

## **The Emission Trading Scheme in Polish Law. Selected Problems Related to the Scope of Derogation from the General Rule for Auctioning in Poland**

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### **CONTENTS**

- I. Introduction
- II. Transposition of EU law into the Polish legal system
  1. Legal framework
  2. Scope of application
  3. Greenhouse emission permit
  4. Allocation of allowances
  5. Administration of allowances
  6. Emissions allowance trading
  7. Charges related to participation in the Polish emission trading system
  8. Monitoring and sanctions
- III. Selected key problems related to the implementation of Phase 3 of the ETS Directive in Poland in terms of the electricity sector
  1. Derogation from the auctioning principle
  2. Obtaining emission permits by 30 June 2011 as one of the derogation conditions
  3. Meaning of the phrase “*investment process physically initiated*”
  4. Free allocation of emission allowances and State aid
    - A. Tradable emission permits and State aid
    - B. Imputability to the Member State
    - C. The resources of the Member State
    - D. Selective advantage
    - E. Effect on trade between Member States and distortion of competition.
    - F. Consequences
- IV. Conclusion

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### *Abstract*

The subject matter of this article is the implementation in Poland of Directive 2003/87/EC on the emissions trading scheme for greenhouse gases in the Community. The first part of the article focuses on the presentation of the legislation and institutional arrangements which transpose the obligations contained in Directive 2003/87/EC into Polish law. On the basis of this, the article then presents some problems regarding the implementation in Poland of important changes introduced into Directive 2003/87/EC by Directive 2009/29/EC. This part of the article contains an analysis of Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces specific rules for licensing bodies that undertake investment in terms of compliance with the provisions of Directive 2009/29/EC. Secondly, this paper also presents a preliminary assessment of the proposed free allocation of greenhouse gas emissions allowances in Poland to electricity production enterprises. This is examined from the viewpoint of the possibility of State aid in the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

### *Résumé*

L'article traite de l'application en Pologne de la directive n° 2003/87/CE établissant un système d'échange de quotas d'émission de gaz à effet de serre dans la Communauté. La première partie de l'article présente les actes juridiques ainsi que les solutions institutionnelles nécessaires à la transposition de l'ensemble du contenu normatif de la directive n° 2003/87/CE en Pologne. Par la suite, l'article explicite certains problèmes liés à l'application en Pologne de modifications significatives de la directive n° 2003/87/CE introduites par la directive n° 2009/29/CE. Cette partie de l'article contient l'analyse de l'art. 50 de loi relatif au système d'échange de droits d'émission de gaz à effet de serre, lequel introduit des règles spécifiques concernant le système d'octroi de permis aux sujets entreprenant la réalisation d'un investissement, du point de vue de sa conformité avec les dispositions de la directive n° 2009/29/CE. L'auteur donne aussi une estimation préliminaire du plan d'allocation de quotas d'émission de gaz à effet de serre gratuits en Pologne aux entreprises de production de l'électricité sous l'aspect d'éventuelle aide d'Etat au sens de l'article 107 alinéa 1 du *Traité sur le fonctionnement* de l'Union européenne.

**Classifications and key words:** environmental law, directive 2003/87/EC, emission trading, auctioning, free allocation, State aid.

## I. Introduction

The concept of using tradable emissions permits in environmental policy is not a new idea. It was first proposed by J.H. Dales<sup>1</sup> more than 40 years ago, and received much attention in economic literature in the latter part of the 20th century.<sup>2</sup> The international discussion around emissions trading has gained new momentum due to its inclusion as a policy tool in efforts to protect the global climate. In 2003, the EU created an internal emissions trading scheme to assist the European Union and its then 15 Member States in achieving their commitments to reduce greenhouse gas emissions under the Kyoto Protocol in a cost-effective manner.<sup>3</sup> The EU Emissions Trading Scheme (EU ETS) is based on the recognition that creating a price for carbon offers the most cost-effective way to achieve the deep reductions in global greenhouse gas emissions that are needed to prevent climate change from reaching dangerous levels. Since January 1, 2005, greenhouse gas emissions in the EU, up to that point virtually unregulated, have been subject to limitations. At the same time these limitations became tradable in the EU.<sup>4</sup>

According to the European Commission the EU ETS is being implemented in distinct phases or ‘trading periods’.

Phase 1, from January 1, 2005 to December 31, 2007, was a three-year pilot phase of ‘learning by doing’ in preparation for the crucial Phase 2. It successfully established a price for carbon, free trade in emission allowances across the EU, and the necessary infrastructure for monitoring, reporting and verifying actual emissions from the businesses covered. The generation of verified annual emissions data filled an important information gap and created a solid basis for setting the caps on national allocations of allowances for Phase 2.

Phase 2, running from January 1, 2008 to December 31, 2012, coincides with the ‘first commitment period’ of the Kyoto Protocol – the five-year period during which the EU and its Member States must comply with their emission targets under the Protocol. The 2005–2007 pilot phase was necessary to ensure

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<sup>1</sup> J.H. Dales, *Pollution, Property and Prices*. Toronto 1968.

