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Proposal for a

COUNCIL DECISION

on the conclusion, on behalf of the European Union, of an Agreement between the European Union and the Swiss Confederation on the Linking of their Greenhouse Gas Emissions Trading Systems

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

Cap and trade systems are policy tools that cost-effectively reduce greenhouse gas emissions. The cap on greenhouse gas emissions ensures that the policy is environmentally effective and the trading of emission allowances allows for flexibility in achieving emission reductions. The EU has more than a decade's experience with the EU's Emissions Trading System, the world's largest cap and trade system.

When emissions trading systems are linked, they enable participants in one system to use units from the linked system for compliance. Such linking is expected to result in broader carbon pricing. By expanding the market and increasing the availability of reduction opportunities, linking enhances the cost-efficiency of emissions trading.

• Consistency with existing policy provisions in the policy area

The development of a well-functioning international carbon market through bottom-up linking of emissions trading systems is a long term policy goal of the EU and the international community, notably as a means to achieve climate objectives, including under the Paris Agreement.

Article 25 of the Directive establishing the EU's Emissions Trading System (EU ETS)¹ allows for the EU ETS to be linked with other emissions trading systems provided they are mandatory, have an absolute cap on emissions and are compatible. On 20 December 2010, the Council adopted a Decision authorising the Commission to open negotiations with the Swiss Confederation for a link between the EU and the Swiss greenhouse gas emissions trading systems.

The Swiss Emissions Trading System (Swiss ETS) became mandatory in 2013 for large, energy intensive entities and puts an absolute cap on greenhouse gas emissions, meeting two of the basic conditions for linking with the EU ETS.

Overall, the Swiss ETS has a very similar design to the EU ETS. The EU ETS and the Swiss ETS cover the same gases and industry sectors, with equal inclusion thresholds, and define liable entities at installation level. The quantity of allowances that are issued each year under the Swiss ETS decrease annually in line with the decrease in the EU-wide quantity of allowances. The allocation methodologies are compatible: auctioning is the default method and similar benchmarks are applied for allocation to industries that receive transitional free allocation. The quantitative and qualitative standards for international credits are alike. The current trading period of the two systems covers 2013-2020. In both systems, the compliance period covers calendar years, with covered entities having until 31st March and 30th April of the following year to report emissions and to surrender allowances. The penalties for failing to surrender sufficient allowances are similar in the two systems.

While the Swiss ETS does not yet cover aviation, aviation activities are one of the biggest sources of greenhouse gases from Switzerland, and coverage of aviation by the Swiss ETS has been considered essential for linking with the EU ETS. Switzerland is working on including aviation in the Swiss ETS, with Switzerland mirroring the EU ETS rules on aviation.

¹ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC

Like the EU ETS, the Swiss ETS is currently undergoing review for its next period from 2021 to 2030. The agreement to link the Swiss ETS and EU ETS (the Linking Agreement) includes provisions to ensure a continued compatibility between the systems for the link to be maintained in the 2021-2030 period.

- **Consistency with other Union policies**

Despite increasing use of emission trading in Asia and North America, for the time being no international carbon market with a uniform global carbon price exists. Countries are taking differing types of mitigation action, both market-based and more traditional 'command and control' policies. This constitutes a risk of carbon leakage for the most energy intensive sectors, i.e. transfer production to countries with less ambitious targets and policies. Linking will lead to convergence of carbon prices in the linked systems, which contributes to an improved level-playing field. As concerns aviation, once the Swiss ETS covers it, flights within Switzerland, flights between Switzerland and the EU and flights between EU Member States will be treated similarly.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The proposal is made under Article 192(1), together with Article 218, of the Treaty on the Functioning of the European Union (TFEU).

In accordance with Article 192(1) and 191 TFEU, the European Union shall contribute to the pursuit, inter alia, of the following objectives: preserving, protecting and improving the quality of the environment; promoting measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change.

