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Polski Komitet Energii Elektrycznej
Polish Electricity Association

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The remarks by the Polish Electricity Association with regard to the Judgment of the Court of Justice of the European Union on Case C-5/16 concerning the complaint against the MSR Decision[1]

The judgment of 21.06.2018 given by the Court of Justice of the European Union ("**CJEU**") has finalised the case progressing since over two years, initiated by the application by the Republic of Poland asking the Court to annul the Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve ("**MSR**")[2]. The claims of the Republic of Poland were opposed by the institutions responsible for adopting the act – the European Parliament and the Council, supported by, as interveners: **Denmark**, **Germany**, **Spain**, **France**, **Sweden** and the **European Commission**. The CJEU has dismissed the action in its entirety and ordered the Republic of Poland to pay the costs incurred by the European Parliament and the Council of the European Union.

In the opinion of the Polish Electricity Association ("**PKEE**"), the above judgment has an **unprecedented significance for the interpretation of the extent of the impact of the EU environmental legislation on the energy mix of its Member States**. Part of the conclusions presented in the findings of the Court also raises justified doubts as to the correct interpretation by the Court of the impact of the functioning of the MSR.

Impact of the MSR on the energy mixes of the Member States

The key plea raised by the Republic of Poland was the infringement of Article 192 (2) point c) of the TFEU, that requires adopting the measures **significantly affecting a Member State's choice between different energy sources** and the general structure of its energy supply in accordance with the special legislative procedure, **requiring unanimous adoption by the Member States**.

To demonstrate that the MSR decision has such an impact, the Republic of Poland has presented an analysis compiled by the Krajowy Ośrodek Bilansowania i Zarzadzania Emisjami (National Centre for Emissions Management, Poland) ("**KOBiZE**"), according to which the adoption of the MSR decision (in its 2015 wording) **will lead to a significant increase in the use of natural gas in the 2035 perspective, even up to 700% of its current level.** The consequence of the MSR Decision would thus be an increase of natural gas imports and energy dependence of both Poland and the entire European Union.

The CJEU, when reviewing the above plea, has not at all referred to the analysis submitted by the Republic of Poland. Instead, it only referred to the aim stated in the MSR Decision, i.e. the problem of structural supply-demand imbalances in CO_2 emissions allowances. The CJEU has decided that the special procedure referred to in Article 192 (2) point c) of the TFEU shall be used **only and**

[1] Judgment of the CJ of 21.06.2018 on case C-5/16, Poland against the Parliament and the Council, EU:C:2018:483.

[2] Decision (EU) 2015/1814 of the European Parliament and of the Council of 6 October 2015 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and amending Directive 2003/87/EC (OJ 2015 L 264, p. 1-5).

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exclusively when the legal act explicitly states that its aim is to change a Member State's choice of energy source.

In the opinion of the PKEE, the position of the CJEU in practice eliminates the possibility to effectively invoke Article 192 (2) point c) of the TFEU. It is hardly imaginable that the EU legislators would explicitly inscribe in any legal act that its aim is to change a Member State's choice of energy source.

Moreover, the wording of Article 192 (2) point c) of the TFEU indicates that it is possible to interpret it as **the actual impact of the measure concerned** should be reviewed and not only its aims stated in its preamble or first articles. Thus, the CJEU should have assessed **to what extent in light of the available analyses such as the one presented during the proceedings by the KOBiZE, the contested decision will actually be influencing the energy mix of the Member States**. In light of our studies, the MSR Decision – by regulating the supply of emissions allowances, will be influencing the pace and with what generating units the hard coal and lignite based capacities will be replaced. An analysis based on total costs of generation indicates that with high CO_2 prices (related to the adoption of the MSR), the preferred technologies are the gas-steam power plants and the RES. Therefore, this specific environmental regulation may not be viewed in isolation from its direct impact on the energy mix, which in the case of Poland will be significant due to the need to significantly increase the natural gas imports and to transition from coal to gas and to the RES.

