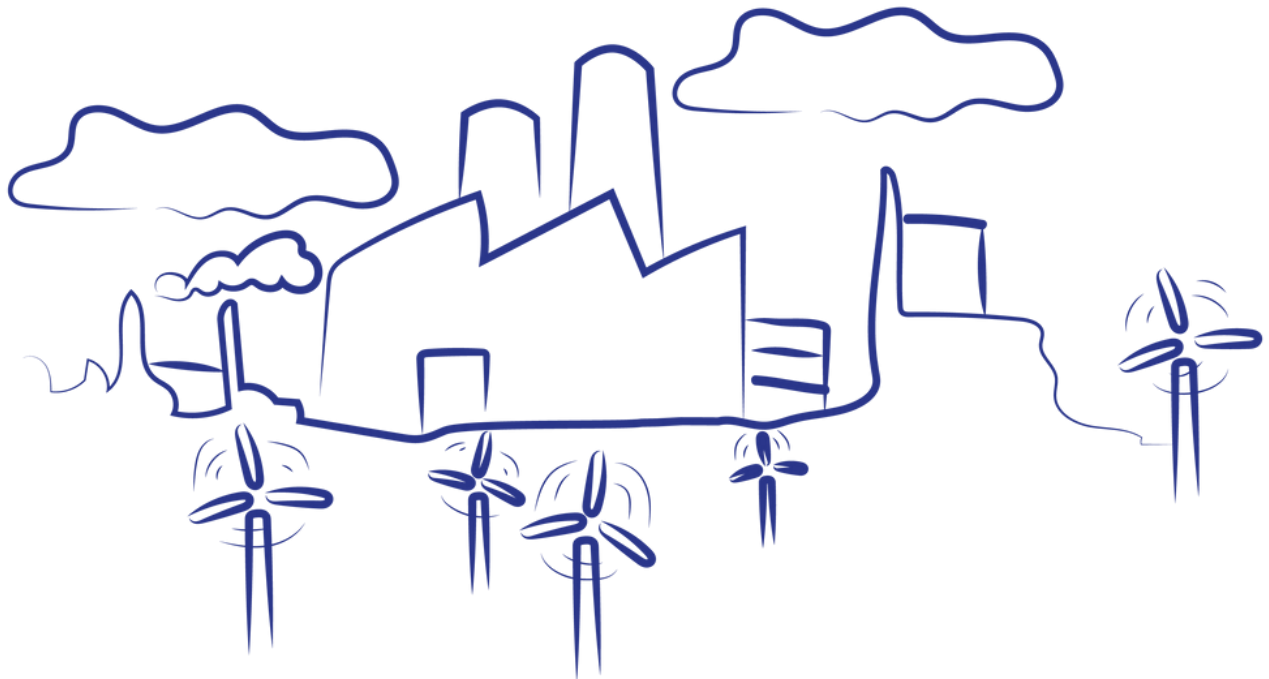


February, 2023

NEWSLETTER // **Environmental Law**



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The new EU agreements following the COP 27

**The Emission Trading System, the social climate fund,
and the carbon border adjustment mechanism**

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After a long negotiation process, which ended on 18.12.2022, the European institutions have reached new agreements on the characteristics of the European CO₂ market, the Emission Trading System (hereinafter “ETS” or “System”) which since 2005 gives specific prices to the emissions by implementing the “the polluter pays” principle.

Under the new agreements, the ETS system will now cover the emissions produced by the sea transport sector with the aim, in the following years, to further take over the road transport sector, the heating of civilian homes and the incinerator plants.

For the first time, in the wake of an increasing practical as well as programmatic approach, the European institutions have decided to create a social climate fund (hereinafter also “SCF”) that the EU and the Member States will use in order to protect citizens from rising energy costs.

The discipline of the carbon tax, also known as the “Carbon Border Adjustment Mechanism” (“CBAM”), has also been renewed. The CBAM will apply the European price of CO₂ to the imported products of certain sectors in order to allow European companies to compete at a level playing field with companies from countries where climate policies are less stringent and to solve issues such as delocalization and job losses.



1. Emission Trading System, definition, uses and latest news

The Emission Trading System (ETS) of the European Union is the main tool used by the EU to control and manage polluting and greenhouse gas emissions caused by installations and by the aviation sector at an international level. The System operates through the monetary quotation of the connected emissions and the trade of the shares between different states in order to comply with the obligations imposed by the Kyoto Protocol.