Article 218 TFEU lays down the procedure for the negotiation and conclusion of agreements between the European Union and third countries or international organisations. Paragraph 5 thereof provides for the Council, on a proposal from the Commission as negotiator, to adopt a decision authorising the signature of an agreement on behalf of the European Union. Paragraph 6(a) of Article 218 TFEU provides for the Council, on a proposal from the Commission as a negotiator, to adopt a decision authorising the conclusion of the agreement after obtaining the consent of the European Parliament.

- **Subsidiarity (for non-exclusive competence)**

The EU ETS Directive is an existing EU policy instrument that continues after 2020. In accordance with the principle of subsidiarity set out in Article 5 TFEU, the objectives of the Linking Agreement can only be achieved through a proposal from the Commission at EU level, as the Agreement will enable participants in the EU system to use units from the Swiss system for compliance.

Acting at EU level, and where possible at global level, is more efficient than acting at the Member State level, due to the trans-boundary effects of climate change. Action at EU level will most effectively deliver the EU's domestic and international climate targets while preserving a level-playing field in the EU's internal market.

- **Proportionality**

The proposal complies with the proportionality principle because it does not go beyond what is necessary in order to achieve the objectives of implementing the EU's GHG reduction

targets for 2020 and 2030 in a cost-effective manner, while at the same time ensuring the proper functioning of the internal market.

3. BUDGETARY IMPLICATIONS

No budgetary implications.

4. OTHER ELEMENTS

- **Detailed explanation of the specific provisions of the proposal**

The proposal sets out a decision authorising the signature of the Agreement between the EU and Switzerland on behalf of the European Union. The TFEU foresees for the Council to adopt a Commission proposal for a decision to authorise the signature and conclusion of an international agreement.

Agreement

The Agreement sets out the key objectives and principles, as well as the institutional structure for linking the two emissions trading systems. Once the link between the EU ETS and the Swiss ETS is operational, emission allowances that originate from one system are eligible for compliance in the other system (Article 4(1) of the Agreement). To ensure compatibility, Article 2 of the Agreement provides that the EU ETS and the Swiss ETS must meet essential criteria. These criteria are set out in Annex I to the Agreement and largely reflect the provisions of the EU ETS legislation or its implementing acts. Either system can adopt provisions that are more stringent than the essential criteria. In Article 10, the Agreement accommodates the possibility for future legislative developments in the systems without the need for substantial re-negotiation provided that the systems continue to meet the essential criteria. A process for information-sharing and coordination in areas of relevance to the Agreement is established by Articles 10 and 11 of the Agreement to ensure its proper implementation and the on-going integrity of the linked systems, which amongst others requires the Parties to keep each other informed of relevant legislative development (Article 10(2) of the Agreement).

The Agreement clarifies that Switzerland will mirror the EU ETS provisions on aviation in the Swiss ETS before the Agreement enters into force. Aviation operators will be administered by an EEA State or Switzerland under the 'one-stop shop' approach, so that a single authority takes responsibility of the implementation of the two systems.

The Joint Committee established by Article 12 of the Agreement is the main steering structure of the Agreement. It is composed of representatives of both Parties and is responsible for the administration and proper implementation of the Agreement. Notably, it plays an essential role in the process for information-sharing and coordination, as well as in the assessment of whether the Parties continue to meet the essential criteria. The Joint Committee can propose changes to articles of the Agreement and make amendments to the Annexes. The Joint Committee becomes provisionally functional from the date of signature of the Agreement.

Article 14 of the Agreement establishes a dispute settlement mechanism. Disputes on the interpretation or application of the Agreement can be referred by either Party to the Joint Committee for resolution. Where the Joint Committee is unsuccessful in settling the dispute within six months, the dispute can be referred to the Permanent Court of Arbitration at the request of either Party.

The Agreement can be permanently terminated by either Party (Article 16). Interim suspension modalities are foreseen in Article 15 that are capable to protect the integrity of the

emissions trading systems at short notice. The proposed suspension mechanism prevents the surrender of allowances from the linked system for compliance. The suspension mechanism can only be triggered in limited circumstances for a fixed period of time and may be extended up until termination.