<sup>2</sup> See: W.J. Baumol and W.E. Oates *The Theory of Environmental Policy*. Second Edition. Cambridge 1988; N. Hanley, J.F. Shogren, B. White, *Environmental Economics in Theory and Practice*. London 1997.

<sup>3</sup> The European Union had 15 Member States when the Kyoto Protocol was agreed. On May 1, 2004, EU membership increased to 25 with the accession of Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Malta, Slovakia and Slovenia. On January 1, 2007, Romania and Bulgaria joined the EU.

<sup>4</sup> U. Ellinghaus, P. Ebsen, H. Schloemann, ‘The EU Emissions Trading Scheme (EU ETS): a Status Report’ (2004) 1 *Journal for European Environmental & Planning Law*, p. 3.

that the EU ETS contribute fully to the achievement of these targets by functioning effectively during Phase 2. On the basis of the verified emissions reported during Phase 1, the Commission has cut the volume of emission allowances permitted in Phase 2 to 6.5% below the 2005 level, thus ensuring that real emission reductions will take place.

Phase 3 will run for eight years, from January 1, 2013 to December 31, 2020. This longer trading period will contribute to the greater predictability necessary for encouraging long-term investment in emission reductions. The EU ETS will be substantially strengthened and extended from 2013, enabling it to play a central role in the achievement of the EU's climate and energy targets for 2020.<sup>5</sup>

The EU ETS is built on three main legal instruments, established for Phase 1 and accordingly amended and enlarged for Phase 2 and Phase 3. The first instrument is the Emissions Trading Directive (ETS Directive)<sup>6</sup>, which establishes the 'cap and trade' system itself, including key requirements on e.g., covered installations, allocation of allowances, monitoring, and trading. The second is the so-called Linking Directive<sup>7</sup>, which allows for, and regulates, the introduction into the emissions trading scheme of emission reduction credits generated through specific projects abroad that lead to emissions reductions. The third is the Registries Regulation<sup>8</sup>, which provide rules for

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<sup>5</sup> See: European Commission, *EU action against climate change. The EU Emission Trading Scheme*, edition 2009, p. 8; M.J. Mace, J. Anderson, 'Legal and design issues arising in linking the EU ETS with existing and emerging emissions trading schemes' (2009) 6.2. *Journal for European Environmental & Planning Law*, pp. 197–232.

<sup>6</sup> 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, OJ [2003] L 275/32; Directive 2008/101/EC of the European Parliament and of the Council of 19 November 2008 amending Directive 2003/87/EC so as to include aviation activities in the scheme for greenhouse gas emission allowance trading within the Community, OJ [2008] L 8/3; Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community, OJ [2009] L 140/63.

<sup>7</sup> 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 emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms, OJ [2004] L 338/18.

<sup>8</sup> Commission Regulation (EC) No 2216/2004 of 21 December 2004 for standardised and secured system of registers pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2004] L 386/1; Commission Regulation (EC) No 916/2007 of 31 July 2007 amending Regulation (EC) No 2216/2004 for standardised and secured system of registries pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2007] L 200/5; Commission Regulation (EC) No 994/2008 of 8 October 2008 for standardized and secured system of registries pursuant

the establishment and operation of national electronic registers for the EU system's emission allowances in the Member States.

The main subject matter of this article is a presentation of a general overview of the transposition of EU ETS law into the Polish legal system. As a result I will investigate selected key problems related to the implementation of Phase 3 of the EU ETS in Poland, especially within the scope of derogation from the general rule for auctioning in Poland. I will analyze Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces specific rules for licensing bodies that undertake investment, in terms of compliance with the provisions of Directive 2009/29/EC. I will also present a preliminary assessment of the free-of-charge allocation of greenhouse gases emissions allowances in Poland to electricity production enterprises from the viewpoint of the possibility of the existence of State aid.

## II. Transposition of EU law into the Polish legal system

### 1. Legal framework

EU ETS law was originally transposed into the Polish legal system by the Act of 22 December 2004 on greenhouse gases (GHG) and allowances trading in the emission of other substances (Emission Trading Act)<sup>9</sup> and the Act of 17 July 2009 on the management of emissions of GHG and other substances (Emission Management Act)<sup>10</sup>.

The Emission Trading Act sets out the general framework for the Polish emission trading system and provides for the necessary procedures and the administrative structure to make emission trading operational in Poland. It regulated e.g. which installations and GHGs fall within its scope, the permit procedure for emission of GHGs, the procedure for issuing allowances, the design of a national emission trading registry, as well as provisions on the transfer of allowances and compliance instruments.

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to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2008] L 271/3.

<sup>9</sup> Journal of Laws 2004 No 281, item 2784 and 2008 No 199, item 1227.

<sup>10</sup> Journal of Laws 2009 No 130, item 1070. This Act is focused on monitoring and management of the Kyoto units and is not a subject for analysis in this article.

