36, paragraph 6, provides similar consequence in case the operator does not surrender sufficient allowances every year, by April 30th. In this case, the fine is 100 Euros for each tonne of carbon dioxide equivalent emitted and not surrendered.

Consequently, in both cases under article 36, the operators could be asked to pay millions of Euros, and in some cases, that could lead them to bankruptcy. Under article 36, paragraph 6, of Legislative Decree n. 30/2013, consistently with the EU Directive, a fixed amount penalty is set. As a result, the Competent Authority cannot establish the penalty on the basis of the gravity of the infringement and of the responsibility of the operator, as penalties are fixed, something which contrasts Italian legislation (Law n. 689/81) as penalties are set according to the degree of responsibility and blame.

Under article 36, paragraph 6, the penalty is also applied if the operator surrenders sufficient allowances later than April 30th. In this case the penalty is not proportional and can, in fact be very high. In Italy, Parliament recently approved Law n. 117/2019, to transpose Directive n. 2018/410/EU. Moreover, under the afore mentioned law, the Government holds power to issue a legislative decree and solve some critical issues of Legislative Decree n. 30/2013 which is the Italian transposition of Directive n. 2009/29/EC that amended Directive n. 2003/87/EC. Furthermore, Law n. 117/2019 aims to strengthen the organizational structure of the Competent Authority for the ETS and to revise the national sanctioning system.

Brief Notes on Climate Litigation

A growing number of citizens and of environmental associations are taking (legal) actions against their States, to push Governments to comply with their International and European commitments to combat climate change. An important climate litigation case, "Urgenda", was brought against the Dutch State (2015) [8]. Urgenda (Urgent Agenda), is a citizens' platform with members from various sections of society. For the first time a Court (the District Court in The Hague) recognized the right of citizens to take legal action against the State to obtain respect of international obligations to fight climate change. The decision of the District Court in The Hague, dated 24 June 2015, allowed Urgenda's claim that the Dutch State be ordered to achieve a reduction of greenhouse gas emission by at least 25% by the end of 2020, relative to year 1990 [9]. According to the District Court, the emission reduction target of the State (17%) was not enough to combat climate change.

In 2018 (decision dated 9th of October 2018), The Hague's Court of Appeal confirmed the District Court's sentence. The Hague's Court of Appeal stated that the State has an obligation to protect the lives of citizens in its jurisdiction under Articles 2 and 8 of the ECHR [10]. In this light, the State has to take precautionary measures to prevent future violations to the right to life (article 2 ECHR) and to home and private life (article 8 ECHR). According to The Hague's Court of Appeal, the Dutch State violates human rights "*which calls for the provision of measures" (n. 67),* to reduce the greenhouse gas emission.

Among other things, the Court disagrees with the State that the ETS system "*stands in a way of the Netherlands taking measures to further reduce CO_2 emissions" (n. 54).* In fact*, "Article 193 TFEU states that protective measures adopted under Article 192 TFEU do not prevent a member State from maintaining and adopting more ambitious protection measures, provided that ... these measures do not interfere with the functioning and the system of the ETS in an unacceptable manner*".

The Court applied the ECHR provisions directly, as a part of the Dutch law. After the Urgenda Case, in many countries, citizens have taken their governments to Court to respect constraints deriving from international Treaties against climate change.

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