

“Trading with emissions allowances under the EU state aid law regime”

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I. Introduction

As a result of a summit held in Rio de Janeiro in 1992, informally known as the Earth Summit, the United Nations promulgated the Framework Convention on Climate Change (hereinafter the UNFCCC). This is an international environmental treaty produced at the United Nations Conference on Environment and Development (hereinafter "the UNCED"). The treaty aims at reducing emissions of greenhouse gases in order to combat global warming. The UNFCCC included provisions for updates (called "protocols") that would set mandatory emissions limits. The principal update is the Kyoto Protocol.

One of the three Kyoto mechanisms is the emissions trading¹ which provides for Kyoto Protocol Signatories (hereinafter "the Annex I Parties") to acquire units from each other.

An emissions trading scheme may be established as a climate policy instrument at the national level (e.g. in Japan) or at the regional level (e.g. in the European Union). In this paper I would like to focus on the emissions trading scheme governed by the European Union.

In this system the allowances price is neither set nor imposed. As in any other free market, it is governed by the supply and demand. In this system, market intermediaries quote prices for allowances offered. Should distortions with regard to European Union scheme occur, European competition law would apply. Thus, it is worth investigating how the emissions allowances trading scheme would be affected by competition law.

As will be described in more details below, Member States of the European Union allocate emissions trading allowances among installations producing CO₂ involved in the scheme under certain criteria. A company that has more allowances than it actually needs may sell them on a free market. The possibility for a company to obtain extra money from unused emissions allowances could be regarded in some cases as a government-induced distortion of competition. Therefore, it should be investigated under what conditions the allocation of allowances would amount to a state aid.

II. Different laws regarding emissions allowances trading

2.1. Different forms of regulations regarding the reduction of pollution

At first, it is worth specifying what kind of forms of regulations regarding the reduction of pollution are accessible nowadays and why there is a need to reduce pollution at all.

As Professor Timothy Taylor suggests,² while thinking about the economy and its interaction with the environment, we should think how to make this interaction as positive as we can, to include the value of the environment in what we do. Furthermore, economically speaking this idea of interaction comes to a term called “externalities”. This is simply speaking the situation whenever a buyer and a seller exchange goods, but this exchange also affects a third party who is not a party of that exchange. That third party, who is external to the negotiation, is affected by what we call an externality. This negative externality may amount to, among others, pollution or other environmental issues.

Professor Taylor goes on to suggest that pollution is something that is imposed as a result of the action of others and people suffer from pollution with inadequate or no compensation. When a firm manufactures certain products it looks at its private costs. In a case of an externality like pollution, we would say that that this firm does not only bears its private costs but it also bears social costs. If the firm had to take the social costs into account, it would most certainly have the incentive to reduce these social costs. Consequently, we should make firms recognise that they are imposing social costs and take those social costs into account in their operations. The purpose is to strike a fair balance between the development of industry and protection of environment and choose the most adequate trade off between these two.

There are different ways to bring social costs into line. The first one is the so-called command and control regulation, the basic notion of this solution is to set some sort of a level, that stipulates how much pollution firms are able to emit and then you control whether these limits are being respected. The problem with this approach is that it does not leave any flexibility and there is no incentive to go beyond the level that is set by the legislation, to reduce the pollution further or faster.

The second approach is a pollution tax. The rationale behind this system is that a firm has to pay certain fee for every bit of pollution it emits. However, this system does provide a firm with an incentive to reduce or even to eliminate pollution because thus they will avoid paying taxes and compete more effectively with other companies on the market.

The third approach is the approach of marketable permits. This is another, after the pollution tax, economically oriented way of reducing pollution. The idea is that, instead of imposing a tax we give everyone a permit to emit certain amount of pollution into the air and the entities included are able to sell or buy those permits. The companies that can cut pollution in the less expensive way will have extra permits to sell to those companies which do not have cheap and easy ways to do it. Normally, the amount of marketable permits decreases over time.

A system of marketable permits was chosen to regulate the issue of pollution by the United Nation in the Kyoto Protocol, establishing mechanisms of emissions trading. One allowance (certificate) gives right to emit one ton of CO₂³. If a company wants to emit more, it needs more allowances, on the other hand if the company emits less CO₂ than it has allowances, it can trade those additional allowances on a free market.