## 2. Scope of application

The Emission Trading Act established an emission trading system in Poland. This system includes two sub-systems: 1) a community emission trading system and 2) a national emission trading system.<sup>11</sup> The system covers GHGs and other substances. GHGs are described in Annex II to the ETS Directive as: carbon dioxide (CO<sub>2</sub>), methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulphur hexafluoride (SF<sub>6</sub>).<sup>12</sup> ‘Other substances’ covered by the system are sulphur dioxide (SO<sub>2</sub>), nitrogen oxides (NO<sub>x</sub>) and dusts.<sup>13</sup> The community emission trading system covers GHGs. The national emission trading system covers the emission of ‘other substances’ into the air. The system covers emissions from installations. The concept of ‘installation’ is defined in Article 3(6) of the Act of 27 April 2001 on Environmental Protection Law<sup>14</sup>. The most important part is the definition of an ‘installation covered by the system’. Installations covered by the system are described currently in the Regulation of the Ministry of the Environment of 27 July 2009 on installations covered by the community emission trading system.<sup>15</sup> This Regulation transposes into the Polish law Annex I of the ETS Directive.

## 3. Greenhouse emission permit

The Emission Trading Act in Articles 33–36 transposed Articles 4–6 of the ETS Directive in terms of greenhouse emissions permits. The operator of an installation covered by the system has an obligation to obtain a “permit”. This permit should be understood as a “greenhouse emission permit” in the light of Article 4 of the ETS Directive. This permit is issued by the authority competent for issuing integrated pollution prevention and control permits for a period of 10 years.

## 4. Allocation of allowances

The allocation of allowances ensures the effectiveness of emission trading as an environmental policy instrument. It determines the overall budget of allowances allocated to the participants in the system. Operators of

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<sup>11</sup> Article 5(1) ETA.

<sup>12</sup> Article 3 (5) ETA.

<sup>13</sup> Article 3 (14) ETA.

<sup>14</sup> Journal of Laws 2001 No 62, item 627 with amendments.

<sup>15</sup> Journal of Laws 2009 No 136, item 1120.

installations who exceed their allowance budget will either need to reduce emissions themselves or buy allowances on the market. In general, allowances in Phase 2 of EU ETS can be auctioned or allocated free-of-charge, depending on the respective political decision. The ETS Directive states that for the three-year period beginning January 1, 2008, Member States shall allocate at least 90% of the allowances free-of-charge. Therefore it is possible to auction up to 10% of allowances in this period.

In Poland the allocation of allowances in Phase 2 of EU ETS is organized as follows: the National Administrator of the Emission Trading System (KASHUE) prepares a draft of the National Allocation Plan (NAP).<sup>16</sup> The process for preparation of the NAP is open for public participation.<sup>17</sup> Pursuant to the ETS Directive, the European Commission examines the NAPs and can require amendments and subsequently reject them. This provision is transposed into ETA in Article 18(1). According to this provision of ETA the NAP is accepted by the European Commission and next adopted by the Government in the form of regulation.<sup>18</sup> The acceptance of the Polish NAPs by the European Commission was beset by long procedural disputes, including proceedings before the Court of First Instance of the European Community.<sup>19</sup> The NAP which is currently in force was accepted by the Regulation of the Council of Ministers of July 1, 2008.<sup>20</sup> In Phase 2 of the EU ETS Poland has allocated all allowances free-of-charge. Allowances are in principle allocated to operators of existing installations on the basis of the average absolute emissions of the respective individual installation during the last five years (grandfathering system).<sup>21</sup> Allocations are in principle granted for each installation in the content of the NAP.<sup>22</sup>

## 5. Administration of allowances

The competent authority in terms of the administration of the system is the National Administrator of the Emission Trading System (NAETS). The main task of the NAETS is hosting the emission trading registry<sup>23</sup> pursuant to the Registry Regulation of the European Commission which provides for

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<sup>16</sup> Article 14(4) ETA.

<sup>17</sup> Article 17 ETA.

<sup>18</sup> Article 18(2) ETA.

<sup>19</sup> Poland won the case T-183/07 [ECR] 2009, 23.09.2009. Commentary onto this case significantly transcends the scope of this paper. See: J. de Cedra de Larragan, 'Case note: Republic of Poland v. Commission' (2000) 1 *Climate Law*, pp. 199–206.

<sup>20</sup> Journal of Laws 2008 No 202, item 1248.

<sup>21</sup> Article 16(4)(2) ETA.

<sup>22</sup> Article 22(2) ETA.

<sup>23</sup> Article 9(2)(1) ETA.



a purely electronic emission trading system in which allowances exist solely electronically.<sup>24</sup>

## 6. Emissions allowance trading

The determination of the contract provisions governing the transfer of allowances, due to the lack of EU-wide regulations, is subject to the law of the Member State. According to Article 26(1) of the ETA, allowances granted to each installation can be used for its own needs related to real emission from the installation or can be traded or used in the next reporting years of the next reporting period. In principle, the relevant provisions of the Polish Civil Code<sup>25</sup> are applicable to the purchase of an emission allowance.<sup>26</sup>

## 7. Charges related to participation in the Polish emission trading system

Costs of participation in the system include *inter alia*: a) a charge for the first entry into the National Emission Allowances Register (NEAR) in the reporting period; b) a charge for the granting of an emission allowance. That charge for the first entry into the NEAR is set as a constant charge of 450 PLN.<sup>27</sup> Both charges, due to a lack of EU regulations on this subject, are regulated by Polish law only.