Impact of the MSR on carbon prices

The next element of the findings of the Court raising our doubts is the **statement by the CJEU that the MSR Decision was "by its nature, neutral" with respect to impact on the CO_2 prices**. The Court points to, among others, that the EU ETS "*does not intervene directly to set the price of allowances, the latter being determined exclusively by market forces*" (para. 63) and that the likely effect of the functioning of the Reserve "*is that it will stabilise the price of emissions rather than increase it*" (para. 65). The CJEU has at the same time pointed out that impact of the functioning of the emissions allowances system is "*an increase in the price of allowances in the future*", but at the same time "*those effects are only an indirect consequence of the close relationship between the contested decision and Directive 2003/87*" (para. 67-68). According to the CJEU's reasoning**, although the supply of allowances is related to their price, for reasons unknown, the CJ has related this fact only to the functioning of the linear reduction factor**, **while ignoring the price-making impact of the functioning of the MSR.**

This is surprising though, as the impact of the MSR on the price of allowances was broadly commented during a recently completed revision of the EU ETS, which also resulted in the strengthening of the MSR. For instance, the analytics house ICIS has pointed to the strengthening of the MSR as one of the key factors impacting the **CO_2** price[3]. Moreover, even the formal impact assessment compiled for the draft MSR Decision, referred to elsewhere in the judgment, points to a **direct impact of the MSR Decision on the change of carbon prices**[4].

[3] ICIS, *The impact of the Post-2020 EU ETS reform The Impact of Parliament, Council and Commission positions*, 10 May 2017.
[4] SWD(2014) 17 final, Brussels, 22.1.2014.

Due to the above one may get the impression that the CJEU has not more deeply considered the reasons for adopting the MSR. Although the findings of the CJEU state that the MSR addresses the main problem of the EU ETS relating to the "*large imbalance between the supply and demand of allowances*" (para. 51-53), however, in its considerations concerning the relation of the MSR and the carbon price, the Court should have taken into account the fact that the direct impact of this imbalance is a too low price of CO_2 for many market participants, as well as for the European Commission and the Parliament themselves, and for a significant number of the Member States. Therefore, it was the **problem of low CO_2 prices that was the actual driver for the legislative initiative on the development of the MSR Decision, similarly to the inclusion in the recent revision of the EU ETS Directive of the provisions strengthening the functioning of the Reserve**. The CJEU has ignored an important relation of the MSR to the CO_2 emissions prices also in the point of the findings that indicate that the MSR is not a pricing mechanism but a "quantitative mechanism" (para. 57).

The existence of a relationship between the MSR and the CO_2 prices is demonstrated by the changes taking place in the market – on the day of submission of the legislative proposal on establishment of the MSR Decision, the price of allowances was 4.93 EUR/t, and consistently increased thereafter to reach over 8 EUR/t on the day the MSR was adopted. An even more radical increase of the price of allowances was noticed in recent months. When the revised EU ETS Directive was adopted, which significantly strengthened the functioning of the Reserve, the prices of allowances have nearly doubled over six months. It is worth noting that the **present increases are motivated just by the perspective of the entry into force of the Reserve**. Therefore it is hard to accept as true the CJEU's assurances as to the "stabilising" influence of the MSR on the price of allowances (para. 65). The chart below, presenting the relationship of the carbon price to the milestones of the decision process on adoption and revision of the Reserve proves that the MSR is in practice a pricing mechanism oriented at increasing the price of allowances.