Turning to the advantages of this system, it should be mentioned that as companies can sell those permits they have an incentive to reduce pollution beyond the level set by the applicable legislation. This might work well with the problem of greenhouse effect. The greenhouse effect is the idea that there is going to be a lot of carbon dioxide emitted into the atmosphere and because of it the globe will warm up and that this will cause various difficulties. It is plausible that the emissions trading scheme would give us the cleanest environment at the lowest cost. The "marketable permits" approach seems to be the best idea that is available today.

The issue of the greenhouse effect was dealt with by the United Nations because many experts predict that growing weather anomalies might be the symptom of a human-induced global climate change, affecting the ecosystems. This is mainly the effect of emitting CO₂ into the air by combustion of fossil fuels. Concentration of CO₂ in the air over the last sixty years has grown by 17% and according to many experts it will grown further.⁴

2.2. The Kyoto Protocol

As mentioned above, the UNFCCC played a key role in changing the situation and dealing with the CO₂ issues. It was opened for signature on May 9, 1992 and it entered into force on March 21, 1994.

The principal update to the Treaty, the Kyoto Protocol, has become much better known than the UNFCCC itself. The Kyoto Protocol was adopted in 1997 with a view of strengthening the UNFCCC commitments by its signatories. The industrialized countries (the Annex I Parties) have accepted legally binding emissions reduction target and all parties that ratified the Kyoto Protocol adopted a general policy on reduction of emissions. The Annex I Parties have agreed to reduce their collective emissions of six greenhouse gases, CO₂ being the most important one and other being methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons and sulphur hexafluoride, by 5.2% below 1990 levels during the period 2008-2012 (the first commitment period under the Kyoto Protocol). The European Community approved the Kyoto Protocol by Council Decision 2002/358/EC of 25 April 2002⁵ and committed itself to reduce its emissions by 8% in the timeframe of 2008-2012. This limit was shared between the Member States under a legally binding burden-sharing agreement, which sets individual emissions targets for each Member State. In the longer term, global emissions of greenhouse gases will need to be reduced by approximately 70% compared to the 1990 levels.

In order to meet their targets, the Annex I Parties have to put in place domestic policies and measures either to reduce greenhouse gas emissions or to offset those emissions by increasing the uptake of carbon dioxide by so-called carbon sinks. On the other hand, no emissions goals for developing countries have been set.

Supplementary to this domestic action, the Annex I Parties may use the three so-called Kyoto flexible mechanisms - Joint Implementation (hereinafter "the JI"), the Clean Development Mechanisms (hereinafter "the CDM") and International Emissions Trading (hereinafter the IET), in order to meet their emissions reduction targets. The Kyoto mechanisms are designed to help the Annex I Parties cut the costs of meeting their emissions targets by means of giving them the opportunity to use cheaper methods available in other countries or in other companies. Terms for the implementation of these additional mechanisms were agreed in November 2001.

According to explanations presented on the United Nations Framework Convention on Climate Change web page “the Clean Development Mechanism (CDM) defined in Article 12 provides for Annex I Parties to implement project activities that reduce emissions in non-Annex I Parties, in return for certified emissions reductions (CERs). The CERs generated by such project activities can be used by Annex I Parties to help meet their emissions targets under the Kyoto Protocol. [...] A CDM project might involve, for example, a rural electrification project using solar panels or the installation of more energy efficient boilers.”⁶

On the other hand “Joint implementation” (JI) under Article 6 of the Kyoto Protocol provides for Annex I Parties to implement projects that reduce emissions or remove carbon from the atmosphere in other Annex I Parties in return for emissions reduction units (ERUs). The ERUs generated by JI projects can be used by Annex I Parties towards meeting their emissions targets under the Protocol. A JI project might involve, for example, replacing a coal-fired power plant with a more efficient combined heat and power plant.”⁷

International Emissions Trading⁸ makes it possible for Annex I Parties to obtain units from other Annex I Parties. This scheme leaves a company various choices: to decrease their own emissions, to advance emissions reduction projects or to trade emissions allowances in a new market. On 23 July 2003 the European Commission adopted a proposal that links credits from JI and CDM projects with the emissions trading system. Under this proposal, European companies taking part in the EU emissions trading scheme will be allowed to convert credits from JI and CDM projects towards meeting their commitments under the trading system. During the first Kyoto commitment period 2008-2012, governments will be allowed to use credits from JI and CDM projects towards meeting their commitments under the Kyoto Protocol.⁹

The logic behind JI and CDM is analogous to the one behind emissions trading. It does not matter where emissions reductions are accomplished because climate change is a global problem. It is significant that they take place and are achieved in the most cost-effective way.