## 8. Monitoring and sanctions

ETS Directive in Article 14 (Monitoring and reporting of emissions) and in Article 15 (Verification and accreditation) has established the obligations of the Member State to ensure that emissions are monitored and reported, and that the reports submitted by operators are verified independently. These requirements are implemented in Section 7 of ETA. Each operator of an installation who has been granted allowances has an obligation to monitor

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<sup>24</sup> See: Commission Regulation (EC) No 2216/2004 of 21 December 2004 for standardised and secured system of registers pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council, OJ [2004] L 386/1.

<sup>25</sup> Journal of Laws No 16, item 93 with amendments.

<sup>26</sup> Article 26(4) ETA.

<sup>27</sup> Article 12(1) ETA.



and report the emissions from that installation during each calendar year.<sup>28</sup> The Ministry of the Environment has described specific rules regarding the monitoring of emissions in the Regulation of September 12, 2008 on monitoring of emissions covered by the EU ETS.<sup>29</sup>

### **III. Selected key problems related to the implementation of Phase 3 of the ETS Directive in Poland in terms of the electricity sector**

#### **1. Derogation from the auctioning principle**

The legal framework for Phase 3 of EU ETS (2013–2020) is established in Directive 2009/29/EC of the European Parliament and of the Council of 23 April 2009 amending Directive 2003/87/EC so as to improve and extend the greenhouse gas emission allowance trading scheme of the Community (Directive 2009/29/EC).<sup>30</sup> Member States shall transpose and implement this Directive by December 31, 2012. However, they shall publish and submit to the Commission, by September 30, 2011, a list of installations covered by this Directive and any free allocation to each installation in their respective territories.<sup>31</sup>

In terms of the energy sector, Directive 2009/29/EC sets up a general rule for the auctioning of emission allowances from 2013.<sup>32</sup> Pursuant to Article 10(1) of Directive 2003/87/EC as amended by Directive 2009/29/EC ('amended ETS directive') from 2013 onwards, Member States shall auction all allowances which are not free-of-charge in accordance with Articles 10a and 10c. Article 10c was included in the package of elements of the final compromise for the adoption of the amended ETS Directive. This Article establishes the option for a transitional free allocation for the modernization of electricity generation on the basis of an authorization by the Commission. According to Article 10c (1) of the amended ETS Directive by derogation from Article 10a(1–5), a Member State may give a transitional free allocation to installations for electricity production in operation by December 31, 2008 or installations for electricity production for which the investment process was physically initiated by the same date, provided that described conditions are met. The list of conditions set up in Article 10c for the derogation is too

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<sup>28</sup> Article 40 ETA.

<sup>29</sup> Journal of Laws 2008 No 183, item 1142.

<sup>30</sup> OJ [2009] L 140/63.

<sup>31</sup> Article 2 and Article 11(1) of the Directive 2009/29/EC.

<sup>32</sup> Preamble to the Directive 2009/29/EC, recital 19.

long to be described and analyzed in this paper. Selected problems regarding free-of-charge allocation in the case of the Polish electricity sector investments will be highlighted below.

## **2. Obtaining emission permits by June 30, 2011 as one of the derogation conditions**

Article 10 a(7), of the amended ETS Directive provides that ‘No free allocation shall be made in respect of any electricity production by new entrants’. Clearly, one of the purposes of this condition is to limit the scope of the derogation from the general rule for auctioning. It should be taken into consideration that the derogation described in the Article 10c of the amended ETS Directive is not extended to Article 10a(7), but includes only Article 10a(1–5).<sup>33</sup> In terms of the scope of derogation from that perspective, the definition of ‘new entrant’ is crucial. Pursuant to Article 3h of the amended ETS Directive ‘new entrant’ means

- any installation carrying out one or more of the activities indicated in Annex I, which has obtained a greenhouse gas emissions permit for the first time after 30 June 2011,
- any installation carrying out an activity which is included in the Community scheme pursuant to Article 24(1) or (2) for the first time, or
- any installation carrying out one or more of the activities indicated in Annex I or an activity which is included in the Community scheme pursuant to Article 24(1) or (2), which has had a significant extension after June 30, 2011, only in so far as this extension is concerned.’

It follows from Articles 10a(7) and Article 3h that the amended ETS Directive requires installations benefiting from free allowances under Article 10c to have their emissions permits by the end of June 2011.

