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CLIMATE CHANGE UPDATE

Legislative Acts in Furtherance of the European Council's Decisions on the Climate Change and Energy Package

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The Council of Ministers is expected to formally endorse at one of its forthcoming sessions several significant decisions that were made at the last European Council on 11 and 12 December 2008. These decisions stem from the translation into legislative acts of political targets established in March 2007 by European heads of government. The so-called 20-20-20 targets for the year 2020 provide for increasing the share of renewable energy to 20 percent of the European energy mix, increasing the use of biofuels to 20 percent and reducing greenhouse gas emissions by 20 percent compared to 1990 levels.

The European Council also confirmed the European Union's commitment to increasing the greenhouse gas emissions reduction to 30 percent within the framework of an ambitious and comprehensive global agreement in Copenhagen on climate change for the period after 2012. This commitment is premised on the other developed countries undertaking to achieve comparable emission reductions, and on the economically advanced developing countries making contributions commensurate with their respective responsibilities and capabilities.

This final summit under the French Presidency of the European Council brought about political agreement on the "Climate Change and Energy Package," a set of closely linked legislative acts. Prior to this agreement, the European Parliament and the Council had already completed political negotiations on a Directive promoting renewable energy, a Directive on fuel quality and a Directive on CO_2 emissions from cars. The outstanding proposals for December's European Council were the following:

- A Decision on effort sharing;
- A Directive on carbon capture and storage (CCS); and
- A Directive revising the current EU Emissions Trading Scheme (ETS).

These measures, and particularly the revision of the ETS, will considerably impact business in the European Union and might further fuel debates in other parts of the world where similar measures are being considered.

The Decision on Effort Sharing

The 20 percent reduction of greenhouse gas emissions is achieved through both the ETS and the Decision on effort sharing for all sectors not covered by the ETS (such as transport, buildings, services, smaller industrial installations, agriculture and waste). The Decision establishes binding individual reduction targets for the Member States between 2013 and 2020.

While in the coming years some Member States are allowed to increase their emissions not covered by ETS, others must achieve a reduction of up to 20 percent in order to reach an overall reduction of 10 percent in the European Union. The final agreement (i) provides for the possibility to trade and transfer overachievements among Member States, (ii) allows for up to 3 percent of the domestic reduction obligations to be fulfilled by financing clean development projects in third countries, and (iii) establishes compliance rules.

The Directive on Carbon Capture Storage

The aim of the CCS Directive is to provide a legal framework for establishing coal-powered plants equipped with carbon capture technology as well as the storage infrastructure needed to contain the captured CO_2. Other than on the issue of funding of CCS demonstration projects, there wasn't much revision or negotiation by the European Council on 11 and 12 December with regard to the CCS Directive.

The text of the CCS Directive itself is generally considered to be fairly well-balanced between sometimes competing industrial and environmental goals. The Commission worked closely with industry and other stake-holders on many aspects of the proposal, and the Parliament largely adhered to the resulting compromises. The provisions that may remain of greatest concern to industry involve operators' obligations to fund the monitoring and potential remediation of storage sites, as well as the extent of their liability for sites once they are closed.

With respect to the funding of CCS demonstration projects, it was decided by the European Council to use 300 million emission allowances equivalent to approximately €6 to 9 billion depending on the future price of CO_2. Whether this may be sufficient to finance the 10 to 12 demonstration projects initially foreseen by the Commission is questionable. However, it is equally questionable whether so many projects may really be necessary to test all of the available technologies and possible storage modes. Accordingly, this ultimately generous allocation of allowances should help a sufficient number of committed companies proceed with their CCS projects.

The Directive Revising the EU Emissions Trading Scheme

The ETS was established in 2005. It will be considerably revised by the new Directive. The scheme covers more than 10,000 installations in the energy and industrial sectors from which approximately 40 percent of European greenhouse gas emissions stem. While until now the emission allowances have been allocated to the industry, the new system provides for a linear reduction of free allowances from 80 percent to 30 percent between 2013 and 2020. As a consequence, allowances will be auctioned, placing an economic burden on business and, thus, providing an incentive for more efficient installations.

Against the backdrop of the economic recession, the compromise agreed to by the Council addresses industry concerns by providing for free allowances at the "best technology available" benchmark until 2020 for sectors and sub-sectors that face a significant risk of carbon leakage to countries where companies face less stringent emission caps. By 31 December 2009, the European Commission will determine those sectors and sub-sectors that are eligible for these free allowances according to both the extent to which production costs increase and the share of external trade conducted in the relevant sector. This exception will mostly favor energy-intensive sectors such as the steel, chemicals or cement industries. However, these derogations are subject to potential revision.

With regard to the electricity sector, which must buy 100 percent of allowances from 2013 onwards, Member States that produce more than 30 percent of electricity from a single fossil fuel, and whose GDP is below 50 percent of the European average, will receive up to 70 percent free allowances, decreasing gradually until 2020. This derogation is aimed at the new Member States and, in particular, coal-dependent Poland. As mentioned above, 300 million emission allowances will also be allocated to CCS demonstration projects.

A solidarity fund of 10 percent of all auctioned allowances was established for new Member States, complemented by 2 percent more allowances to be distributed among Member States that had already achieved a 20 percent emission reduction in 2005. The 88 percent remaining allowances will be distributed among the Member States according to their 2005 verified emissions. While Member States are not restricted in how they may spend the income from auctioning, they have officially declared their willingness to spend half of the funds on measures aimed at reducing greenhouse gas emissions, mitigating and adapting to climate change, as well as technologies that help building up a low-carbon economy.

Next Steps

The Commission will identify by the end of 2009 the industry sectors that qualify for free allowances. Furthermore, implementation of the various Directives by the Member States will warrant close scrutiny in the years ahead. Finally, the outcomes of the Copenhagen UN Climate Change Conference will determine whether the EU will commit its economy to more stringent targets in reviewing the decisions taken in 2008.

For more information about this topic, please contact your regular Mayer Brown lawyer or the author of this Client Update listed below.

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