To enter into force, the Kyoto Protocol had to be ratified by at least 55 countries accounting for at least 55% of the total carbon dioxide emissions in 1990. The treaty took effect on February 16, 2005 without the participation of two large industrialized economies, the United States, the world’s largest emitter of greenhouse gases and Australia.

The European Union committed to reduce greenhouse gas emissions, regardless of whether the Kyoto Protocol enters into force or not. This was confirmed at a meeting of the European Council in Gothenburg in June 2001.

The first trading period for this scheme runs between 2005-2007. The second period runs in parallel to the Kyoto Commitment Period (2008-2012) and is expected to involve more rigorous targets. In addition, there will be more five-year trading periods with the third one starting in 2013.

2.3. The European Union legislation concerning EU-ETS

2.3.1 Directive 2003/87/EC

The EU has adopted Directive 2003/87/EC establishing an emissions allowance trading scheme (hereinafter “the EU-ETS”), which took an effect on 1 January 2005. This Directive, amending Directive 96/61/EC, came into force on 25 October 2003. The purpose of Directive 2003/87/EC was to help Member States to achieve compliance with commitments under the Kyoto Protocol. The scheme covers among others, activities in the iron and steel production and processing, the energy sector, the mineral industry and the wood pulp, paper or cardboard industry.¹⁰ Other CO₂-producing sectors, not being listed in the Annex I of the Directive 2003/87/EC, remain excluded from the emissions trading scheme for the time being.

Since there are significant differences within the Community with regard to economic growth, energy mix and the economic structure of the different Member States, such as between Germany and Portugal, the European Union has agreed on a distribution of the obligation to reduce emissions which derives from the Kyoto Protocol within the framework of its “burden sharing” agreement.¹¹ For instance, according to this agreement Germany is obliged to decrease emissions by 21% and Luxemburg by 28%, whereas Portugal, can increase its emissions up to +27%, from the base 1990 level.

According to Article 4 of the Directive 2003/87/EC, as of January 2005 all installations carrying out any of the activities listed in Annex I and emitting the specific greenhouse gases associated with that activity must be in possession of an appropriate allowance (permit) issued by the competent authorities. Member States should ensure that this obligation is fulfilled. According to Article 3 (a) of the Directive 2003/87/EC “allowance means an allowance to emit one tone of carbon dioxide equivalent during a specified period, which shall be valid only for the purpose of meeting the requirements of this Directive and shall be transferable in accordance with the provisions of this Directive”. Interestingly, Directive 2003/87/EC neither covers all emitters nor all greenhouse gases, choosing only the most important ones.

Relevant national authorities should issue an allowance, provided that they are satisfied “that the operator of the installation is capable of monitoring and reporting the emissions”¹². An allowance may cover one or more installations operated by the same operator.

According to Article 9(1), each Member State was obliged to develop a National Allocation Plan complying with the criteria set out in Annex III to Directive 2003/87/EC, indicating the allowances it intends to allocate for the applicable period and how it proposes to allocate them to each installation.

For the initial three-year period, at least 95% of the allowances were allocated to the installations free of charge. For the five-year period beginning 1 January 2008, Member States will have to allocate 90% of the allowances free of charge.¹³

According to Article 12, Member States should ensure that allowances can be transferred between persons within the European Community as well as between persons in the EC and persons in third countries, where such allowances are recognized. These transactions of buying and selling allowances can be made by operators of the installations covered by the Directive 2003/87/EC as well as by third parties, such as intermediaries, non governmental organization, individuals, and banks.

By April 30 each year at the latest, Member States are obliged to ensure that the operators of the installations surrender the correct quantity of allowances commensurate with the total emissions over the previous years.

