Avosetta Meeting

Madrid, April 2005

Legal aspects of climate change.

In particular, emissions trading mechanisms

(european and national perspectives)

Report on Germany by Gerd Winter[1]

1.- *Council Decision 2002/358 introduced, among others, a compulsory burden sharing for EC Member States as regards the commitments under the Kyoto Protocol (annex II). Was there any legal discussion in your country as regards the method of calculation of this burden sharing, and its fairness; was there any participation of the public as regards the opportunity to accept the political burden sharing of 1997 and its legal fixation of 2002?.*

Germany has agreed to the quite ambitious reduction committment of 21 %, and so it was fixed in Council Decision 2002/358. There was not much of a specifically legal debate about this, although scholars of international law did discuss the committment in the context of the general principle of joint but differentiated responsibility, whilst scholars of Community law found it acceptable because it replicated the logic already probed in Council Directive 88/609 on emissions from large combustion plants which had also established differentiated obligations among MS. The target is in fact less demanding than it appears because after 1990 much of the old Eastern industry had been closed down and was anyway about to be replaced by more efficient technology.

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1 The legal debate abounds. Significant contributions include M. Burgi, Die Rechtsstellung der Unternehmen im Emissionshandelssystem, NJW 2003, 2486 – 2492; C. Corino, Der Handel mit Treibhausgas-Emissionsrechten, EuZW 2002, 165; Y. Kerth, Emissionshandel im Gemeinschaftsrecht, Baden-Baden (Nomos) 2004; K. L. Mehrbrey, Verfassungsrechtliche Grenzen eines Marktes handelbarer Emissionsrechte, Berlin (Duncker & Humblot) 2003; M. Pohlmann, Kyoto Protokoll: Erwerb von Emissionsrechten durch Projekte in Entwicklungsländern, Berlin (Duncker & Humblot) 2004; T. Zimmer, CO_2-Emissionsrechtehandel in der EU. Ökonomische Grundlagen und EG-rechtliche ProblemeBerlin (Erich Schmidt) 2004; Emissionszertifikate und Umweltrecht. 19. Trierer Kolloquium, Berlin (Erich Schmidt) 2004; M. Burgi, Ersatzanlagen im Emissionshandelssystem, Stuttgart (Boorberg) 2004; E. Rehbinder, M. Schmalholz, Handel mit Emissionsrechten für Treibhausgase in der Europäischen Gemeinschaft, UPR 2002, 1 – 10; A. Reuter, Grund- und Grundrechtsmängel des CO_2-Handels in der EU, RE 2003, 262 – 268; A. Reuter, K. Kindereit, EG-Emissionshandelsrichtlinie und Beihilferecht am Beispiel prozessbedingter Emissionen, DVBl. 2004, 537 – 543; C.-S. Schweer,, B. Ludwig, Der erste naonale Zuteilungsplan für handelbare Emissonszertifikate, VBl. 2004, 932 – 941; C. Stewing, Emissionshandel in der Europäischen Gemeinschaft, Köln (Heymanns) 2004.

Germany could have insisted to „cash in“ on „hot air“, like Russia can do today on the Kyoto level, but in the nineties the German public at large was still environmentally concerned and willing to pioneer with ambitious goals.

Much more than on goals the legal debate concentrated on instruments. There had been a long-stand controversy between regulatory and economic approaches. Economists had since long propagated charges and emission rights schemes but failed to convince the more traditional administrative law culture which primarily has in mind effectiveness of and equal treatment by instruments. Only rare victories such as the waste water charge had been won by economists. But more and more administrative lawyers drifted towards the efficiency culture. The allegation that regulation requiring BAT (such as it was used in the phasing out of old combustion installations) leads to an inefficient use of financial resources became a general belief (although it was never empirically tested). As a compromise solutions combining the setting of binding targets with economic instruments such as charges or tradable emission rights became fashionable. On this basis, the German legal profession was quite willing to accept the Kyoto mechanisms which are a version of precisely the standard-price approach.

2. *Directive 2003/87 (OJ L 275/203 p. 32) introduces a system of how emission rights shall be allocated and how they can be traded.*

a) Was there any legal discussion of the major elements of this directive in your country? Was the basic approach – i.e. tradable emission allowances – easily accepted ? Were frictions discussed in relation to BAT-approaches, voluntary committments, or emission charges/taxes schemes?

The major elements of the Directive were repeatedly discussed as to their compatibility with EU primary law and as to possible frictions with other secondary legislation.

