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## **EUROPEAN UNION**

# **USE OF REVENUES FROM AUCTIONING OF EMISSIONS ALLOWANCES FOR AVIATION**

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**LAW LIBRARY OF CONGRESS**

**EUROPEAN UNION**

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*Executive Summary*

*The European Union established the Emissions Trading Scheme (ETS) in 2005 to reduce greenhouse gas emissions. In 2008, ETS was expanded to include aviation activities. Revenues from auctioning of allowances belong to the EU Members. EU Members are required to appoint an auctioneer who will auction the allowances and give the proceeds to the Members. The EU legislation contains a pledge that at least 50% of such revenues should be used for climate related purposes. However, since spending is discretionary, each EU Member may use such revenues for purposes essential to its political, social and financial situation. The EU Members are required to report to the Commission on the spending of the revenues.*

**I. Introduction**

In 2005, the European Union (EU) established an Emission Trading Scheme (ETS) for greenhouse gas emissions<sup>1</sup> in order to reduce such emissions in a cost-effective way and to meet its long-term objective to comply with commitments arising from the Kyoto Protocol.<sup>2</sup> As described by the European Commission, the ETS operates on “a cap and trade” principle. A “cap” or limit is imposed on the total amount of greenhouse gases emitted by factories or plants. Such industries receive emissions allowances within the limit permitted which they can trade with one another.

Initially, the ETS included the energy sector, iron and steel production and processing, minerals, and the paper industry. Currently, the ETS covers 11,000 power stations and industrial plants and applies to the twenty-seven EU Members and the three European Economic Area (EEA) countries (Iceland, Liechtenstein and Norway). In 2008, the EU expanded the ETS to

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<sup>1</sup> *Emissions Trading System (EU ETS)*, EUROPEAN COMMISSION, [http://ec.europa.eu/clima/policies/ets/index\\_en.htm](http://ec.europa.eu/clima/policies/ets/index_en.htm) (last visited Nov. 15, 2011).

<sup>2</sup> The Kyoto Protocol to the United Nations Framework Convention on Climate Change (UNFCCC) requires developed countries to limit or reduce emissions from greenhouse gases. The Kyoto Protocol was adopted by the European Union and its Members in 2002, in accordance with Decision 2002/358/EC Concerning the Approval, on Behalf of the European Community, of the Kyoto Protocol to the United Nations Framework Convention on Climate Change and the Joint Fulfillment of Commitments Thereunder. O.J. (L 130) 1, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:32002D0358:EN:HTML>.

incorporate aviation activities. Under the ETS on aviation, which will enter into effect on January 1, 2012, emissions from all domestic and international flights that arrive or depart from an airport within the territory of the EU and EEA countries will be covered by the ETS.<sup>3</sup>

Beginning in 2013, EU Members will be required to auction all allowances which are not allocated free of charge. Revenues generated from such auctioning, which are quite high, fall within the purview of the EU Members.<sup>4</sup> For example, as of February 2011, Germany had generated over 2 billion euro (approximately US\$2.70 billion) from auctions.<sup>5</sup> The United Kingdom (UK) had auctioned 73 million tons of EU allowances and made over 1 billion euro (approximately US\$1.35 billion), which went into its Treasury.<sup>6</sup> The EU legal regime on ETS contains language to the effect that revenues accrued from auctioning “should” be used for climate related purposes. The UK objects to this recommendation on the ground that it is an issue for the EU Members to decide.<sup>7</sup> Germany earmarks 400 million euro of such revenues (approximately US\$541 million). Of these, approximately 280 million euro (US\$379 million) is given to national projects and to fund small scale emission reduction projects and 120 million euro (US\$162 million) is granted to international projects.<sup>8</sup>

This report examines whether EU Members have a legal obligation to use revenues to mitigate the effects of climate change, or whether such spending is discretionary.

## II. Analysis of Applicable Legislation and Policy

The initial directive that established the ETS within the EU, Directive 2003/87/EC,<sup>9</sup> does not contain any specific reference to the use of revenues.

Language concerning the use of revenues was added to Directive 2003/87/EC with the adoption of two subsequent directives and a regulation: (a) Directive 2008/101/EC, which expanded ETS to include aviation activities;<sup>10</sup> (b) Directive 2009/29/EC, which amends

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<sup>3</sup> *Supra* note 1.

<sup>4</sup> *Id.*

<sup>5</sup> *Government Should Earmark Carbon Allowance Money for Green Projects*, CARBON RETIREMENT 3 (Feb. 2011), available at [http://www.carbonretirement.com/sites/default/files/Government%20EUA%20revenue%20report\\_0.pdf](http://www.carbonretirement.com/sites/default/files/Government%20EUA%20revenue%20report_0.pdf).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.* at 3 & 5.