At the end of each year, the operator must submit a detailed report to the competent authority describing the greenhouse gas emissions produced by the installation during that year. The European Commission issued "guidelines for the monitoring and reporting of emissions", and each report must comply with the rules established therein.¹⁴

The principles set out in Annex V to Directive 2003/87/EC will be taken into account during verification of the reports submitted by operators. If a report is not verified as satisfactory in accordance with the criteria stated therein, the operator is obliged to cease trading with allowances until the report is deemed satisfactory.

Although, the penalty for emitting CO₂ without equivalent amount of allowances will be EUR 100 for each tonne of carbon dioxide; during the current three-year period which started on 1 January 2005 it amounts to EUR 40.¹⁵ In addition, the payment of the penalty will not release the operator from the obligation to surrender an amount of allowances equal to the excess emissions. Moreover, each Member State was obliged to create its own regime of sanctions and notify the Commission by the end of 31 December 2003 about established therein rules.

The Commission adopted a regulation on the establishment of a system of registries in the form of an electronic database for monitoring the issuance, holding, transfer and cancellation of allowances. These registries guarantee conformity with the provisions of the Kyoto Protocol.

On 29 January 2004 Commission Decision 2004/156/EC was adopted establishing guidelines for the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC. Eleven Annexes to this Decision contain guidelines for monitoring and reporting greenhouse gas emissions. Annex I contains general guidelines and Annexes II to XI specify guidelines for particular activities. The guidelines are intended to guarantee regular and accurate monitoring and reporting of greenhouse gas emissions in the European Community.¹⁶

The Directive 2003/87/EC seems to provide a comprehensive regulation with regard to emissions allowances trading scheme, going only as far as necessary. It should be assessed positively that the Directive 2003/87/EC neither regulates the price of allowances, nor it imposes the manner in which they should be traded. Consequently, the process can evolve freely using forward contracts, futures contracts as well as the spot market.¹⁷ The scheme will

undoubtedly expand risk management systems and all distortions will be regulated by European competition law.

2.3.1 National Allocation Plans - the NAP

As it was mentioned above, the responsibility for reaching the goal to reduce emissions is incumbent on the Member States. They, as sovereign entities, must allocate the allowances to the operators of the installations. In this respect the Directive 2003/87/EC in Article 9 obliges Member States to develop National Allocation Plans. "These plans must state the total quantity of allowances a Member State intends to allocate to an operator of an installation during a specific period, and the rules applied to any such allocation during that period".¹⁸ In addition to that "within the framework of the National Allocation Plans, Member States have to take a number of important decisions such as how many allowances it will issue altogether? How many installations will each of the operators receive (...), classified according to its line of trade? How are 'newcomers' provided with allowances if it had not been possible to take them into consideration in the National Allocation Plan?".¹⁹

Moreover, Member States have to establish how they would allocate the available allowances to the individual installations. These rules of allocation constitute the ultimate political and legal challenge in the emissions trading system as the total quantity to be allocated is limited. Thus it is inevitable that a battle for a share of the allowances between the state, industry and among the operators themselves will occur. With regard to implementation into national law, clear standards in this respect are not set, leaving considerable freedom to the Member States. Nevertheless, the Commission of the European Communities will take the final decision whether or not to accept the National Allocation Plan submitted to it by the Member States.

2.3.3 Directive 2004/101/EC

The EU Emissions Trading Scheme is independent from the Kyoto Protocol scheme, which is why it was necessary for the Commission to consider a proposal for a Directive amending the scheme in respect of the Kyoto Protocol's project mechanisms. The issue was dealt with by the European Commission through the so called Linking Directive.²⁰ "The Linking Directive will allow organizations covered by the EU scheme to carry out emissions reduction projects in other countries, and to convert the credits earned into emissions allowances under the EU

scheme.”²¹ In order not to delay the starting date of the trading scheme, it has been adopted as a separate Directive. It provides increased flexibility in meeting goals to operator through investment in cheaper emissions reduction solutions within the EU and beyond.

The Clean Development Mechanism (CDM) and Joint Implementation (JI) as mentioned above are two of the Kyoto Protocol mechanisms which are designed to allow its parties some sort of flexibility in achieving their quantified emissions limitation commitments. These mechanisms provide that any project which reduces emissions or remove carbon dioxide from the atmosphere generate emissions certificates. These are Certified Emissions Reductions (CERs) in the case of the CDM, and Emissions Reduction Units (ERUs) in the case of JI.