(1) The introduction of an authorisation requirement for carbon dioxide emissions is certainly an intrusion into the *basic right of economic freedom*. Some have argued that also the *right of property* was affected, arguing that the possibility to burn fossil fuels and emitting CO_2 is part of the propertied assets of an industrial installation. In any case, however, climate protection is regarded as a legitimate interest of Community policy justifying the restriction of basic economic rights. Uncertainty about whether climate change is caused by human impact is no objection because the precautionary principle allows and –according to some scholars – even mandates action.

(2) It has also been discussed whether the possibility of trading emission rights might violate the *polluter pays principle* considering the fact that the polluter is conceded to avoid investment into better technology by buying additional pollution rights. Of course everything depends here on how the polluter pays principle is interpreted the dominant opinion being that the principle allows to make the polluter either prevent pollution or pay for it. I believe, however, if the price becomes too low it may not be regarded as an equivalent for real cure.

(3) Discussion was also incited concerning the principle of *equal treatment*. According to this principle equal situations may not be treated differently if there is not an objective reason of substantive weight justifying different treatment. Concerning Directive 2003/87 the industry subject to the trading regime must be allocated an overall quantity of climate gas emissions which reflects its actual share in

greenhouse effect as compared with other sectors like households, transportation, and professions/commerce/services. The Directive does give adequate advice in this direction in Art. 9 and Annex III No. 1. As for the instruments employed there are good reasons for using different instruments on households and transportation because the quantity of addressees of measures is too high to allow for trading schemes.

(4) There is a tension between various measures of climate policy on the level of secondary law. The BAT-approach under *IPPC-Directive 96/61* and the emission rights approach of Directive 2003/87 contrast each other. If BAT is taken seriously no further reduction of CO_2 emissions is possible in the normal case. The remaining emissions may still be priced but only as a compensation for the consumption of a common good rather than with a view to provide an incentive to further reduce emissions. Vice versa, if in the framework of the emission rights approach an emission right is legitimately acquired this cannot be questioned on the ground that BAT allows to avoid the emission. German lawyers have discussed two ways to overcome this tension: some have argued that BAT is only a general standard allowing to go beyond in individual cases - however, this approach would have left only a small quantity of emissions for the trading scheme – whilst others have proposed that BAT should only figure as a bench-mark for allocating the first round of emission rights leaving the further development to the logic of the trading scheme. The choice of option is left to the MS by Art. 26 Directive 2003/87. The ensuing German Law on Emissions Trading has taken a third route. It opts in favour of a grandfathering approach thus almost completely disregarding BAT. Only recent and future installations are assessed according to benchmarks based on BAT. It is envisaged that for the second instalment period BAT benchmarking will be reconsidered as a general orientation.

(5) German industry has in 2000 made a self-committment to „voluntarily" reduce until 2012 its emissions by 28 % as compared to 1990. In exchange the German government promised not to take further regulatory steps in the near future. That the EC did introduce legislation in 2003 was of course no violation of the that promise. Nevertheless the voluntary approach was now discouraged. Industry soon discovered that the emission rights regime, and in particular its element of grandfathering was a lot more comfortable. Although a pooling of allowances as provided by Art. 28 Directive 2003/87 might have been used for the self-committment this was not further persued. Incrementally the ambitious self-regulatory approach although still valid lost its momentum. NGOs have alleged that the effective reduction will be substantially less than 28 %.[2]

b) Have there been considerations in your country whether there was an EC competence in this matter; whether Article 175(1) was the right legal basis, instead of Article 175(2)?

Ther was a discussion on whether the trading scheme is not a measure significantly affecting the choice between different energy sources (Art. 175 para. 2 3rd indent), because it provides an incentive to step out of the use of fossil energy resources. I

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[2] WWF paper „Deutschlands Regeln für den Nationalen Allokationsplan" of March 30, 2004.

believe this is correct, and Art. 176 para 2 should have been chosen as a competence basis. The counter-argument was that the thrust of the emission trading was to encourage energy efficiency, not to influence the choice of energy sources.[3] To the extent emission allowances must be purchased from government the price to be paid can also be regarded as a tax for the making use of a common good.[4] In this case even Art. 175 para. 2 1st indent would be applicable.

c) *Were there any considerations in your country to recur to Article 176 and to include other sources of climate gases into the emission trading system than those listed in Directive 2003/87? Has there been any thinking, whether Article 24 of Directive 2003/87 is not compatible with Article 176? What do you think of this argument?*

