THE EU CLIMATE LAW

Sandbag's response to the 2020 EU Climate Law consultation

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Introduction

The development of a new EU Climate Law should be informed by best practices from existing climate change legislation globally. Past experience shows that a number of key elements can contribute to successful climate law[1]: First, a new Climate Law should establish an overarching comprehensive policy framework that allows for the development of more specific measures to reduce greenhouse gas emissions, as well as to increase climate resilience. Second, that framework must be governed by a clear science-based emissions trajectory with short- and long-term legally binding emissions targets. Third, clearly assign duties and responsibilities should be established for meeting those targets as well as an implementation forum established. Developing climate laws in this way provides a means of upholding a consistent level of climate ambition across all policies, both at EU and Member State levels.

A core component of a new EU Climate Law should be a science-based EU-wide carbon budget, consistent with the proposed 2050 net zero target. This carbon budget can be divided into long- and short-term intervals:

- The long-term budget will state the quantity of emissions remaining up to 2050, based on an emissions trajectory that is in keeping with a 1.5 degree warming scenario.
- Five-yearly carbon budgets, timed to coincide with the Paris Agreement "ratchet mechanism" (i.e. 2020, 2025, 2030, etc..), will set a stable trajectory to meeting the 2050 target. Each of the 5-year budgets should be set at least a decade in advance. Consequently, all short-term budgets up to 2030 should be agreed by the time at which the new Climate Law becomes effective.

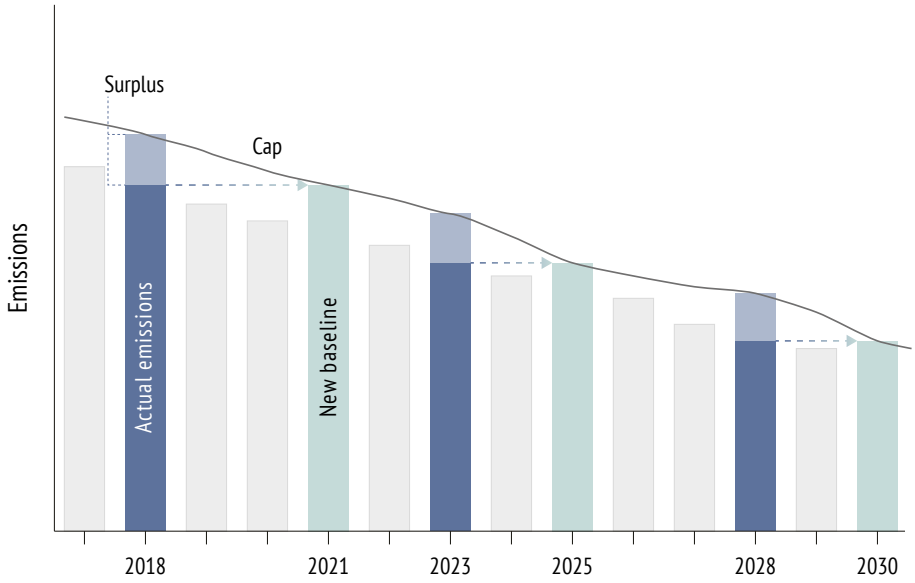
Introducing a direct link between real emission levels and complementary policies, to promote a virtuous cycle, could be achieved through the introduction of a 5 year baseline automatic adjustment to the EU ETS. This would mean that every 5 years, the supply on the market would be adjusted to reflect the level of emission reductions reached through complementary policies and therefore increasingly and gradually lower the slope of the trajectory to reach net-zero by 2050.

This option can further create the link to the Paris Agreement process, which also operates on 5 year cycles. As such, in 2020 the baseline could be adjusted to reflect the level of 2018 when the Paris facilitative dialogue will take place and in 2025 it could be adjusted to 2023 and the updated information we will have resulting from the Global stock take.