“The new Directive establishes a link between CDM and JI on the one side and the EU-ETS on the other. The CDM/JI project developer will receive CERs/ERUs after the identified project has successfully undergone the project cycle for CDM/JI project respectively. The project developer then sells these CERs/ERUs to an operator that operates an installation that must participate in the EU-ETS. The operator can then request the conversion of the CERs/ERUs into the corresponding amount of allowances. After the conversion, the Member States hold the CERs/ERUs in their account and can use them for compliance with obligations under the Kyoto Protocol.”²²

In other words, with the adoption of the Linking Directive carbon credits from Clean Development Mechanism and Joint Implementation projects under the Kyoto Protocol will be able to be imported for use in the EU Emissions Trading Scheme.

Both Directives created a completely new system of the environmental protection. Operators of installations producing emissions may decide whether they want to avoid emissions, thus disposing additional allowances which they may sell on the free market. In addition they may also increase their emissions of CO₂ and purchase the allowances required for such additional emissions levels.

As it is suggested by Patricia Park²³ the European legislation did not resolve all issues associated with the Emissions Trading Scheme such as the legal status of allowances. Whether they should be considered as bonds, negotiable instruments, bills of exchange or otherwise. A

related issue is the right of ownership associated with them, to be able to assess the legal nature of trading transactions.

III. Application of state aid rules to the emissions allowances market

Articles 87, 88 and 89 of the EC Treaty regulate granting of state aid by Member States.

According to Article 87(1) of the EC Treaty “any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.”

This Article contains a general prohibition of the distortion of competition by favouring production of certain goods or undertakings, and, since 2002 also in the coal and steel sectors.²⁴ Exemptions to this prohibition are provided in the Articles 87(2) and 87(3) of the EC Treaty and a number of Commission instruments.

In addition, Article 88 of the EC Treaty regulates the procedural aspects of state aid supervision, while Article 89 provides that for the application of Articles 87 and 88 the Council might create suitable regulations.

The state aid might be understood in two ways:²⁵ Firstly as a subsidy. This may include a direct money transfer to the company concerned, such as grants or credit warranty or non-monetary, such as free use of public property or supply of goods and services on favourable conditions. One of the criteria is whether the service furnished in return by the company concerned is adequate, i.e. whether under normal market conditions such company would be treated in the same way.²⁶ However, state aid can also be seen as a diminution of public burden such as decrease of duties, fees and charges. In either way the recipient of aid is better off in result of its application.

For the state aid to occur, certain conditions have to be met. Firstly, there must be an intervention by the State or through State resources. Secondly, the intervention must distort or threaten to distort competition. Thirdly, it must confer an advantage and be selective in the meaning that it must favour certain undertakings or the production of certain goods. Fourthly,

it must affect trade between Member States.²⁷ All of the above mentioned conditions must be met cumulatively.

The important question is whether and when allocation of emissions allowances will be regarded as a state aid. Occurrence of state aid is possible as the national authorities are allocating emissions allowances. The allowances might be traded within the free market so every allowance has a certain market value. Assigning allowances is necessary for the emissions trading scheme to operate, but it should be made in an impartial way, so as the allowances will not amount to an undercover state aid.

The Emissions Trading Scheme, as a system established by the European Union does not constitute a state aid per se. On the other hand, for the system to operate Member States have to assign emissions allowances to certain companies, engaged in the sectors covered by the scheme. The assignment of emissions allowances by a Member State might constitute a state aid if all conditions from Article 87(1) are met. Therefore, it is worth considering each condition separately.

The first condition for the state aid to occur, classified in the line with Article 87(1) of the EC Treaty is that there must be an intervention by the state or through state resources. This applies to aid granted by either central or local bodies. However, Article 87 of the EC Treaty does not require the money to come directly from the state budget, it also might come from state resources but assigned to the separate entities, controlled by the state or to which the state entrust the administration or management of those resources, such as banks or foundations.²⁸ Such entities might also be private ones, as being a public entity is not a requirement.²⁹ Here the requirement is, however, that the state is able to control such an entity, it has special power, it does not have over other entities. With regard to the EU Emissions Trading Scheme, the allowances are traded between companies in most cases being private entities, not influenced by the state.