As far as I know the German government did not consider to include other sources. Nor have there been concerns about the compatibility of Art. 24 of the Directive with Art. 176 ECT. I myself believe that Art. 24 is not compatible insofar it establishes the requirement of Commission approval. This is not foreseen by Art. 176. On the other hand the EC legislator is free to set material conditions such as that a reliable monitoring must be ensured. This moulds the right of MS to go further but does reserve the Commission the right of final decision.

d) *When and by what legal act (if at all) was the Directive transposed into national law? Was it transposed in due time? What kind of public attention was given to the performance of the country in the transposition of the Directive?*

The Directive was transposed by the Law on the Trading with Allowances for the Emission of Greenhouse Gases of July 8, 2004 (THEG) (BGBl. I 1578), as amended July 21, 2004 (BGBl. I 1756, 1762). By another law the National Allocation Plan was established. These laws came into force later than required by the Directive, but the term set by the Directive was impossible to fulfil given the difficult decision involved.

.**3.-** According to Article 9 of the Directive national allocation plans have to be established.

a) *Do they have to be national or could they also be regional? Compatibility with Article 175/176 (interference with rights of the regions)? Are there regional plans in your country? Please provide exact dates of the approval/publication of the plan or plans*

I believe they must be national at least in the sense that a common framework for regional plans is introduced. In Germany only a national plan was considered and inaugurated.

b) *Was the public informed of the draft national allocation plans (NAPs)? Was there a possibility to comment or to rectify the original data? Or was the content of the plan discussed with affected industries only? Was there a publication of the plan in draft form?*

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3 Y. Kerth (2004) p. 235.

4 See for this view Mehrbrey (2003) p. 186.

Of course, industry was heard in every single detail of the NAP. Economic expertise was invited to develop allocation criteria, in particular in relation to adequate consideration of early action of Eastern German industry. Legal expertises were produced concerning questions such as the treatment of CO2 which is used in production processes (e.g. oxygenisation of steel). A forum („Arbeitsgemeinschaft Emissionshandel“) was instituted by the Ministry of the Environment where the different societal groups were invited to discuss criteria of allocation. The ministers for the environment (Green Party) and for economy (Social Democratic Party) took quite different positions in the matter the minister for environment pushing for stricter reduction targets. The whole matter was often discussed by the general media.

c) *What allocation criteria were followed in your country? Or does the plan just mirror political power play? What kind of empirical information was used in order to draft the plan? Was it really accurate/updated?*

Germany adopted the grandfathering concept for the first allocation period. For each industrial installation the „historical“ emissions in the years 2000-2002 were identified and multiplied by a so-called implementation factor (Erfuellungsfaktor) of 0, 9707. The analysis of the historical emissions was very difficult to do in the very short time required. It was based on data collected in 2002 as an obligation under the Kyoto Protocol and new data submitted by industry or available from other sources. The following situations are treated in a special way:

- Newcomers are provided with free allowances for a period of 14 years. This appears to be too long given the possibility of technical progress in reducing emissions.

- Early actions are honoured by allowing an implementation factor of 1 (instead of 0,9707).

- The same applies to process based emissions (i.e. emissions not resulting from combustion, e.g. in the processing of ore). This priviledge was motivated by the fact that process related emissions of CO2 cannot be reduced. The argument is nevertheless doubtful because reduction could as well be reached by using alternative products the production of which does not involve CO2 emissions.

- Installations combining electricity and heat production are given extra allowances in order to honor their particular energy efficiency.

A so-called macro plan fixes the number of tonnes which shall be reduced in each trading period taking account of the contributions of the different economical sectors. A so-called micro plan lays down the reduction factor for historical emissions and exemptions for early actions, process based emissions, Power-Heat-Installations, and banking.

d) *What happens if the Commission exceeds the three months attributed to it under Article 9(3)? What is the situation in your country in similar legislative cases?*

This has already been the case with Germany. The Comission even refused consent on one proposal arguing that the power companies had been priviledged. Meanwhile the allocation of allowances was completed so that the late consent is of no importance any more.

e) Would Article 10 allow Member States to recur to Article 176 EC Treaty? If so, did your state allocate lower percentages?

Germany allocated a higher rather than a lower percentage than 95%, i.e. 97 %. This was motivated with the difficulties of industry to adapt in a very short time. As for the general question I believe that MS could indeed make use of Art. 176 and set more ambitious reduction goals. I cannot see any incompatibility with other Treaty provisions here.

f) What is the weight of Clean Development Mechanisms as compared with pure „reductions" in emissions?