1. http://www.lse.ac.uk/GranthamInstitute/publication/10-years-climate-change-act/

FIGURE 1:

Option 1 - UNFCC ratchet mechanism



This option maintains the connection with the UNFCCC process as agreed to in the Paris Agreement, with the only difference from option A being that within the 5 year baseline period, we would have a gradual and balanced readjustment taking place on a yearly basis. It would still make it possible for the yearly readjustment to contain the emission levels reported in a UNFCCC year in the average.
Benefits of this option include:

- **Enhanced environmental integrity of the carbon budgets**: previous emission reductions would be recognized in setting the baseline, reducing the risk of what is sometimes referred to as the 'waterbed effect' - where reducing emissions in some sectors leads to increased emissions elsewhere;
- **A functioning carbon market**: The price of EUAs would be commensurate with real market demands, which is not the case in today's structurally oversupplied market;
- **Policy coherence**: This option would ensure better alignment with the provision recently proposed for the Governance Regulation, which refers to 5-year carbon budgets, improving the link between energy and climate planning and assessment, and operation of the ETS.

  Whereas previously, energy efficiency and renewables policies were considered to lead to increased emissions elsewhere, under the proposed mechanism, this would no longer be the case.

A second option to ensure alignment with 5 year budgets build on the previously presented one, with the core difference that it would take the average of each period of 5 consecutive years[2], and roll it forward on a yearly basis, adjusting in annual steps to changes in emission levels. This option would produce a smoother pace of adjustments, rather than a set of 5-year stair-steps as in the first option. Furthermore, this option cushions the system against the risks of basing a five-year compliance period on market conditions in a single base year, enhancing investor certainty that each adjustment would be relatively moderate and predictable. This option maintains the connection with the UNFCCC process as agreed to in the Paris Agreement, with the only difference from option A being that within the 5 year baseline period, we would have a gradual and balanced readjustment taking place on a yearly basis. It would still make it possible for the yearly readjustment to contain the emission levels reported in a UNFCCC year in the average.

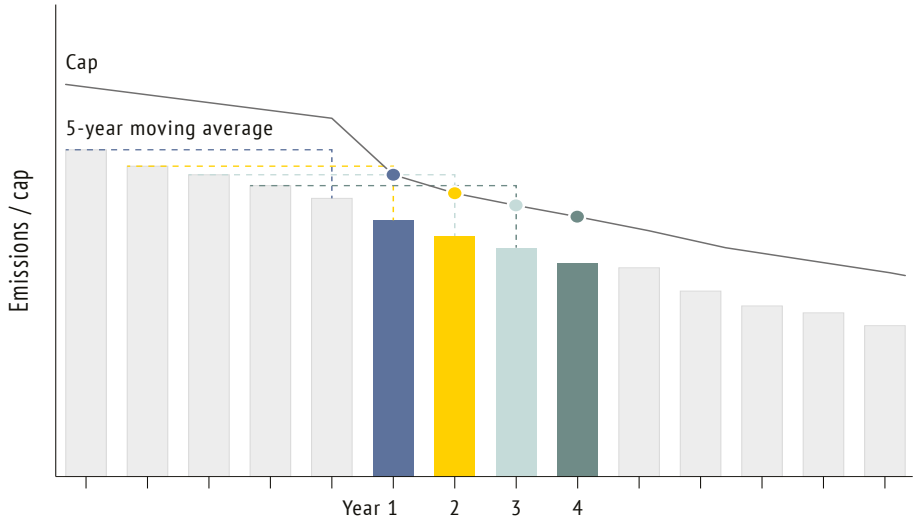
Should emissions increase in any one year, the 5-year moving average cap will continue to exert downward pressure on emissions. This will prevent emissions from increasing in the short term.