As a matter of fact, in order to comply with the duties undertaken by signing the Protocol, the EU has issued Directive 2003/87/EC of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC that created the basis for the greenhouse gas emission trading system.

The ETS is the first and most extensive multinational emission trading scheme, which encompasses more than 11,000 power plants, industrial plants, and flights between the airports of the participating states. It is estimated that more than 45 % of greenhouse gas emissions in the EU are regulated by the ETS.

Currently, the participating states are the 27 belonging to the European Union, Norway, Iceland and Liechtenstein; the new 2030 target is to reduce emissions from the sectors covered by the system by 43 % compared to the 2005 levels.

Following the negotiation that took place in December 2022, for the first time in the world the CO₂ market will cover the sea transport sector, the road transport sector and the heating of civilian homes. Finally, in the following years, the System will further cover incinerator plants.

Indeed, by 2030, large-scale industries and the energy sector will have to reduce their emissions by 62 % compared to the first years of the System's operation, further increasing the speed of reduction. From 2027, by including the sea transport sector, shipping companies will have to pay for all their CO₂ emissions including methane and nitrogen peroxide with the ETS covering 100 % of emissions.

Finally, from 2027, a separate ETS will be entirely devoted to road transports and buildings, thus targeting emissions from pump fuels and heating fuel. In this case, the system has been designed to have a direct impact on fuel suppliers and not on private citizens, but according to the Commission's impact assessments, significant effects on the latter will be inevitable.



2. The social climate fund

In the “Fit for 55%” package, the European Commission has proposed the creation of a Social Climate Fund (SCF) to compensate vulnerable households, micro-enterprises, and transport users for some of the green transition costs. The proposal was developed jointly with the Commission for the Environment (ENVI) and the Commission for Employment and Social Affairs (EMPL).

On 14.07.2021, the Commission has adopted the SCF legislative proposal that would bring more than 72 billion Euros in additional EU funding over the 2025-2032 period, mainly by sourcing itself on the Union’s own resources. The SCF would benefit from a 25% share of future ETS revenues flowing into the EU from the construction and road transport sectors. However, the EU fundings should come with an (at least) equal level of funding from Member States, which could use their ETS revenues. Lastly, it should be noted that on 22.6.2022 the European Parliament has approved its position on the SCF making itself open for negotiations with the European Union’s governments.

Therefore, Member States will have to develop quantified and detailed social climate plans, with inputs and the approval of the Commission, as an essential and necessary step to obtain their financial envelope under the SCF.

Poland, France, Italy, Spain, and Romania have been identified as the largest beneficiary states, followed by Bulgaria and Hungary.

3. The Carbon Border Adjustment Mechanism

A carbon tax is a type of financial imposition levied on the carbon emissions required to produce goods and services, positively evaluated by economists for its ability to tackle the problem (carbon dioxide pollution) by not affecting the sectors involved in the use of energy. It is a fiscal policy tool under which a tax rate set out by the government will be levied for every ton of carbon dioxide pollution released by fossil fuels.

The carbon tax has two main objectives:

- direct companies into adopting behaviors that will limit the result of production activities on the environment;
- guarantee a tax revenue that can be used for various purposes such as facilitating the ecological transition, promoting initiatives aimed at mitigating global warming or supporting the most vulnerable areas by allocating the same revenues to social needs as well, in favor of the most vulnerable categories.

In order to prevent the risk of carbon leakage outside the EU and to protect its companies from countries with less stringent climate and ecology regulations and standards, the European Union is opening its doors to a possible carbon tax on imports of carbon-intensive products (the CBAM) with the aim of bringing the mechanism into force by the end of 2023.

The CBAM will seek to create a level playing field, following the multiple complaints of the Union that had to endorse very high costs to meet the climate goals. Therefore, with the entry into force of the mechanism the importing company will be required to demonstrate the quantity of pollutant of its production and based on the latter, will have to pay a fee. Furthermore, the CBAM will try to avoid the delocalization of industries and, consequently, job losses.

The sectors impacted will be those mainly active in the production of:

concrete	fertilizers	iron
aluminum	electric energy	steel

The CBAM will work in parallel with the ETS by mirroring and complementing its functioning as regards imported goods. It will gradually replace the existing Union mechanisms to address the risk of carbon leakage and, to ensure an even greater effectiveness of the system, a centralization at the European level of the new CBAM Register of declarants (importers) is also foreseeable.

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