



First EU international agreement linking greenhouse emissions trading systems

24 January 2020

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As of 1 January 2020, Switzerland is the first country to link its greenhouse gas emissions trading system (SETS) with the EU emissions trading system (EU ETS). A process that took almost 10 years, is now finalized allowing the entry into force of the entire agreement between the EU and Switzerland on the linking of their greenhouse gas emissions trading systems that was signed in Bern on 23 November 2017 (Agreement). The EU and Switzerland operate separate greenhouse gas emissions trading systems (ETS) as part of their respective policies to tackle climate change. After the Agreement's entry into force in 1 January 2020, the SETS is now linked to the much larger EU ETS to allow for the mutual recognition of emission allowances from the two systems.

The EU ETS

The EU ETS is a market mechanism that was set up in 2005 and designed to cut the EU's greenhouse gas emissions. It was established by virtue of Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a system for greenhouse gas emission allowance trading within the EU (the Directive). It is based on the "cap and trade" principle, meaning that it sets a cap on how much greenhouse gas energy-intensive industries, power stations and civil aviation can emit, while the total volume of allowed emissions is distributed to companies as allowances. Each allowance gives the right to emit one (1) ton of CO₂ and companies can trade allowances with one another. The mechanism provides for a gradual reduction in the number of allowances each year pushing their value up in order to bring greenhouse gas emissions down.

The function of the EU ETS changes as it progresses through its different phases covering different periods. The first phase covered the years 2005-2007 and only concerned emissions from power stations and energy-intensive industries, while almost all allowances were provided to companies for free. During the second phase, covering the years 2008-2012, the cap on allowances was lowered and the aviation sector was included in the scope of the Directive. The EU ETS is now in its third phase, covering the period 2013-2020. The main features of this phase include (i) an EU-wide cap on emissions replacing previously applicable national caps; (ii) auctions as the default method to allocate allowances; (iii) the placing of 300 million allowances in the New Entrants Reserve to fund renewable energy and carbon capture and storage technologies through the NER 300 program. The 2021-2030 fourth phase increases the pace of annual reductions in allowances to 2.2% from 2021.

The ETS mechanism was pioneered by the EU ETS; the latter remains the largest among such systems in the world. However, the EU ETS has received criticism for failing to reduce emissions with critics blaming the high number of allowances in the market, which results in CO2 prices remaining low.

International carbon markets

As the number of ETSs around the world increases, Article 6 of the Paris Agreement recognized the importance of international carbon markets and provided for a basis to use them to meet emissions reduction targets. Compatible ETSs may be linked with each other offering several benefits, such as achieving cost reductions and harmonizing CO2 prices. Article 25 of the Directive provides the legal basis to link the EU ETS with other compatible, mandatory systems.

Overview of the Agreement

On 20 December 2010, the process to link the EU ETS with the SETS started, when the Commission was authorized by the Council to open negotiations with Switzerland to link their ETS. On 10 November 2017, the Council authorized the signing of the Agreement, which was eventually signed on 23 November 2017. The Agreement constitutes an international agreement entered into by the EU, which according to Article 216 TFEU is binding upon the EU institutions and its Member States.

According to Article 21 of the Agreement, the latter would enter into force "*on 1 January of the year following the exchange of the instruments of ratification or approval by the Parties*". Articles 11 to 13 of the Agreement have been provisionally applied since its signature on 23 November 2017. These Articles concern (i) the coordination of efforts and exchange of information between the parties; (ii) the establishment of a joint committee comprised of representatives of the parties (Joint Committee) that convenes upon request by either of the parties and may take binding decisions and (iii) the functions of the Joint Committee, which include the tasks to administer the Agreement and ensure its proper implementation, as well as to adopt a new or amend an existing annex to the Agreement.

Article 25 1a of the Directive requires the third country ETS to be linked with the EU ETS to be compatible with the latter, be mandatory and have an absolute emissions cap. Compatibility as such was not defined in the Agreement, however, the Annexes to the Agreement provide the essential criteria that are necessary to ensure that the EU ETS and the SETS are compatible. Recent amendments in the Swiss CO2 Act and the Swiss CO2 Ordinance, which will enter into force as of 1 January 2020, introduced the necessary latest changes to make the SETS compatible with the EU ETS, and in particular, to include civil aviation and any fossil-thermal plants to be included in the SETS.

The Annexes to the Agreement were recently amended by virtue of Decision 2/2019 of the Joint Committee to include the key elements ensuring that the EU ETS and the SETS are compatible pursuant to Article 25 of the Directive. As such, the conditions to link the two systems are now met, and following a meeting on 5 December 2019, the parties to the Agreement exchanged instruments of ratification setting off the entry into force of the Agreement as of 1 January 2020.

Conclusion

The Agreement is the first of its kind, and its negotiation and implementation can offer useful lessons for future similar efforts. For instance, should the UK, following Brexit, opt for an ETS allowing mutual recognition of allowances between the UK and the EU systems, the linking of the SETS with the EU ETS would be a reference point for such negotiations. China, Canada, Japan, New Zealand, South Korea and the United States are operating or are developing ETSs. The linking of the EU ETS and the SETS paves the way for further cooperation between States in the area of emissions

trading.

At the outset, such agreements demonstrate the now established closer cooperation among governments and international organizations alike in what is a more coordinated international effort to address the effects of climate change. What is left to be seen is whether the EU will keep assuming leadership roles in such an effort in line also with recent intra EU regulatory initiatives on the environment and energy sectors.

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