

§ 3 A trend-setting approach to reconcile industrial production and the environment in times of globalisation: emissions trading law [Emissionshandelsrecht]

I. Clarification of terminology

- despite the misleading term, not emissions but limited rights to make emissions are traded
- the correct and precise term would be: "greenhouse gas emission allowances trading law"

II. Backgrounds

- see already supra, slide 2, § 2 I
- the need to reduce greenhouse gas emissions to mitigate climate change
- the commitments in the global common fight against climate change
 - the United Nations Framework Convention on Climate Change (UNFCCC) of 1992
 - the Kyoto Protocol of 1997 and its Doha Amendment of 2012
 - the Paris Agreement on climate protection of 2015
- the European Green Deal of 2019

III. The concept of reducing greenhouse gas emissions through a limited market of tradable emission allowances [Emissionszertifikate]

1) The idea: to require allowances for emissions, create a market for them and make them gradually more rare & expensive

- the innovative idea to utilise market mechanisms instead of direct state intervention to reduce greenhouse gas emissions
 - reconciles need for climate protection with needs of the market economy
 - allows fairer distribution of the burden to those who emit or benefit the most from their emissions
 - prevents unfair externalisation of production costs
 - inspires to look for alternatives to emissions
 - allows decentralised decisions on how emissions can be reduced most cost-effectively
- the dependence of this instrument on an appropriate limitation of the total quantity of emissions (cap) and an appropriate minimum price for emissions
 - even minor changes can render this instrument useless or turn it into a sharp weapon
 - high risk of manipulation through lobbying, nepotism and corruption

2) The development and first implementation of the concept in the USA

- first developed in the 1960s by American scholars
- first implemented in 1990 with the Acid Rain Program of the amended US Clean Air Act

3) The first and model wide-scale implementation of the concept in the European Union

- proposed by the European Commission in 2000, introduced by European legislation in 2003, launched 2005
- first comprehensive emissions trade system in the world, for broad and important sectors for the economy
- development in four phases: pilot phase (2005 - 2007), implementation of Kyoto Protocol (2008 - 2012), implementation of Doha Amendment (2013 - 2020 and later) and after the reform of 2023 (since 2023)

IV. The EU Emissions Trading System in the energy, industry, aviation and maritime transport sectors (EU ETS 1) and its implementation in German law

1) Regulation in a European Union directive plus national law

- Two-level regulatory system: The EU *directive* sets general rules that do not apply directly but need to be *implemented in the legal order of the member states*. It is binding, as to the result, but leaves choice of form and methods to the national authorities (cf. art. 288 sub-sect. 3 FEU Treaty).
- So the European emissions trading follows the same concept but can be different in detail in the various member states.
- A coherent regulation of the basic system in a directly applicable European regulation (art. 288 sub-sect. 2 FEU Treaty) might be more appropriate.

2) The European Union's Emissions Trading Directive of 2003 (Directive 2003/87)

- frequently amended to further develop the ETS; last major reform: 2023
- **"Cap and trade" system:** Every year the EU member states issue *emission allowances* to the participating companies. Some are for free, most are auctioned off. Each allowance entitles to emit one ton of greenhouse gas. Each company must submit each year the appropriate number of allowances for the amount of greenhouse gas it has emitted. If necessary, it needs to buy more allowances on the market. They are traded at the stock exchange, at special energy exchanges, via brokers (e.g. banks) or directly.

The quantity of available allowances is limited by the **"cap"**, a political decision on the maximum amount of greenhouse gases that may be emitted by all participating companies together. The cap is *lowered every year* (from 2005 to 2030 by 62 %) and the rules on the cap are constantly tightened.

The cap is determined by the national government in cooperation with the European Commission. Since the third period (2013 - 2020) there is a *cap for the whole European Union*, what reduces the discretion of the national governments. In the coming years, the cap will be more and more predetermined by European standards that are already anchored in the European law.

- In 2024, ca. 9.000 installations in the energy sector and emission-intensive industries that accounted for 40 % of the European greenhouse gas emissions participated in the system.
- A Market Stability Reserve (MSR) shall counteract allowance oversupply or shortage that could render emissions trading dysfunctional. Every year, the supply of allowances to be auctioned is adjusted to *predefined thresholds of the total number of allowances in circulation (TNAC)*, without discretion of the member states or Commission. Surplus allowances are removed from the market but can be reintroduced later if necessary.
- Participating companies, emission allowances and transfers of allowances are registered in the Union Registry, a central European emissions trading register (see Regulation 2019/1122).