<sup>8</sup> *Id.* at 6.

<sup>9</sup> Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003 Establishing a Scheme for Greenhouse Gas Emissions Allowance Trading Within the Community and Amending Council Directive 96/61/EC 2003 O.J. (L275) 32.

<sup>10</sup> Directive 2008/101/EC of the European Parliament and of the Council of November 19, 2008 Amending Directive 2003/87/EC so as to Include Aviation Activities in the Scheme for Greenhouse Gas Emissions Allowances Trading Within the Community. 2008 O.J. (L8) 3, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:008:0003:0021:EN:PDF>.

Directive 2003/87/EC to improve and extend the ETS;<sup>11</sup> and (c) Regulation No.1031/2010, which concerns the timing, administration, and other aspects of the auctioning of emission allowances.<sup>12</sup>

### A. Directive 2008/101/EC on ETS -Aviation

Article 3d, paragraph 2, of Directive 2008/101/EC provides that as of January 1, 2013, 15 percent of allowances to be allocated to aircraft operators shall be auctioned. Paragraphs 4 and 5 of Article 3d state as follows:

4. It shall be for Member States to determine the use to be made of revenues generated from the auctioning of allowances. Those revenues should be used to tackle climate change in the EU and third countries, *inter alia*, to reduce greenhouse gas emissions, to adapt to the impact of climate change in the EU and third countries, especially developing countries, to fund research and development for mitigation and adaptation, including in particular in the field of aeronautics and air transport, to reduce emissions through low-emission transport and to cover the cost of administering the Community scheme. The proceeds of auctioning should also be used to fund contributions in the Global Energy Efficiency and Renewable Energy Fund,<sup>[13]</sup> and measures to avoid deforestation.

Member States shall inform the Commission of actions taken pursuant to this paragraph.

5. Information provided to the Commission pursuant to this Directive does not free Member States from the notification obligation laid down in Article 88(3) of the Treaty.

Recital no. 22 of Directive 2008/101/EC provides further clarification and guidance on revenue spending.<sup>14</sup> It states that since aviation contributes to climate change, the adverse impact of greenhouse gas emissions from aircraft to the environment can be mitigated through the adoption of measures intended to mitigate climate change in EU and developing countries. Recital no. 22 also affirms that based on the principle of subsidiarity, a basic EU principle which dictates that certain matters are better left to the EU Members, it is for the EU Members to decide on national public expenditures. While acknowledging the principle of subsidiarity,

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<sup>11</sup> Directive 2009/29/EC of the European Parliament and of the Council of April 23, 2009, Amending Directive 2003/87/EC so as to Improve and Extend the Greenhouse Gas Emission Allowance Trading Scheme of the Community, 2009 O.J. (L140) 63, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:140:0063:0087:EN:PDF>.

<sup>12</sup> Commission Regulation (EU) No. 1031/2010 On the Timing, Administration and Other Aspects of Auctioning of Greenhouse Gas Emission Allowances Pursuant to Directive 2003/87/EC of the European Parliament and of the Council Establishing a Scheme for Greenhouse Emission Allowances Within the Community 2010 O.J. (302) 1., available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:302:0001:0041:EN:PDF>.

<sup>13</sup> The creation of a Global Energy Efficiency and Renewable Energy Fund (GEEREF) was proposed by the Commission in 2006. The GEEREF is designed to encourage private investment in energy efficiency projects in developing countries. *GEEREF: A Global Risk Capital Fund to Boost Investment in Energy Efficiency and Renewables*, EUROPEAN COMMISSION, ENVIRONMENT, [http://ec.europa.eu/environment/jrec/energy\\_fund\\_en.htm](http://ec.europa.eu/environment/jrec/energy_fund_en.htm) (last visited Nov. 17, 2011).

<sup>14</sup> Recital no. 22 of Directive 2008/101/EC, *supra* note 9.

however, the recital states that such revenues from auctioning or “an equivalent amount where required by overriding budgetary principles of the Member States” should be used to reduce greenhouse gas emissions in EU and third countries, on low emission transport, and in particular to fund contributions to the Global Energy Efficiency and Renewable Energy Fund.