Nevertheless, before emissions allowances are traded they are assigned through the National Allocation Plan to each installation and exactly at this stage the state aid might occur. It is the state that is assigning a specific amount of emissions allowances of certain economic value to each company.

According to the settled case law³⁰ it is not necessary to establish that there has been a transfer of state resources to one or more undertakings for state aid to occur. Moreover, 87(1) EC Treaty covers all financial means by which the public authorities may actually support undertakings.³¹

The European Court of Justice (hereinafter "the Court") suggested³² that, in turn, it is necessary to show that the actual deployment of those resources for the advantage of particular undertaking can be attributed to some form of government decision (the attributability element). This should not pose a problem in the case of emissions allowances as they are assigned to specific companies in the National Allocation Plan introduced into the national legislation in most countries by the regulation of the government. Thus, it is a decision taken by the government to assign specific amount of allowances to each company. On the other hand, it is also the government that in the end imposes an obligation on installations covered by the EU- ETS to obtain relevant number of emissions allowances.

Thus the proper allocation, in line with the current law should be done according to the impartial, historical basis, meaning that the whole amount of emissions allowances accessible for particular Member State should be divided between different companies on the basis of the amount of pollution they had issued in previous years and the amount they might need in the future.

The second condition established in the Article 87(1) of the EC Treaty is that the aid must distort or threaten to distort competition. This will not be the case if emissions allowances are distributed among all companies involved in the system on an impartial basis.

It is important to indicate that the mere fact that the aid threatens to distort competition is enough for this condition to be satisfied. In addition, it applies to the current or potential competition within the market.³³ Distortion or threat to distort competition may occur when assigning more allowances to a specific company than it needs or by hindering the access to the market by potential competitors.

The third condition, stipulated in Article 87(1) of the EC Treaty is that the aid must confer an advantage for certain undertakings. Conversely, if a company receives more allowances than it needs, it would be able to sell additional emissions allowances and obtain extra money. The

amount of additional money gained through emissions trading, would amount to an advantage.

Moreover, for the state aid to occur the selectivity test must be satisfied. It would happen so with regard to the allocation of emissions allowances, if a company would be placed in a better position than its competitors. In other words, the state measure must have the effect of conferring a selective benefit or advantage. Provided that allowances are granted to all companies and allocated according to objective economic and historical data in an impartial way, the selectivity requirement will not be met.

To assess whether by allocation of allowances a company X has been given the selective benefit, one should take all data that the relevant Member State used while composing the National Allocation Plan and see whether all companies were treated in the same way and whether company X received amount of allowances proportional to its needs in the previous years. Although this looks pretty obvious in theory, such assessment might be quite difficult in the practice. The big amount of data, constantly changing economical and production environment can produce obstacles in assessing this issue.

The European Commission has taken the preliminary view that even if the coverage of the Directive 2003/87/EC is selective (the Directive 2003/87/EC only covers certain industries as listed in the Annex I of the Directive) it cannot in and of itself lead to the conclusion that a national NAP automatically falls within the state aid regime. "This would be otherwise if the NAP conferred a selective advantage on particular facilities within one of the sectors or industries to which Directive applies. It might be observed that notification of the national NAPs for Commission assessment under the Directive is not equated with notification under Article 88(3) and Regulation 659/99"³⁴

It should be noted that every National Allocation Plan is subject to approval by the European Commission. However, as mentioned such an approval is not equal to the notification of state aid, it amounts to a preliminary assessment of the Member States' accuracy and impartiality in allocating the emissions allowances. However, after the Commissions approval it seems that it still would be possible to challenge the National Allocation Plan on the basis of the state aid rules. Challenging the NAP might be due to occurrence of new facts, or prove that the data

used by the Member State were false, or just by indicating that the European Commission did not take important facts into consideration while assessing the National Allocation Plan.

The fourth condition, stipulated in the Article 87(1) of the EC Treaty, is that the intervention is liable to affect trade between Member States. It is sufficient that the Commission establishes a link between the measure in question and likely or potential effect on competition and trade.