The end of June 2011 as the final term for obtaining an emissions permit is an unrealistic timescale for almost all the new power generators which are being planned by the Polish government to receive free allocations under Article 10c derogation.<sup>34</sup> Polish legislators have realized that this is a real problem and have prepared a solution in the new Act on the System of Greenhouse Emission Trading (‘New ETS Act’).<sup>35</sup> One of the main purposes of the new act is the

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<sup>33</sup> See M. Ballesteros, ‘Transitional free allocation of allowances to the power sector’ (2010) 3 *ClientEarth*, p. 3.

<sup>34</sup> See M. Głowacki, *Why can't new investments in Polish power generators benefit from derogation laid down in Article 10 c of the Directive EU ETS*, 2009, [www.emissions-euets.com](http://www.emissions-euets.com), p. 1.

<sup>35</sup> See: [http://orka.sejm.gov.pl/opinie6.nsf/nazwa/3887\\_u/\\$file/3887\\_u.pdf](http://orka.sejm.gov.pl/opinie6.nsf/nazwa/3887_u/$file/3887_u.pdf). The legislative procedure hadn't been completed by May 29, 2011. However, the Act needs only to be signed by the President.

transposition into Polish law of amendments to the ETS Directive in the scope of changes made by Directive 2008/101/EC and Directive 2009/29/EC.<sup>36</sup> The new ETS Act in Article 50 introduces specific rules for issuing emissions permits to entities which begin the process of realization of an installation. According to Article 50(1) of the new ETS Act, 'The permit is issued upon the application of an entity which begins the realization of a combustion installation, with the exception of installations for incineration of hazardous or municipal waste with the rated thermal input exceeding 20 MW, that will generate electricity to be sold to a third party and that will not be used for activities defined in points 2–29 in the Part B of the Annex to this Act.'<sup>37</sup> Pursuant to Article 50(2) of the new ETS Act, 'Commencement of realization of the installation takes place on the day of the actual initiation of the investment process related with this installation (...)'<sup>38</sup> The day of the actual initiation of the investment process is described as, 'a day, prior to 31 December 2008, on which preparatory works were started on the installation's construction site'.<sup>39</sup> There are two legal problems which result from Article 50 of the new ETS Act.

The first problem concerns the correct transposition of the amended ETS Directive. The Polish legislators intend not to treat as yet non-existent but planned installations as 'new entrants', by granting them emissions permits. The concept of issuing emission permits to installations that haven't been completed on the day of issuing is more than dubious. The declared goal of the regulation of Article 50 of the new ETS Act is implementation of Article 10c of the amended ETS Directive into Polish law in a way that will make free-of-charge allocation to electricity producers possible.<sup>40</sup> In fact, the regulation of Article 50 of the new ETS Act is intended to limit the effect of Articles 10a (7) and Article 3h. The clear purpose of these Articles is the exclusion of new entrants from the benefit of free-of-charge allocations. As the amended ETS Directive explains in Article 1, it 'provides for the reductions of greenhouse gas emissions to be increased so as to contribute to the levels of reductions that are considered scientifically necessary to avoid dangerous climate change'. It should be obvious that the main purpose of the ETS Directive is to limit greenhouse pollution. The main instrument to achieve this purpose is the auctioning rule established in Article 10(1) of the amended ETS Directive. An unjustifiable extension of derogation from that general rule provided in Article

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<sup>36</sup> Justification of the draft Act, p. 2, see: [http://www.mos.gov.pl/g2/big/2010\\_08/f79b98d3e6a89f264326bd6fce2ef624.pdf](http://www.mos.gov.pl/g2/big/2010_08/f79b98d3e6a89f264326bd6fce2ef624.pdf).

<sup>37</sup> Author's own translation of Article 50.

<sup>38</sup> Author's own translation of Article 50.

<sup>39</sup> Author's own translation of Article 50.

<sup>40</sup> Justification of the draft Act, p. 28, see: [http://www.mos.gov.pl/g2/big/2010\\_08/f79b98d3e6a89f264326bd6fce2ef624.pdf](http://www.mos.gov.pl/g2/big/2010_08/f79b98d3e6a89f264326bd6fce2ef624.pdf).

48 of the draft ETS Act is contradictory to the main aim of the amended ETS Directive and therefore constitutes an incorrect transposition of this Directive. It should be stressed that the general principle governing the implementation of the directives into national law is the assurance of achievement of the desired result of the directive (*effect utile*).<sup>41</sup>

Moreover, Article 3h of the amended ETS Directive provides that ‘new entrant’ means ‘any installation carrying out’ the defined activities under certain conditions. It follows *a fortiori* from this wording that any installation which is not already carrying out the activities must be treated as a ‘new entrant’. In other words, any installation which isn’t carrying out the activities fulfills the definition of ‘new entrant’ in the meaning of Article 3h of the amended ETS Directive. It appears that Article 50 of the new ETS is also in direct contradiction with the wording of Article 3 h of the amended ETS Directive.