The European Parliament fought during the legislative process to include language specifying that the revenues should be spent for climate change mitigation, research on clean aircraft, et cetera.<sup>15</sup> Peter Liese, the European Parliament’s rapporteur on emissions, who helped negotiate the provision on revenues, stated that the Parliament worked very hard for strict provisions concerning the revenues. He also emphasized that “[m]oney should be used to tackle climate change and not disappear somewhere in the general budget. It is not a tax but an environmental instrument. ... The agreement is not perfect, but the Council went further than on any other comparable occasion.”<sup>16</sup>

### **B. Directive 2009/29 Amending Directive 2003/87/EC**

Article 1 number 11 of Directive 2009/29/EC replaces article 10 of Directive 2003/87/EC and provides the following in paragraph 3:<sup>17</sup>

Member States shall determine the use of revenues generated from the auctioning of allowances. At least 50% of the revenues generated from the auctioning of allowances referred to in paragraph 2, including all revenues from the auctioning referred to in paragraph 2, points (b) and (c), or the equivalent in financial value of these revenues, should be used for one or more of the following:

Revenues should be used for the following purposes:

- a) to reduce greenhouse gas emissions through contribution to the Global Energy Efficiently and Renewable Energy Fund and the Adaptation Fund, to fund research and development on reducing emissions, adaptation to climate change, et cetera;
- b) to develop renewable energies;
- c) measures to avoid deforestation;
- d) measures to capture and store CO<sub>2</sub>;
- e) to finance research and development in energy efficiency and clean technologies; and
- f) to cover administrative expenses of the management of the ETS

Furthermore, the revised article 10 provides that the EU Members:

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<sup>15</sup> Press Release, European Parliament, *Aviation to be Included in the European Trading System from 2012 as MEPS Adopt Legislation*, <http://www.europarl.europa.eu/sides/getDoc.do?type=IM-PRESS&reference=20080707IPR33572&language=EN> (last visited November 16, 2011).

<sup>16</sup> *Id.*

<sup>17</sup> Directive 2009/29/EC of the European Parliament and of the Council of April 23, 2009, Amending Directive 2003/87/EC so as to Improve and Extend the Greenhouse Gas Emission Allowance Trading Scheme of the Community, 2009 O.J. (L140) 63, art. 11, ¶ 3, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:140:0063:0087:EN:PDF>.

shall be deemed to have fulfilled the provisions of this paragraph if they have in place and implement fiscal or financial support policies, including in particular in developing countries, or domestic regulatory policies, which leverage financial support established for the purposes of [auctioning] and which have a value equivalent to at least 50 % of the revenues generated from the auctioning of allowances.<sup>18</sup>

### **C. Regulation No. 1031/2010**

Commission Regulation (EU) No. 1031/2010,<sup>19</sup> which amends Directive 2003/87, and applies to auctions of allowances including those generated from aircraft, requires that each EU Member appoints an auctioneer. The auctioneer's tasks include auctioning the volume of allowances of the Member, receiving the proceeds from each auction due to the Member, and disburse the proceeds due to the Member.<sup>20</sup> EU members must notify the Commission of the identity of the auctioneer.

Recital No. 37 of the Regulation reaffirms the rule that EU Members have the right to determine the use of revenues accrued from the auctioning of allowances. It also further clarifies that in order to avoid any doubt as to the disbursement of revenues, the transfer of auction proceeds should go directly to the auctioneer appointed by the Member, who will collect the proceeds and give them back to the Member concerned.<sup>21</sup>

### **D. Analysis of Legislation**

Based on article 3d and recital 22 of Directive 2008/101, article 10 of Directive 2003/87/EC as introduced by article 1, number 11 of Directive 2009/29/EC, and Regulation No. 1031/2010, the following basic principles apply to revenue spending:

(a) EU Members have the authority to use revenues from auctioning, as they see fit;

(b) EU Members are encouraged to use revenues generated from the auctioning of emissions of aircraft for climate purposes in EU and third countries. Both directives include a list of climate related activities, such as investing in renewable energy, climate mitigation and adaptation, et cetera. While the phrase "inter alia" suggests that the list of activities is not exhaustive, activities should be related to climate;

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<sup>18</sup> *Id.*

<sup>19</sup> Commission Regulation (EU) No. 1031/2010 On the Timing, Administration and Other Aspects of Auctioning of Greenhouse Gas Emission Allowances Pursuant to Directive 2003/87/EC of the European Parliament and of the Council Establishing a Scheme for Greenhouse Emission Allowances Within the Community, 2010 O.J. (302) 1, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:302:0001:0041:EN:PDF>.

<sup>20</sup> *Id.*, art. 23.

<sup>21</sup> *Id.*, Recital no. 37.

(c) Beginning in 2013, EU Members will be obliged to auction all allowances which are not allocated free of charge. As of that date, EU Members should allocate 50% of revenues for climate purposes. It appears that this recommendation includes allowances from aircraft emissions;

(d) EU Members have a legal obligation to inform the Commission of how revenues are spent;

(e) EU Members have an additional obligation, arising from Article 88(3) of the Treaty, to inform the Commission of plans to grant state aid. Article 88(3), which has been re-numbered to article 108 of the Treaty on the Functioning of the European Union, as amended by the Lisbon Treaty,<sup>22</sup> provides that aid granted by EU Members or through public resources which distorts competition by favoring certain undertakings or the production of certain goods in a manner that affects trade among EU Members shall be considered incompatible with the internal market. The Commission monitors any aid granted by EU Members and has the right to take a Member to the European Court of Justice (ECJ), in case of non-compliance with state aid rules.<sup>23</sup>