Benefits of this option, in addition to all those that apply to the first option, include:

- **Investor friendly** – this approach has predictability as annual adjustments will, to a large extent reflect the 4 preceding years of known emissions levels. Closer alignment of the cap to actual emissions levels also reduces

FIGURE 2:

Option 2 - 5-year moving average ratchet mechanism



2. This option could be expressed in the following formula: Allowances released for Year X = Ave of Real Emission Levels [(Year X-5) + (Year X-4) + (Year X-3) + (Year X-2) + (Year X-1)]

the likelihood of eratic EUA price movement, and a more stable carbon price is more useful for investors;

- **Live map** to decarbonization, ensuring real time response in the scheme to changes incurred in each year. This will become increasingly relevant in the post 2030 period, when the countdown to 2050 starts – the ETS would become in this way the live map guiding the other policies towards delivering decarbonization of 95%;
- **Compatibility with economic cycles** – One advantage of a rolling average adjustment is that it permits adjustments that reflect economic cycles in either an "up" or "down" direction. If the need for allowances is growing in a period of economic recovery, the evidence for increased allowance releases will be delivered in an actual market with actual prices having been paid. Since there would already be a cushion in the quantity of allowances either banked privately or in the MSR, there would be sufficient flexibility to deal with broad macro-economic changes, but could avoid a long-term period of locked-in "hot air" tons during periods of slower economic activity.

We see the future of carbon budgets under a EU Climate Law as needing an element of reflexivity and self-adjustment to keep track with the rapid pace at which emissions reductions are required under the notion of carbon neutrality by 2050, meaning there will be years with more than a 3% drop in total EU emissions and the carbon budgets need to be configured already to be able to pass this test.

Targets, trajectories and MRV

A consistent set of targets will provide a predictable trajectory for EU businesses to align with. However, as the knowledge base around climate change is constantly being expanded, a process for updating a climate law should be considered in order for it to remain relevant. This self-adjusting mechanism would provide built-in redundancy to amend the emissions trajectory, if required, via a transparent and predictable process.

The carbon budgets set out in a new climate law should also be used to set sectoral targets with progress towards meeting them measured using existing monitoring, reporting and verification (MRV) regimes. This will help to avoid situations whereby sectors that have already achieved significant emissions reduction face low targets or, conversely, underperformance in some sectors being masked by economy-wide emissions reporting.

There could be multilple trajectories for different sectors operating under one

carbon budget, for as long as the overall cap is self-adjusting. Such trajectories would allow for additional carbon pricing or other forms of incentivising reductions to already be introduced for those sectors going over their netzero trajectories, which would help enforce the implementation of agreed schemes.

The European Climate Law needs to make its center piece an improved Climate Action Regulation for the Implementation of the Paris Agreement (Regulation EU 2018/842)[3] because this instrument covers 58% of all EU GHG emissions, a percentage which is growing[4]. It includes sectors such as road transport, buildings, agriculture, small industry installations and waste or in other words, most of the everyday life basic activities of European citizens. Legally speaking, the regulation includes sectors not covered by the EU Emissions Trading System (EU ETS) (Directive 2003/87/EC)[5], which mostly covers large industry, power production and intra-EU aviation[6]. The EU ETS, despite its political weight, covers around 40% of all EU GHG emissions[7], considerably less than the non-traded sectors. As the very name of the Regulation suggests, this piece of legislation is the key to a successful implementation of the Paris Agreement and therefore needs to take center stage in the efforts ahead.

The upcoming Climate Law, expected in the upcoming weeks, is the right legislative instrument to ensure that reductions within the sectors covered by the Climate Action Regulation for the implementation of the Paris Agreement would take place in the most cost-effective, advanced and fair way. We very strongly encourge the development of a governance infrastructure which would enable to fast paste reductions in the covered sectors, most notably through the introduction of an European Project Based Mechanism, governed by the EIB.

3. https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32018R0842

4. European Environment Agency. (2019). Trends and projections in Europe 2019. Retrieved from: https://www.eea.europa.eu/publications/trends-and-projections-in-europe-1

5. https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32003L0087

6. Extra-EU aviation and international shipping are currently not covered under any EU climate tool. Technically speaking, the ETS covers all inbound and outbound flights, but the ETS is currently suspended under the “stop-the-clock”.