### 3. Meaning of the phrase ‘investment process physically initiated’

The second problem arising from Article 50 of the new ETS Act is related to the meaning of ‘investment process physically initiated’ in Polish law. This phrase is used in the amended EU ETS Directive to describe the scope of derogation from the general rule for auctioning. According to Article 10c ‘By derogation from Article 10a(1–5) Member States may give a transitional free allocation to installations for electricity production in operation by December 31, 2008 or to installations for electricity production for which the investment process was physically initiated by the same date ...’.<sup>42</sup> Pursuant to Article 50(2) of the new ETS Act ‘Commencement of realization of the installation takes place on the day of the actual initiation of the investment process related with this installation (...)’.<sup>43</sup> The day of the actual initiation of the investment process is described as ‘a day, prior to 31 December 2008, on which preparatory works were started on the installation’s construction site’.<sup>44</sup> [underlining added – M.S.]. The crucial problem to be settled while deciding which installations in Poland are entitled to enjoy the derogation as foreseen by Article 10c, is the interpretation of when the investment process for an installation may be regarded as physically initiated – in other words, how the operators shall prove that the investment process of their installation

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<sup>41</sup> See: case C-48/75 [ECR] 1976, 497, para 75.

<sup>42</sup> See also: Communication from the Commission – Guidance document on the optional application of Article 10c of Directive 2003/87/EC, OJ [2011] C 99/9, para 15.

<sup>43</sup> Author’s own translation of Article 50.

<sup>44</sup> Author’s own translation of Article 50.

was *physically initiated* before a given date. Article 50(2) of the new ETS Act transposed the phrase ‘physically initiated’ as ‘actual initiation’. According to M. Bar, as the Directive refers to ‘physical initiation’ and not to the mere ‘authorization’ of commencing the investment process (not the mere possessing relevant permits to start the building), it is legitimate to state that one shall prove that the works on construction the installation have actually started.<sup>45</sup> In Poland, the requirements concerning construction works are regulated by the Act of 7 July 1994 – Building Law<sup>46</sup> (Building Law Act), and the draft ETS Act directly refers to ‘preparatory works’. In my opinion this term should be understood according to the Building Law Act. Pursuant to Article 41(1–3):

‘Art. 41.1. The construction commences with undertaking of preparatory works on the construction site.

2. The preparatory works are:

- 1) geodesic marking of objects on the construction site;
- 2) levelling of the construction site;
- 3) management of the site including temporary building objects;
- 4) developing of connections to the technical infrastructure network for construction purposes.

3. The preparatory works may be carried out only on the site encompassed by a construction permit (...).

It is clear that according to the Building Law Act preparatory works may be carried out only on the basis of a construction permit. This interpretation is also presented by the jurisprudence. The Voivodeship Administrative Court in Kielce stated in its verdict of September 11, 2008 that: ‘geodesic marking of objects in the construction site is one of the types of the preparatory works which commence the construction. It is NOT an activity which is to be carried out prior to obtaining a construction permit.’<sup>47</sup> It follows from Article 41(3) of the Building Law Act that in Poland only installations which had already acquired construction permits by December 31, 2008 are entitled to enjoy derogations as foreseen by Article 10c of the amended ETS Directive. Pursuant to Article 45(1) of the Building Law Act ‘a building diary is an official document confirming the course of a construction (...).’ According to the interpretation of M. Bar the most appropriate proof that ‘the investment process was physically initiated’ is the first entry in the building diary for a given project.<sup>48</sup> It should be underlined that this conclusion is valid also to ‘actual initiation’ described in Article 50(2) of the new ETS Act, because

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<sup>45</sup> M. Bar, *Legal opinion concerning of the term „physically initiated investment process” as user by Directive 2003/87/EC under Polish law*, 30.09.2010, typescript. p. 2.

<sup>46</sup> Journal of Laws 2006 No 156, item 1118 with amendments.

<sup>47</sup> Judgement of VAC Kielce, II SA/Ke 342/08; LEX nr 526502.

<sup>48</sup> M. Bar, *Legal opinion...*, p. 3.

this article refers to ‘preparatory works’ and this is the term of the Building Law Act.

#### 4. Free allocation of emission allowances and State aid

##### A. Tradable emission permits and State aid

Poland is planning to allocate free European Union CO<sub>2</sub> Allowances (EUAs) to up to 15,000 MW worth of new power plants. If these plans are realized, it will mean that Poland will hand out around 60 million EUAs to new plants between 2013 and 2020.<sup>49</sup> The question arises whether this planned free allocation will constitute State aid in the sense set out by Article 107(1) TFEU?<sup>50</sup>

The European Commission has stated in the Community Guidelines on State aid for environmental protection that ‘Tradable permit schemes may involve State aid in various ways, for example, when Member States grant permits and allowances below their market value and this is imputable to Member States.’<sup>51</sup> According to the draft of the Community Guidelines on Certain State Aid Measures Relating to the EU Emission Trading System After 2013 ‘some of the provisions and statement linked to the ETS Directive after 2013 involve State aid in the meaning of Article 107(1) of the TFEU’.<sup>52</sup> This draft establishes conditions to be fulfilled for a declaration compatible with the Internal Market of State aid involved in the transitional and optional free allocation for modernization of electricity generation in accordance with Article 10c of the ETS Directive.<sup>53</sup> The Commission has presented its opinion regarding State aid aspects in transitional free allocation of allowances in Phase 3 of the EU ETS in the Communication ‘Guidance document on the optional application of Article 10c of Directive 2003/87/EC’.<sup>54</sup> According to the Commission, ‘the free allocation of emission allowances to electricity generators and the financing of correspondent investments required by

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<sup>49</sup> See: B.Garside, *Poland misled investors on free EUAs: WWF*, PointCarbon.com, 18.08.2010.