3) The German Greenhouse Gas Emissions Trading Act of 2025 [Treibhausgas-Emissionshandelsgesetz] (originally of 2004)

- To release greenhouse gases requires an *emissions authorisation plus* the annual surrender of the necessary *emission allowances* until September of the following year (sect. 4, 7). Plant and airplane operators receive some free allowances in accordance with EU law (sect. 23, 32).
- Operators, companies or responsible persons must determine their annual emissions under an *approved monitoring plan* and submit a *report verified by an accredited test body* to the authority (sect. 5, 6).
- The *emission allowances* are registered in the Union Registry. They are *transferred by agreement plus entry* in the purchaser's account *in the Union Registry* (sect. 8, 9).
- There are special regulations for plant operators, aviation, maritime transport and fuel emissions trading (sect. 19 et seq.).
- The Act is executed by the German Emissions Trading Authority [Deutsche Emissionshandelsstelle - DEHSt], a unit of the German Environment Agency [Umweltbundesamt - UBA].

V. The temporary additional German fuel emissions trading system in other transport sectors and the heating sector

- the *Fuel Emissions Trading Act* [Brennstoffemissionshandelsgesetz] of 2019
- a genuine German "cap and trade" system, complementing EU ETS 1 for emissions resulting from the use of fossil fuels until EU ETS 2 is operational (see infra, VI.)
- a system not directly linked to the greenhouse gas emissions but to the *placing of fossil fuels on the market*
 - lowering fossil fuel consumption in the society by causing higher fuel costs
 - however, emission-intensive enterprises can apply for financial support to cushion the hardship of fuel costs increases
- fuel suppliers must determine and report "their" annual fuel emissions under an approved monitoring plan on the basis of the quantity of fossil fuels placed by them on the market, and surrender the necessary emission allowances (sect. 7, 8)
- The Act is executed by the German Emissions Trading Authority, which also maintains the National Emissions Trading Registry [Nationales Emissionshandelsregister - neHS].

VI. The coming EU Emissions Trading System for fuel emissions in the building, road transport and other sectors (EU ETS 2)

- regulated in the new Chapter IVa of the Emissions Trading Directive
- a new emissions trading system, separate from EU ETS 1, that addresses *emissions from fuel combustion* in buildings, road transport and small industries
- fully operational in 2028 (after one-year postponement); replaces the German fuel emissions trading system (see supra, V.)
- a system also not directly linked to the emissions but to *placing fossil fuels on the market*
- fuel suppliers must have an *emissions authorisation*, determine and *report "their" annual emissions* to the authority and *surrender the necessary emissions allowances*
- all emission allowances will be auctioned
 - a share of the revenues will be used to support vulnerable households and micro-enterprises through a European Social Climate Fund of up to 65 billion € (Regulation (EU) 2023/955)
 - member states must use the remaining revenues for climate action and social measures

VII. Problems and perspectives of emissions trading law

- a concept with a *high potential* for a constant, faire and finely adjusted reduction of greenhouse gas emission, which *could eventually even be globalised*, but also with *many "buts"*:
- *more bureaucracy* for enterprises, increasing production costs
 - companies must prepare the annual reports and set up an emission allowances management
- *vulnerability to strong market fluctuations*
 - in case of an economic crisis, the market price for emission allowances will fall so sharply that there is no incentive anymore to reduce emissions
 - in 2014, a dangerous surplus of allowances causing a far too low market price required a sensitive intervention
 - the auctioning of 900 million allowances needed to be postponed (so-called "backloading"); in 2015, they were transferred to the newly created Market Stability Reserve
- *vulnerability to sabotage* by corruption, lobbyists, populists and other rogue politicians
 - even smallest changes in the law, e.g. a significantly increased cap, can render the system ineffective, although it is still functioning
 - see, for example, the criticised postponement of the start of EU ETS 2

- *excessive complexity* can make the system difficult to understand for non-experts, hinder acceptance among the population and foster populist criticism
 - but will also lead to the creation of high-paying jobs for lawyers...