Neither CDM nor JI pojects have by now been undertaken in Germany. The Environment Ministry is however in the process of elaborating model contracts on the inter-state and inter-individual levels.

4.- *Article 11(1) provides that before 1 October 2004 Member States shall decide on the total number of allowances and their repartition on each installation, "taking due account of comments from the public".*

a) Did the public have the opportunity to make comments? How did this procedure develop? Was the draft decision published? Was it transparent?

The public did have the opportunity to make comments. See above.

b) *What distributional choices were involved in the repartition on the single installations?*

See above: grandfathering as a basis, multiplication with reduction factor, priviledges for newcomers, early action, power-heat combination, processes.

5. *Art. 12 provides that the trading of emission allowances shall be possible.*

a) How is trading supervised in your country?

Trading is organised by brokers. The transfer of allowances resulting from trading is implemented by registration in the national register on emission trading. This register became operative in mid-march 2005 but broke down a few times since then. It still does not contain all allowances allocated. No transfer from trading has been registered by now.

The monitoring of whether the companies do not exceed the allowances allocated to them is based on reports the companies have to submit yearly. These reports must be certified by certified experts and are submitted to and checked by the Federal Environmental Agency. The monitoring is thus a federal task. This runs counter general

principles of the Federal Republic and was criticised by the opposition in the legislatory process.[5]

To the extent future allowances are traded these are regarded as derivates which because of their speculative nature are subject to a special supervision by the banking supervisory agency (Kreditaufsichtsamt).

b) Is trading also possible for other bodies than installations, such as a fund, a charity, a millionaire who has an interest in preventing climate change?

The law is not clear in this respect. But it can be read to also allow for the purchase of allowances by other persons than operators of installations.[6]

c) To which extent is transparency for the public ensured?

(knowledge of trading transactions, etc)

According to the THEG the allocation plan must as a draft be published in the internet for public comment. The plan itself must be published in he Official Journal (Bundeanzeiger). The THEG does not provide that the individual decision allocating emission allowances to an operator is subject to public participation. Nor does it provide access to the emission trading register. Access must be granted according to the general access to environmental information law of the Bund. It is not clear to what extent information in the register would be treated as a trade secret or privacy.

d) How as „allowance" been translated in your country? Does your national linguistic version of the term „allowance" convey the idea of a „right" (subjective/objective) to pollute? (like the Spanish does)

The German word is „Berechtigung". The term „Recht" (right) was avoided in order to express the fact that the allowance fades away after a certain date, even if not used for an actual emission. This definition does not exclude that special provisions may allow for the preservation of an allowance for a future period (the so-called banking).

e) What is the legal nature of the „trading"? Is there any doctrinal controversy about the possibility of „trading" on „rights"? (provided the question to „d" was positive)

The allowance is regarded by some as a position under public law[7], but the transfer of an allowance is framed like the transfer of real property: consent of the parties and

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5 See Bericht des Ausschusses für Umwelt, Naturschutz und Reaktorsicherheit, BT-Drucks. 15/2693.

6 See Arts. 15 and 16. Art. 16 says that any person can apply for the establishment of an account in the emissions tarding register, Art. 15 says that allowances may be traded between a seller and a buyer.

7 Zimmer (2004) p. 246 et seq.; Pohlmann (2004) p. 210.

registration in the register. Others distinguish between the public law regime of allocating allowances and the private law character of the allowance itself.[8]

It is very controversial to what extent the allowance gives a firm position to emit climate gases. Three questions must be distinguished in respect: the content of the allowance, and the possibility to modify the allowance, and the possibility to alter the whole system of allowances.

a) Content: The „Berechtigung" is defined to be consumed by actual emissions, and to expire after a certain date even if not used for emissions.

b) Modification: Allowances which have been allocated or acquired by someone are regarded as property in the sense of the constitutional guarantee of property. This means that once allocated it cannot easily be taken away. This would be an expropriation. The legislator would however be free to phase out allowances without compensation if climate protection considerations so require.[9] The legislator is also free to determine under what circumstances the banking of allowances shall be allowed. This is true, for instance, in relation to the question whether allowances not used because an installation was substituted by another much more efficient one can be banked.[10]

c) Change of system: The legislator is free to change the whole system, e.g. to turn from emissions trading back to a command and control approach relying on BAT. This view is important to defend in order to retain a political margin for the outstanding Kyoto committments. Consider the following constitutional worst case scenario: In contrast to the traditional approach which regards emissions as a freedom subject to regulatory restrictions the emission trading system has provided industry with the „right" of emission (if only randomly restricted). Future policies will have to compensate such rights if they shall be removed.

f) Has there been much discussion about other areas of law that might be relevant to this dogmatic issues (eg.property rights, tax law, administrative law, etc.)