<sup>50</sup> According to settled case law the conditions are as follows: First, there must be an intervention by the State or through State resources. Second, the intervention must be liable to affect trade between Member States. Third, it must confer an advantage on the recipient. Fourth, it must distort or threaten to distort competition. See: Case C-280/00, *Altmark Trans*, para 75.

<sup>51</sup> OJ [2008] C 82/1, pp. 55 and 139.

<sup>52</sup> European Commission, *Community Guidelines on Certain State Aid Measures Relating to the EU Emission Trading System After 2013*, draft dated 2009, para 1.2.

<sup>53</sup> *Ibidem*, para 3.1.3.

<sup>54</sup> Communication from the Commission – *Guidance document on the optional application of Article 10c of Directive 2003/87/EC*, OJ C 99/9, 31.3.2011.

Article 10c of Directive 2003/87/EC would in principle involve State aid in the meaning of Article 107(1) TFUE.<sup>55</sup> The results of a preliminary examination into whether the free allocation of EUAs in the case of Poland will fall within the constitutive elements of State aid are presented below.

### B. Imputability to the Member State

According to the Commission, NAPs may contain elements which distort competition and constitute State aid. Even if the NAP did not contain any ‘over-allocation’, there still might be an element of State aid, having regard to Article 10 of Directive 2003/87. Especially in the case where a Member State allocated **more than 95% of the allowances for the first allocation period free-of-charge**, thereby foregoing public revenue<sup>56</sup>. It should be stressed that Article 10 of Directive 2003/87/EC has been changed by Directive 2009/29/EC, which has established an auction principle. This means the EC law obligation to grant 95% of allowances free-of-charge will be removed starting from 2013. Consequently, the Member State’s decision to use the derogation established in Article 10c and allocate allowances free-of-charge will therefore be imputable to the Member State in Phase 3 of EU ETS?

### C. The resources of the Member State

State resources are involved where public authorities of the Member State enjoy or acquire control over the funds which finance the economic advantage granted to an enterprise. According to the Court of First Instance (CFI) ruling in the NO<sub>x</sub> case ‘Setting up a scheme which provides for the possibility of trading NO<sub>x</sub> emission allowances on the market, the Kingdom of the Netherlands has conferred on them the character of intangible assets which the undertakings concerned are free to sell, even if they are linked to a maximum ceiling applicable to the undertaking concerned. Those assets are put at the disposal of the undertakings concerned free-of-charge, whereas they could have been sold or put up for auction. The Kingdom of the Netherlands has thus forgone State resources.’<sup>57</sup> Pursuant to Article 10(3) of the amended ETS Directive Member States **shall** determine the use of revenues generated from the auctioning of allowances. At least 50% of the revenues **should** be used for the described purposes (energy efficiency, etc.). It is the Member State that has to determine the use of auctioning revenues.<sup>58</sup> Revenues from

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<sup>55</sup> Ibidem, para 27.

<sup>56</sup> See: case T-387/04, para 23.

<sup>57</sup> Case T-233/04, para 75.

<sup>58</sup> M. Ballesteros, *Transitional free allocation...*, points 28–29.



auctioning EUAs which would be resigned by the Member State who make allocations free-of-charge are under the control of the Member State.

#### **D. Selective advantage**

According to the above referenced CFI ruling in the NOx case: the tradability of emission allowances provided for by the measure constitutes an advantage for enterprises subject to emission standards.<sup>59</sup> Poland is planning to grant free-of-charge emission allowances to a selected group of electricity generation enterprises. The concept of ‘selectivity’ established in the jurisdiction of the ECJ is very broad. The ECJ in its *Adria Wien Pipeline* ruling clearly stated that a rebate on an energy tax applying only to the primary and industrial sector was indeed selective, because the measure distinguished between the manufacturing sector and the rest of the economy, including the service sector.<sup>60</sup> Granting emission allowances free-of-charge only to a certain group of electricity generation enterprises will at least distinguish between their situation and the situation of: a) other electricity generation enterprises, who will not be granted them free-of-charge and b) enterprises of other sectors covered by the EU ETS system, who will have to buy the emission allowances at auction.

#### **E. Effect on trade between Member States and distortion of competition**

Electricity generation is a liberalized activity in the European Union’s internal market. The electricity generation market is open for competition. The measure in question could distort competition on several levels, e.g., (i) competition between incumbents and new market entrants, (ii) competition between competing firms within the same Member State, (iii) and competition between beneficiaries and other power plants (e.g. in Poland and beyond).