### **E. Policy Aspects - Declaration of European Council**

In December 2008, the European Council, composed of heads of state and government ministries of the EU Members, reached a compromise on climate and energy issues and on the specific issue of the use of ETS auction revenues. Consequently, the European Council adopted a declaration which inserted language to its Presidency Conclusions to the effect that the use of revenues generated from auctioning is an issue that falls within the purview of the EU Members, in accordance with constitutional and budgetary requirements. It also acknowledges the Members' "willingness to use at least half of this amount for actions to reduce greenhouse gas emissions, mitigate and adapt to climate change, for measures to avoid deforestation, to develop renewable energies [and promote] energy efficiency."<sup>24</sup>

This declaration reflects that revenue spending is a contentious issue among EU Members. The compromise reached indicates that some EU members are more inclined to comply with the recommendation, while others less so.

### **III. Monitoring of EU Members' Compliance with EU law**

EU Members are required to transpose the directives within their legal systems. Directives are legally binding as to the results to be achieved; however EU Members enjoy some discretion as to the method of transposition. Transposition may vary from adopting a new law that may contain the text of the directive verbatim to a mere ministerial decision.

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<sup>22</sup> Treaty on the Functioning of the European Union, as amended by the Lisbon Treaty 2010 (C83)47, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF>.

<sup>23</sup> *Id.*, art. 108, ¶ 2.

<sup>24</sup> Annex I of the Presidency Conclusions of the European Council (2008) Council of the European Union, General Secretariat, 17215/08, [http://www.consilium.europa.eu/uedocs/cms\\_data/docs/pressdata/en/ec/104672.pdf](http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/104672.pdf) (last visited Nov. 17, 2011).

For example, in 2011, Cyprus incorporated into one piece of legislation the ETS legal regime within its domestic system through the adoption of Law 110(I) of 2011, on the Establishment of a Trading Scheme of Greenhouse Gas Emissions and other Issues.<sup>25</sup> Article 8, paragraph (3) (a) of Law 110(I) states that the revenues “should be used” for climate related purposes, for climate mitigation and adaptation in EU and developing countries, to finance research and development, and as contributions to the GEEREF. It designates the Minister of Agriculture, Natural Resources and the Environment, or his designee, as the appropriate authority to report back to the Commission and to submit in writing to the House of Representatives annually the plan for the following year, which includes the allocated amount of spending and purposes as well as an analytical list of revenues accrued from auctioning during the previous year.<sup>26</sup>

The EU Members have an obligation to report to the Commission as to the manner the revenues will be spent. The European Commission, in its role as the guardian of the EU treaties, has the right to constantly monitor transposition of directives into national law and sufficient and correct implementation and application of EU law, under the control of the European Court of Justice.<sup>27</sup> Pursuant to the general infringement procedure contained in articles 258 and 260 of the Treaty on the Functioning of the European Union,<sup>28</sup> the Commission has the authority to deliver a reasoned opinion on the issue and give the Member State concerned time to respond to the Commission’s concerns. If the EU Member does not comply with the Commission’s opinion, the Commission has the right to institute proceedings before the Court of Justice of the EU. However, in the case of revenues, because the pertinent language clearly indicates that this is a non-binding commitment, it appears rather unlikely that the Commission will resort to taking action against EU Members in case of non-compliance with the recommendation to allocate some of the proceeds for climate-related purposes.

#### IV. Concluding Remarks

Revenues from auctioning of allowances belong to the EU Members. Even though it is suggested that they use the revenue for climate-related purposes, nevertheless they have discretion to use such revenues for any purposes deemed critical, based on political, financial and other considerations, as long as they do not violate the EU rules on state aid. EU Members made a political agreement in 2008 to use at least 50% of such revenues for climate purposes. Similar language was incorporated in a subsequent amendment to the ETS legislation. Even though at the EU level there is an enforcement mechanism to ensure compliance of EU Members with EU law, the Commission probably will not use its power to institute proceedings before the ECJ, since the law merely provides a recommendation.

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<sup>25</sup> Ephemeris tes Kyvernseos of the Cyprus Republic, [EKCR] Part I, Issue No. 4290, July 29, 2011.

<sup>26</sup> *Id.*

<sup>27</sup> Article 17 of the Treaty on European Union, as amended by the Lisbon Treaty, 2010 O.J. (C83) 13, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0013:0046:EN:PDF>

<sup>28</sup> Arts 258 and 260 of the Treaty on the Functioning of the EU, as amended by the Lisbon Treaty, 2010 (C83)47, <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2010:083:0047:0200:EN:PDF>

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