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The European Emissions Trading System and its implementation in the Baltic States



Publicity photo

The European Emissions Trading System (EU ETS) allows its participants to trade in allocated emission certificates. In this way, each ton of CO₂ saved is assigned a direct monetary value, which is determined by supply and demand. In 2019, total greenhouse gas emissions in Estonia amounted to 14,699.1 tons of CO₂ equivalent (t CO₂ eq), in Latvia 11 144.81 t CO₂ eq and in Lithuania 20,367.8 t CO₂ eq. In Germany, by comparison, emissions amounted to around 809.8 t CO₂ eq that year. The EU ETS was introduced in 2005 to achieve the targets of the Kyoto Agreement of 16 February 2005 to reduce countries' emissions of climate-damaging greenhouse gases (emissions) such as carbon dioxide (CO₂) and methane.

But how exactly does the EU ETS work and how is it implemented in the three Baltic countries?

The EU ETS was introduced by Directive 2003/87/EC. The system is based on the "cap and trade" principle.

An operator of a registered installation has to provide a valid certificate for each ton of CO₂ emitted. However, there is a cap on allowances, which is further lowered each year. A limited number of emission allowances is made available to some companies free of charge under this cap. Companies that do not receive free emission allowances or for which the allocation is not sufficient must acquire emission allowances at an auction or buy them from other companies ("trade"). Currently, a certificate is traded for approx. €60.

The distribution of allowances is regulated by each participating country in so-called National Allocation Plans (NAPs): the macroplan and the microplan. The macroplan specifies how much in terms of emission allowances is to be issued to installations in a country in total, while the microplan determines how the allowances are distributed among the individual installations in each country.

Issuance and trading of CO₂ certificates must comply with

European Directive 2003/87/EC as well as the Commission's Implementing Regulations (EU) 2018/2066 and 2018/2067. Due to these Europe-wide regulations, conditions in Estonia, Latvia and Lithuania are similar.

All three countries have transposed the requirements of EU directives through national regulations and laws; in Estonia by the Air Protection Act and the Ordinance on Greenhouse Gas Emission Credit Trading; in Latvia by the Pollution Act and in Lithuania by the Regulation Approving the Description of the Procedure for Allocation and Trading of Greenhouse Gas Emission Allowances.

An operator of an installation that wants to trade with a certificate must first be assigned one. The basis for receiving a certificate is initially a permit. This is distributed in all three countries by the competent authority in the Ministry of the Environment. In doing so, the authority examines the installation's pollution activity. In Estonia, 58 permits were distributed in 2019, while in Latvia 64 and in



Lithuania 87 installations applied for a permit. Based on these authorizations, allowances are then distributed to the operators under the respective NAP.

A company whose emissions are then lower than the allocated emission allowances can sell the unnecessary allowances on the market – or alternatively buy them in the case of higher emissions.

Trading takes place on several marketplaces, such as the European Climate Exchange (ECX) in London, the European Energy Exchange (EEX) in Leipzig or Energy Exchange Austria (EXAA) in Vienna. Note, however, that this trade takes place purely electronically.

This means that a potential market participant must first open an account with the Greenhouse Gas Emissions Trading Register (Union Register). This is a pan-European electronic database listing all market participants in the trading system and the transactions they have carried out with emission allowances, the units of measure

allocated to the installations and transactions with them as well as certified and surrendered greenhouse gas emission allowances of installations.

To open an account, a market participant must apply to the national administrator, who will check that all the conditions for opening the account are met. The task of the national administrator is undertaken in Estonia by authority of the Ministry of the Environment, in Latvia by the Centre for the Environment, Geology and Meteorology, and in Lithuania since 2018 by the Environmental Project Management Agency. Once an account is opened, the account manager can trade certificates for the applicable trading period under the conditions mentioned.

Trading can take place on the exchanges mentioned but also “over the counter”, i.e. between two companies through a civil law contract or with the help of a broker.

On stock exchanges, trading generally takes place in spot and

forward transactions. The difference between the two transactions lies in the time of fulfilment. In the case of spot business, the emission allowance is delivered within one to five days, whereas in the case of forward transactions, the transaction is fulfilled later. In an OTC trade, framework agreements are usually used. Such a contract reduces the administrative burden as it regulates the basic framework conditions of a legal relationship between the contracting parties. Later, these conditions need only be specified in individual contracts, such as determination of price and quantity.

The EU ETS thus offers companies not only an environmental incentive, but also an economic one. At the end of the day, those who manage to reduce their emissions can participate in trading by selling their certificates and thus generate additional revenues for their company. And in terms of environmental protection, the system seems to pay off with the trade in pollution rights: between 1999 and 2019, emissions in Europe fell by 26%.