According to the ECJ ruling in case 730/90, *Philip Morris*, in order to consider that a measure ‘distorts or threatens to distort competition’ and ‘affects trade between Member States’, it is sufficient for the Commission to prove that the measure in question has the potential to do so.<sup>61</sup>

#### **F. Consequences**

If free allocation of EUAs constitutes State aid in the meaning of Article 107(1) of the TFEU, this will be incompatible with the internal market as a

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<sup>59</sup> Case T-233/04, para 74.

<sup>60</sup> Case C-143/99, *Adria Wien Pipeline GmbH* ECR [2001] p. I-8365.

<sup>61</sup> Case 730/90, *Philip Morris*, para 11.

general rule and therefore prohibited. State aid in the form of free allocation of EUAs may be considered to be compatible with the internal market (and therefore allowed) on the grounds of Article 107 (3)(c) of the TFEU as ‘aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest’.

Nevertheless, pursuant to Article 108(3) of the TFEU, the Commission shall be informed of any plans to grant State aid (an obligation of notification). Directive 2009/29/EC in Article 10c includes two legal basis of obligation of the Member State related to the free-of-charge allowances allocation. First, any Member States that intends to allocate allowances on the basis of this Article shall, by September 30, 2011, submit to the Commission an application containing the proposed allocation methodology and individual allocations.<sup>62</sup> Second, the Member State concerned shall submit to the Commission a national plan that provides for investment in the retrofitting and upgrading of infrastructure and clean technologies.<sup>63</sup> It should be stressed that the notifications referred to above cannot be treated as a formal notification of the State aid measure pursuant to Article 108(3) of the TFEU. This conclusion follows from the CFI ruling in case T-387/04, *EnBW Energie Baden-Württemberg v. Commission*. This case concerned a German NAP which was notified to the Commission according to the obligation under the ETS Directive. The Court sustained the approach presented by the Commission that the decision of acceptance of the NAP was only a provisional assessment in the light of the rules concerning State aid and such a provisional assessment cannot be interpreted as a definitive position in that regard.<sup>64</sup> This means that the Polish plans concerning the granting of free-of-charge emission units as a State aid measure shall be subject to official notification pursuant to Article 108(2) of the TFEU to the European Commission (DG Competition), additionally to the obligatory notifications established in Directive 2009/29/EC.

#### IV. Conclusion

1. EU ETS law is transposed into the Polish legal system by the Act of 22 December 2004 on GHG and trading in the emission allowances of other substances and the Act of 17 July 2009 on management of emissions of GHG and other substances and executive regulations to these acts.

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<sup>62</sup> Directive 2009/29/EC, Article 10 c (2), point 2.

<sup>63</sup> Directive 2009/29/EC, Article 10 c (5).

<sup>64</sup> Case T-387/04, *EnBW Energie Baden-Württemberg v. Commission*, para 136.

These acts organize Phase 2 of EU ETS in Poland. Transposition and implementation in Poland of the EU Directives which constitutes the basis of EU ETS in Phase 2 were in general of proper and appropriate quality.

2. On April 28, 2011 the Polish Parliament adopted the new ETS Act. One of the main purposes of the new act is the transposition into Polish law of amendments to the ETS Directive in the scope of changes made by Directive 2008/101/EC and Directive 2009/29/EC. Some important problems derive from the transposition into the Polish legal system of these EU Directives which constitute the legal basis for Phase 3 of EU ETS. In this paper only selected problems, connected with the scope of derogation from the auctioning general rule in Poland, have been examined.

Specific problems are related to Article 50 of the new Act on the System of Greenhouse Emission Trading, which introduces extraordinary rules for issuing emissions permits for entities who commence realization of an installation. Firstly, the fact that Article 50 of the new Act of the System of Greenhouse Emission Trading introduces an unjustifiable extension of derogation from the general rule for auctioning emission allowances provided by the amended ETS Directive is contradictory to the main goal of this Directive and therefore constitutes mistaken transposition of this Directive. Secondly, this mistaken transposition of the scope of derogation from the general rule for auctioning cannot be successful in terms of *ex post* proof of investment, which in fact was not physically initiated by the end of December 2008. The Polish Building Law Act clearly states that preparatory works (“the physical initiation of the investment process”) may be carried out on the basis of a construction permit only.

Different kinds of problems arise from EU State aid rules and assessment of the planned free-of-charge allocation to new power plants from a State aid perspective. According to a preliminary examination of the free allocation of emission allowances in the case of Poland, this free-of-charge allocation will constitute a State aid measure in the meaning of Article 107(1) of the TFUE. As a consequence it will be incompatible with the internal market as a general rule and therefore prohibited. Polish plans concerning the granting of free-of-charge emission units as a State aid measure shall be subject to official notification pursuant to Article 108(2) of the TFEU to the European Commission (DG Competition), additionally to the notification obligations established in the EU ETS Directive. After the Commission’s examination the measure in question may be considered as a State aid measure compatible with the internal market (and therefore allowed) on the grounds of Article 107(3)(c) of the TFEU.

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