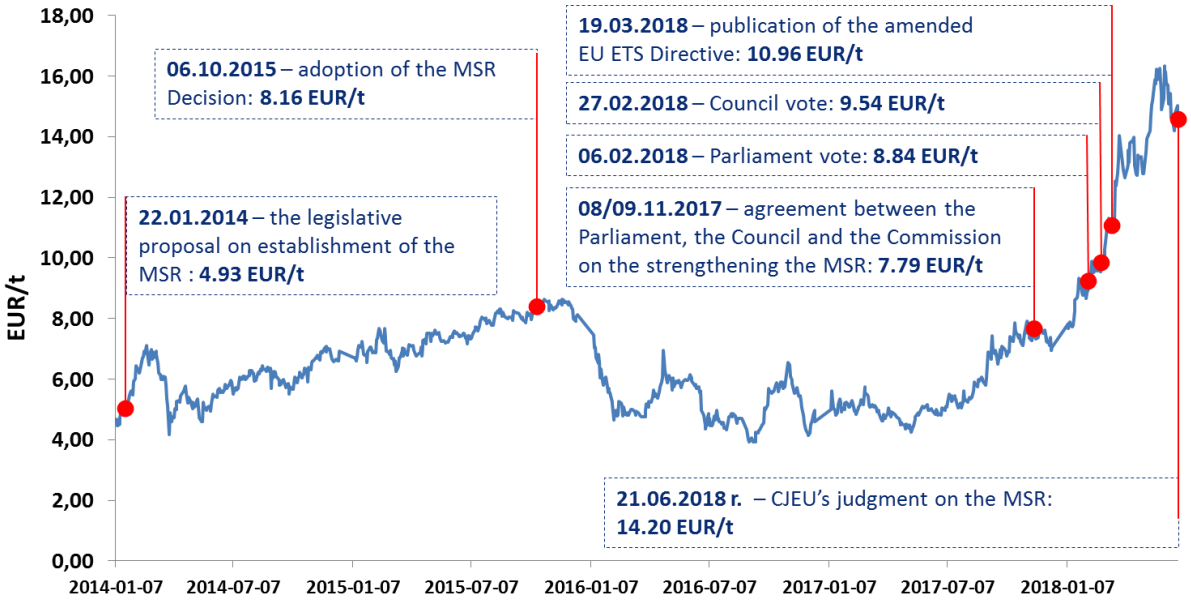

Chart 1: *Prices for CO2 emissions allowances against the milestones of the decision making process on the MSR*, source of data: eex.

At this point, it is worth noting the argument by the Council quoted in the judgment, according to which the change in prices of allowances leaves the operators with: "***the option of either buying allowances or reducing emissions, or even passing on the cost to their customers***" (para. 34). With a legally sanctioned obligation to purchase emissions allowances, technologically limited factual possibilities to reduce the CO_2 emissions, the solution recommended by the institution defending the validity of the MSR Decision becomes the passing on the cost of purchasing the emissions allowances to final consumers. **Thus, the functioning of the MSR will result not only in higher bills for households but also – in the longer run – will weaken the competitiveness of Poland's industry and its entire economy.**

MSR versus the principles of legal certainty and the protection of legitimate expectations

The next plea faced by the Parliament and the Council was the alleged infringement of the principles of legal certainty and its derivative principle of protection of legitimate expectations. As rightly pointed out by the CJEU itself in its findings in the commented judgment: "*The price signal created at EU [ETS] level is supposed to influence the operational and strategic decisions of investors*" (para. 63). Therefore, the participants in the EU ETS could have made a presumption that the number of allowances on the market will not be reduced during the still open trading period. Particularly so, as the investment decisions in the power sector are being made taking into account multiyear perspectives.

The CJEU has, however, concluded that there are no contradictions between the predictability of the EU ETS and even relatively frequent changes in the number of allowances in the market. Without referring to the recent revision of the EU ETS Directive the CJEU has pointed out that: "*the contested decision establishes objective and transparent legal rules allowing those concerned to inform themselves as to the details and establishes a transition period of a sufficient duration to allow economic operators to adapt to the new system that has been implemented*" (para. 108). Let us just add that these "objective and transparent" legal rules have already been subjected to a fundamental revision that not only **doubled the volume of allowances entered into the Reserve but also introduced partial cancellation of allowances**.

The CJEU's assurances as to the fact that the establishment of the reserve "*in which surplus allowances are placed temporarily would therefore be an appropriate solution to reduce the number of allowances, without abolishing them*" was outdated already at the moment of passing the judgment. So thus it seems the **CJEU has narrowed down the legal protection of legitimate expectations that could be based on assumption as to the stability of the legal framework concerning the EU ETS.**

Also, the credibility suffers in case of the assurances by the CJEU that "*it is a one-off intervention*" (para. 61). It is worth reminding that **over the last few years we have witnessed three regulatory interventions aimed at limiting the supply of emissions allowances**. These were, respectively: the 2014 back-loading of 900 million emissions allowances that will not enter the auctions in 2019-2020, adoption of the MSR in 2015 and strengthening of the functioning of the Reserve adopted in 2018. Therefore, we are in fact facing permanent interference with the supply of allowances, **undermining the predictability of the EU ETS for market participants and that in the long run will lead to a shift from the market based mechanism in favour of intervention mechanism**.