7. European Environment Agency. (2019). Trends and projections in Europe 2019. Retrieved from: https://www.eea.europa.eu/publications/trends-and-projections-in-europe-1

Currently, the CAR allows member states to trade surplus allocations. Specifically, article 5, paragraph 7 states:

> *"Any transfer of annual emission allocations pursuant to paragraphs 4 and 5 [surplus allocations] may be the result of a greenhouse gas mitigation project or programme carried out in the selling Member State and remunerated by the receiving Member State, provided that double counting is avoided and traceability is ensured."*

Even if it is a step in the right direction, it doesn't guarantee that trading between member states will take place.

Therefore, we suggest the creation of a European Project Mechanism (EPM). Such a system would have many advantages:

1. **Technology and know-how** would be transferred across the Union space, especially when certain member states focus on specific sectors. This would have a catalysing effect, helping member states with less resources to be better prepared to implement 2050 targets.
2. **Reduce the overall costs**, delivering more emission reductions at equal cost.
3. **Revealing price**: under the Effort Sharing Decision (running up to 2020), member states could also trade allowances. Until today[8] only two member states (Bulgaria and Malta) have traded with each other. However, there is a total lack of transparency[9] on the price paid per tonne of CO2 built, nor how the received investment will be spent.
4. **Collectively head towards climate-neutrality**: given that countries with the highest cost-effective potential are also the ones with the lowest targets by 2030, they need to go beyond their current targets if they are going to start a trajectory towards 2050 climate-neutrality. Otherwise, the effort required in just two decades would make reaching climate-neutrality particularly challenging.
5. **Creative momentum to increase ambition**: the creation of the EPM would create the right political momentum and framework that would allow many member states to reconsider the increase in their CAR targets, having a clear understanding on where the opportunities lie, and at what price.

8. European Commission. (2020). European Union Transaction Log. Consulted on 3 February 2020. Retrieved from: https://ec.europa.eu/clima/ets/esdTransactions.do

9. Martin, I. (2018, November 3). Malta again fails emission test, has to pay "hundreds of thousands". Times Malta. Retrieved from: https://timesofmalta.com/articles/view/malta-must-again-pay-for-emission-failings.693276

The main challenge of the EPM is creating the right framework to make it happen. We foresee three different parties to be involved: the host member state (where the emission reduction would take place), the guest member state (the one claiming the emission reductions) and a third party acting as a broker.

We suggest that the third party in this case, working as the facilitator for investments between member states, could be the European Investment Bank (EIB).

The EIB has recently shown its commitment to move away from funding fossil fuel projects[10]. Additionally, the EIB has started to call itself "the EU's climate bank". This sends a clear signal of the role the EIB sees for itself in decarbonising Europe's economy. The implementation and management of the European Project Mechanism would be the perfect example of its new ambitions.

The EIB could create a platform of potential projects, based on expressions of interest submitted by host member states, where the emission-reduction project would take place. Regional or local government, and also the private sector, could also submit project ideas. The projects would come at a price per tonne of CO2, based on project costs. A platform could also be created, where the host member state could present potential projects to guest member states. Only sectors under the CAR would participate in the EPM.

The funding for the project would come from the host member state, from the guest member state receiving the emission reductions and loans from the EIB itself. The proportions to be contributed by each party could be subject to the specific arrangement. Getting the EIB on board could unleash more emission reductions that would have not taken place otherwise. At the same time, the guest member state would receive more emission reductions at a lower price, while the host member states would benefit from all the co-benefits of reducing GHG emissions, such as improved air quality, energy independence, quality of life or modernisation of its economy.