“It is sufficient that the importation of competing products or services from other Member States may be rendered more difficult through the beneficiary’s stronger market position”.³⁵ Aid granted to an undertaking operating only locally may affect trade, even if the recipient does not provide services outside its state of origin as the condition that the aid must affect trade between Member States, does not depend on the local or regional character of the services supplied, or the scale of the activity covered.³⁶ This is due to the fact that a strong position of one company in a Member State might hinder exports to this Member State.

There is also another possibility that can be imaginable. Let us assume that a state-owned company receives emissions allowances, which then are subject of a commercial transaction, i.e. sold. Such a situation may occur either through obtaining too many allowances from the very beginning or through investments made, which would lessen the amount of emissions produced into the air. Possession of additional emissions allowances allows the company to sell them to others companies. As a price is not set or imposed, every company will sell it at the price it wishes. A company functioning in the market economy should endeavour to sell allowances at the highest price possible. In particular, if the company made some investments to reduce pollutions of CO₂, the price of allowances sold should at least make up for the whole investment process.

Nevertheless, let us assume that such a state-owned company sells emissions allowances to another private company for a price far below the market price. The interesting question which occurs here and should be considered is whether this also could amount to a state aid. Provided that all the above mentioned conditions will be satisfied, meaning that there is an intervention by the state or through state resources, this intervention is liable to affect trade between Member States, it distorts or threatens to distort competition and it confers an advantage, is selective and will favour certain companies, the answer should generally be positive. Nevertheless, each situation should be considered on a case-by-case basis.

The possibility of a state aid to occur while allocating the emissions allowances is very important. According to the Article 11 of the Directive 2003/87 EC, the assignment of emissions allowances is not a one-time operation. Before 1 January 2005, each country developed a National Allocation Plan assigning emissions allowances for the period of 1 January 2005 until the end of 2007. Nevertheless, the idea of the Emissions Trading scheme as a whole is that the total amount of allowances will be shrinking. In order to achieve this goal, after 2007 Member States will prepare a new National Allocation Plans for the next five-year period. This operation will then be repeated for every subsequent five-year period. As every time the amount of allocation will be smaller than during the previous period, the pressure on the companies involved will be growing exponentially.

Already in the Directive 2003/87 it was envisaged that distortion on this ground might occur, thus Article 11(3) contains the provision that decisions concerning rules of allocation and allocation periods "shall be in accordance with the requirements of the Treaty, in particular Articles 87 and 88 thereof."

VI. Conclusion

The European Union Emissions Trading Scheme is an effective and economic-based tool for improving the environment. The legislation created at the European level gives the impression that the scheme is well organised. However, there are still some imperfections at the national level, especially in the countries for which system of tradable permits is new. In big picture, it seems that once the first obstacles are overcome the scheme will start operating smoothly.

In general it seems that choosing the system of tradable permits was the best, market-oriented idea to regulate the problem of over-emissions of CO₂ to the atmosphere and the compliance with the Kyoto Protocol. This very flexible approach will allow the European Union economy as a whole compete even more effectively with others. A well-designed legislation in this respect will help to develop and easily control the whole process.

EU-ETS, based on tradable allowances creates a separate market. For this market to function easily, maintenance of competition is necessary. As underlined in this paper, anticompetitive behaviour is possible within or through this market especially with regard to a state aid.

Maintenance of competition within the market underpins the full functioning of the European Union Emissions Trading Scheme. Competition law is not a new tool and is well developed within the European Communities. Many of the legal provisions regarding state aid might be applicable to the emissions allowances market. The same regards case-law and doctrines. Nevertheless one should be aware that not every provision included in the general European state aid law might be applicable to the emissions allowances market, for example because of the specificity of this market. All provisions should be thus, adopted taking into account the specific features of the emissions trading market. DG Competition of the European Commission holds special role in achieving this policy objective.

¹ Set out in Article 17 of the Kyoto Protocol.

² Timothy Taylor, "Economics", lesson 7 "Environment and negative externalities", published by The Teaching Company, third Edition .

³ See Article 3(a) of Directive 2003/87/EC of the European Parliament and the Council of 13 October 2003 establishing a scheme for greenhouse gas emissions allowance trading within the Community and amending Council Directive 96/61/EC, [2003] O. J. L 275, hereinafter Directive 2003/87/EC and Clemens Stewing.

⁴ Anna Biedrzycka, " Handel emisjami gazów cieplarnianych. Zanieczyszczenia o wartości rynkowej", Energia Gigawat, No 11/2004 p.60.