Transparency of the decision making process

The last part of the judgment requiring attention is the CJEU's approach to the transparency of the decision making process at the level of the European Union. The Republic of Poland submitted that the assessments made during the negotiations prior to the adoption of the contested decision **have not been made public and have also not been the subject of public consultation**. Thus, the transparency of the decision making process itself was significantly reduced as it could not have been attended by the representatives of all the stakeholders – particularly those directly affected by the consequences of the contested decision. Instead, non-public meetings were organised with participation of industries and organisations interested in raising the reduction ambitions.

The CJEU has considered such a practice as perfectly admissible, stating that: "*the non-public nature of certain consultations cannot call into question the lawfulness of the contested decision*" (item 165). In the opinion of the PKEE, **the CJEU's judgment sanctions a practice allowing only some of the stakeholders to have a guaranteed access to the decision makers in the European Union**.

The significance of the conclusions by the European Council

The judgment of the Court of Justice **casts doubt as to the sense of the heads of the Member States taking decisions of strategic nature at the level of the European Council**. The European Council has in fact set forth in the conclusions of October 2014 the date of entry into force of the MSR exactly according to the initial EC's proposal, i.e. as of 2021. This date was subsequently set forth during the discussions between the European Parliament and the Council as 01.01.2019. The findings of the CJEU are also partially contradictory, as on the one hand the CJEU discredits the fact that a specific date of functioning of the Reserve was agreed on the forum of the European Council, while on the other it admits that the "political will" expressed by the European Council has no major importance in view of the legislative powers of the European Parliament and the Council (para. 89).

It is worth noting that according to the current decision making practices relating to adoption of the climate policy instruments **it was actually the European Council that was first setting the goals of strategic nature** (such as, for instance, the 40% reduction of CO_2 emissions by 2030), **which were then implemented by the legislative acts**. This was helping to build a consensus on values of importance to the entire European Union. Discrediting the so developed way of proceeding may make it more difficult to define future climate goals of long-term nature.

Balancing the interests of the Member States

Building the political consensus on strategic issues will also not be favoured by the CJEU's declaration that **the legislature does not have to take into consideration the particular situation of a Member State** (para. 167). Thus, the Court has declared that the balance between the interests may be built in the European Union while ignoring the Member States with the most specific fuel mixes – including Poland. Such an approach, though effective and facilitating the adoption of even the most controversial solutions, **ignores the national circumstances and different starting points forming the grounds for the need for selecting solutions that are appropriate for all the Member States**.

Lessons for the future

- Firstly, the CJEU had confirmed **an almost unlimited possibility to change the supply of the allowances in the EU ETS** – significantly weakening the predictability for the participants in the EU ETS market and the CO_2 prices – one of the most important factors driving the electricity prices. Predictability is also not supported by **the further weakening of significance of the European Council's conclusions** that in this way lose their strategic nature in the environmental legislation process;
- Secondly, the CJEU's judgement shows that the **possibility to effectively invoke the Article 192 (2) point c) of the TFEU is purely illusionary** – the use of unanimity in the Council on environmental matters significantly influencing the energy mix was practically excluded by stating that the only thing that counts is the declared aim of a measure and not its actual impact;
- Thirdly, the **CJEU has reduced the extent of protection resulting out of the principle of protection of legitimate expectations**, which could be based on the wording of the key elements of the EU ETS-related legislation. Thus, the commented judgment allows for frequent changes to the rules of the game even during the progress of a specific trading period.

Therefore, even the review of the current climate legislation inscribed in the recently adopted EU ETS directive does not provide the market participants with predictability as to the date of a potential change of the legislation that directly impact their economic standing. The CJEU **has given permission to unrestricted changes to one of the most important price drivers of the EU ETS**.

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