The emission allowance has been discussed as a form of a property right in the framework of those strands of economic theory which propagate individual rights concepts as a means to protect public goods. To the extent allowances must be paid the price has been regarded as a tax (or fee to be more precise because taxes unlike fees and charges are defined not to have a quid pro quo).[11] They have also been compared to permits allowing the discharge of waste water into public waters, as well as to the right to use certain electromagnetic radio waves, but differences can be identified.[12] In general, it appears that a whole new theory of user rights must be developed responding to the trend to individualise (commercialise?) environmental protection.

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8 Burgi (2004) p. 41.

9 Zimmer (2004) p. 249 et seq.; Pohlmann (2004) p. 213 et seq.;

10 Contrastingly, Burgi (2004) argues in favour of a constitutional duty to provide for banking in this case.

11 See above, fn.

12 Pohlmann (2004) p. 193 et seq.

***6**. Arts. 14 – 16 provide guidance for monitoring, verification and penalties.*

a) How is monitoring and verification organised in your country?

See above.

b) What about the penalties that were fixed according to Article 16? Are they effective, proportionate and dissuasive? Are they of criminal, administrative or civil law nature? Are they comparable to national sanctions in similar, comparable cases? Is there any fear that penalties might be too divergent from one country to the other?

Penalties were adequately fixed. It is too early to assess their effectiveness.

c) *How is transparency of monitoring and verification results ensured?*

Transparebcy of monitoring is not specifically regulated. It is covered by general legislation on access to envirnmental information.

***7.** The emission allowance scheme and traditional BAT approach under the IPPC Directive 96/61 somewhat conflict with each other.*

a) Is there a discussion in your country on whether there are vested rights and permits of industry disallowing to turn them into allowances which must finally be purchased.

See above. The basic obligation of the IPPC system to ensure energy efficiency clearly shows that the combustion of fossil fuels and the emission of CO_2 is covered. An installation which was authorised without emission requirements being specified is allowed to emit climte gases without restriction. According to German constitutional doctrine this does not exclude however that the legislator phases out such „rights“ and makes them subject to the emission allowances and trading scheme.

b) *Inversely, Article 26 provides that permits under Directive 96/61 shall not contain emission limit values for greenhouse gases, when the installation participates in emission trading. Is there any discussion in your country, whether this is a departure from the concept of "best available technology"? May countries not provide for this derogation (under Article 176 EC)?*

See above. It is in fact a departure from the BAT approach. This can hardly be challenged in legal terms because BAT is not a binding principle neither under EC nor under German constitutional law. But in political terms it is highly constable.

***8.** Directive 2004/101 (OJ 338/2004 p. 18) provides a framework for joint implementation („JI“) (see Art. 6 Kyoto Protocol) and the clean development mechanism („CDM“)(see. Art. 12 Kyoto Protocol).*

a) Is there a discussion in your country about whether JI and CDM will be used?

Yes, economists and politicians very much discuss these concepts, most often as a possibility of alleviating the burden on German industry of climate policy. But given the complicated procedures foreseen on the international, EC and national level which

involve tremendous transaction costs it is doubtful whether CDM and JI will be used at all.

b) *What will be the organisational devices in your country ensuring the requirements of a fair use of JI and CDM, and in particular its additionality, truthfulness and transparency?*

The system is still being elaborated. The law organising the national forms of CDM and JI are still under consideration.

9. *Could or should emission trading be introduced in other sectors (water, waste)?*

I am sceptical about the whole approach. It seems to be much ado about nothing. Much simpler strategies like BAT appear to be more effectice – and efficient.

10. *To which extent emissions trading has been discussed so far in your national legal literature?*

Very much. See above.

11.- *Besides emissions trading and national plans, does your national legislation create other kinds of devices, such as a specific permit for releasing greenhouse gases emissions? If this is the case, what is the relation between the plan, the trading mechanism and the permit? What body/level of Administration is responsible for performing the respective duties and responsibilities?*

For the sectors not subjected to the emission trading regime such as households, small business, transportation, and services a wide spectrum of measures have been and will be inaugurated, including command and control, tax and direct subsidies, and in the transportation sector also charges/fees. Permits for the emision of climate gases are not required, except in the framework of IPPC installations where the authorisation may also fix requirements in relation to the emission of climate gases.