⁵ Council Decision 2002/358/EC of 25 April 2002 concerning the approval, on behalf of the European Community, of the Kyoto Protocol to the United Nation Framework Convention on Climate Change and the joint fulfilment thereunder, Official Journal of the European Union 2002 L 130.

⁶ http://unfccc.int/kyoto_mechanisms/cdm/items/2718.php

⁷ http://unfccc.int/kyoto_mechanisms/ji/items/1674.php

⁸ Set out in Article 17 of the Kyoto Protocol.

⁹ This issues will be addressed in more details later on.

¹⁰ A complete list of the installations covered by Directive 2003/87/EC is included in Annex I of the Directive.

¹¹ Council of the European Union, document 9702/98 of 19 June 1998.

¹² Article 6(1) of the Directive 2003/87/EC.

¹³ Article 10 of the Directive 2003/87/EC.

¹⁴ Article 14(3) of the Directive 2003/87/EC.

¹⁵ Article 16(4) of the Directive 2003/87/EC.

¹⁶ www.europa.eu.int/scadplus/leg/en/lvb/l28012.htm

¹⁷ Tom Blass "Infrastructure for EU Carbon Markets Failing Into Place as Spot Trading Starts" International Environment Reporter, 23 February 2005, Vol.28 No.4, p. 97.

¹⁸ Herbert Posser and Stefan Altenschmidt " European Union Emissions Trading Directive" Journal of Energy & Natural Resources Law, 2005 Vol. 23 No. 1, p. 64.

¹⁹ Ibid, p. 64.

²⁰ Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004 amending Directive 2003/87/EC establishing a scheme for greenhouse gas emissions allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms, [2004] O. J. L 59, hereinafter Directive 2004/101/EC.

²¹ Patricia Park, Park P., "The EU Emissions Trading Directive" Chapter 3 , of the Energy Law Report II, Energy and Law, Volume 3, Intersentia 2005, p. 38.

²² Ibid, p. 46.

²³ Ibid.

²⁴ European Commission Press release, IP/02/835.

²⁵ Jan Barcz „Prawo Unii Europejskiej”, Wydawnictwo Prawo i Praktyka Gospodarcza 2004, p.781-782, hereinafter Jan Barcz and also case 30/59, De Gezamenlijke Steenkolenmijnen in Limburg v High Authority of the European Coal and Steel Community, Judgment of the Court of 23 February 1961, 1961 ECR 00001.

²⁶ Clemens Stewing, Stewing C. „Emissionshandel in der Europäischen Gemeinschaft –Rechtsfragen im Rahmen der Zuteilung von Verschmutzungsrechten vor dem Hintergrund des Gemeinschaftsrechtes und unter besonderer Berücksichtigung des Wettbewerbsrechtes“, Carl Heymanns Verlag KG, Köln 2004, hereinafter „Clemens Stewing“;p 22.

²⁷ Deducted from the Article 87(1) of the EC Treaty.

²⁸ Case 76/76 Steinike and Weinling v Germany [1977] ECR p 595 or Case 70/85, Kwekerij Gebroeders van der Kooy BV and other v European Commission, [1988] ECR 219 [Dutch Natural Gas Prices I].

²⁹ Case 290/83, European Commission v France [1985] ECR, p. 00439.

³⁰ Case C 387/92 Banco Exterior de Espada, [1994] ECR I- 877, paragraph 14 and Case C 6-97 Italy v Commission [1999] ECR I-2981, paragraph 16.

³¹ Case C-482/99 France v Commission, [2002] ECR I -4397 [Stardust Marine].

³² Case C 67/85, Kwekerij Gebroeders van der Kooy BV and others v Commission of the European Communities [1988] ECR 219.

³³ Jan Barcz, p. 783.

³⁴ Ibid p. 491, see also M. Lorenz „Emissions Trading – the State Aid Dimension” 2004 European State Aid Law Quarterly Vol. 3 (2004) , No. 3, p. 399-405.

³⁵ Leigh Hancher Hancher L. “State aid and the EC Treaty”, EU Energy Law –Volume II, EU Competition Law&Energy Markets, Part 5, State aid; p. 499.

³⁶ Ibid, p. 500.

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