In addition to the principles, objectives and institutional arrangements, the Agreement contains technical provisions for the operationalization of the link that relate to registries (Article 3), accounting (Article 4), auctioning (Article 5), sensitive information and security (Articles 8 and 9).

A direct registry link will be established to enable registry to registry trading, which will be based on Linking Technical Standards reflecting the principles set out in Annex II to the Agreement. The Swiss registry administrator for Switzerland and the central registry administrator for the EU will be responsible for administering the registry link. Next to the Linking Technical Standards, the registry administrators of the registry link are to determine common operational procedures for the registry link. They can individually or jointly temporarily close the link for system maintenance, or due to a security breach or security risk.

Account holders in the registries will be able to identify the origin of the emission allowances after the link. At least on an annual basis, Parties must inform each other of the total amount of emission allowances they hold in their ETS that originate from the linked ETS. Similarly, they must inform each other at least annually of the emission allowances that originate from the linked ETS that were surrendered for compliance or were voluntarily cancelled in the other ETS. The Agreement provides that the EU and Switzerland must account for net flows of allowances between the linked emissions trading systems in accordance with the future rules on accounting that are currently being developed under the United Nations Framework Convention on Climate Change. Provisions are also made for transferring and acquiring Assigned Amount Units should the second commitment period of the Kyoto Protocol enter into force. The Joint Committee is to develop the details on accounting and, if required, for the transfer and acquisition of Assigned Amount Units in Annexes to the Agreement.

The Agreement specifies that allowances not allocated for free are to be auctioned in an open, transparent and non-discriminatory manner. Entities, including operators that are admitted to bid in auctions conducted in one system are also eligible to bid in auctions conducted in the other system. The Agreement allows for the continuation of the current auctioning arrangements in Switzerland, provided the total number of Swiss allowances (stationary installations and aviation) to be auctioned per year is below a threshold of 1,000,000 Swiss allowances. Once the threshold is met, Switzerland will apply the same auctioning arrangements as apply in the EU and that are specified in the Annex I to the Agreement.

The Parties must protect sensitive information. Each Party remains responsible for marking information it releases as sensitive and for the decision on the sensitivity level, as well as the downgrading and removal of sensitivity, and must inform the other Party thereof. The EU and Switzerland will agree on the marking and the level of sensitivity for information that was released jointly.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 192(1), in conjunction with Article 218(6)(a) thereof,

Having regard to the proposal from the European Commission,

Having regard to the consent of the European Parliament²,

Whereas:

- (1) In accordance with Council Decision [XXX] of [...], the Agreement between the European Union and the Swiss Confederation on the Linking of their Greenhouse Gas Emissions Trading Systems was signed on [... November 2017], subject to its conclusion at a later date.
- (2) Cap and trade systems are policy tools that cost-effectively reduce greenhouse gas emissions. Linking cap and trade systems is expected to result in a broader carbon pricing, increasing the availability of reduction opportunities and enhancing the cost-efficiency of emissions trading. The development of a well-functioning international carbon market through bottom-up linking of emissions trading systems is a long term policy goal of the EU and the international community, notably as a means to achieve the climate objectives including under the Paris Agreement.
- (3) The Agreement should be approved on behalf of the Union,

HAS ADOPTED THIS DECISION:

Article 1

The Agreement between the European Union and the Swiss Confederation on the linking of their greenhouse gas emissions trading systems is hereby approved on behalf of the Union.

The text of the Agreement is attached to this Decision.

Article 2

The President of the Council shall designate the person empowered to proceed, on behalf of the Union, to exchange the instruments of approval provided for in Article 21 of the Agreement, in order to express the consent of the Union to be bound by the Agreement.

²

Article 3

This Decision shall enter into force on [...]².

Done at Brussels,

*For the Council
The President*

² The date of entry into force of the Agreement will be published in the *Official Journal of the European Union* by the General Secretariat of the Council.