The EPM would not be a project mechanism in the style of the Clean Development Mechanism (CDM) of the United Nations Framework Convention on Climate Change (UNFCCC), which includes the concept of additionality. The units transferred from the host to the guest member state would be based on a baseline situation, but additionality would not have to be proven, given it would be a closed system. Additionally, the scope of the project would be limited to direct emissions (scope 1), given that other emissions are covered by different EU climate instruments. Going for a whole life cycle analysis approach, including

10. European Investment Bank. (2019, November 14). EU Bank launches ambitious new climate strategy and Energy Lending Policy. Retrieved from: https://www.eib.org/en/press/all/2019-313-eu-bank-launches-ambitious-new-climate-strategy-and-energy-lending-policy.htm

scope 2 (emissions associated to power production) and 3 (embedded emissions in the goods) would make the EPM overly complicated, without adding any additional value[11].

Therefore, the EPM would be considerably simpler from a methodological point of view. If the foreseen emission reductions were originally overestimated in the project documentation, it would be the responsibility of the host country to achieve the CAR targets anyway. So overall, it would not have a negative impact on the EU overall reduction target achievement.

EXAMPLE

EIB mechanism

A host member state has an old fleet of diesel buses in its capital city. It would like to replace them with electric buses, but they don't have the funding nor the know-how to do so. Therefore, it asks for help from the EIB.

The EIB would know of potential guest member states with experience on using electric buses while looking for emission reductions to achieve its own targets. The platform could also be used. The guest member state, together with the EIB and the host member state, would agree to finance the project (i.e. a combination of direct co-financing and loans).

In exchange, the host member state would transfer an amount of CAR units (Annual Emission Allocations - AEAs) to the guest member state, approximately equivalent to the emission reductions expected from changing the bus fleet.

When comparing the baseline (diesel buses) and the project (electric ones), only direct emissions would be considered. Both emissions from producing the diesel and the electricity are covered by the EU ETS, outside the scope of the project. Even if producing the electric buses also incur emissions somewhere (either in Europe or abroad), those are offset during the use of the bus, and more importantly creating the right framework to decarbonise in the long term.

11. Additionality refers to the concept of what would have happened in the absence of the project. In the case of the CDM, it consisted in proving that the emission reductions would have not taken place otherwise. However, there are serious questions about how additional CDM projects are. An analysis for the European Commission proved that 85% of CDM projects have a low likelihood of being additional. Öko Institut. (2016). How additional is the Clean Development Mechanism? Analysis of the application of current tools and proposed alternatives. Retrieved from: https://ec.europa.eu/clima/sites/clima/files/ets/docs/clean_dev_mechanism_en.pdf

The European Project Mechanism has the potential to increase the cost-effectiveness of reducing emissions in sectors included in the CAR, while creating the right political framework to increase CAR targets in the context of the Commission's review of 2030 climate targets.

The European Commission should, in its upcoming proposal for a European Climate Law, include the commitment to create an EPM for sectors under the Climate Action Regulation.

Establishing an independent advisory committee

To ensure that climate and emissions policy is evidence-based and consistent with best practice, a climate law should also establish a body to independently advise policymakers on meeting emissions targets in the most effective manner. This particular aspect is discussed in more detail below.

A new EU Climate Law should establish an independent body to provide impartial advice to policymakers in the European Commission, Council and Parliament on meeting carbon budgets. Its role would be to recommend science-based targets and policy approaches, monitor progress towards meeting emissions targets, and collect evidence from relevant stakeholders. This includes engaging with Member State governments, scientists, businesses, civil society organisations, academics and other individuals or organisations with knowledge relevant to meeting climate targets.

An obvious example to draw on is the UK's Committee on Climate Change (CCC). Like the CCC, the role of an EU climate change advisory committee would be separate from the Commission. It would, however, rely on the Commission to provide access to information relevant for carrying out its functions. Since the advisory committee would not be responsible for policy implementation and would not be under the supervision of the Commission, it will be less subject to political pressure. That, in turn, will allow the advisory committee to provide impartial advice.

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