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The New Swiss Emissions Trading Scheme



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The Swiss emissions trading scheme (*Schweizer Emissionshandelssystem*; "Swiss ETS") was launched on 1 January 2008, allowing Swiss businesses exempt from the CO₂-tax (CO₂-Abgabe) and other Swiss and foreign participants to trade CO₂ emission allowances (*Emissionsrechte*) on a national and international basis. In order to increase market liquidity, it is intended to link the Swiss ETS to the emissions trading scheme of the European Union ("EU ETS"), the world's largest emissions trading scheme.

The global CO₂ emissions trading market has grown rapidly in the last couple of years. In 2007, the value grew by 80% year-on-year to about CHF 65 billion. The EU ETS is currently the world's largest multinational CO₂ emissions market. While new emissions trading schemes are being planned, especially in North America and in Asia, Switzerland's introduction of a CO₂-tax from 1 January 2008 has created the basis for a working Swiss ETS.

What is an Emissions Trading Scheme?

An emissions trading scheme is a market-based instrument used to control emissions (such as CO₂) by providing economic incentives to emitters for achieving reductions of emissions. An emissions trading scheme operates under a so called 'cap and trade' mechanism, which sets a maximum emissions amount for a compliance period. CO₂ emitters, such as industrial businesses, are credited with emission allowances representing their individual emissions target (cap). At the end of a compliance period, the emitters must then surrender (return) sufficient emission allowances to settle against their total actual CO₂ emissions in that period.

Emitters who are able to achieve emissions reductions in a cost-effective manner, can sell unused emission allowances to businesses which cannot meet their caps and must buy additional emission allowances from other emitters or market participants (trade). This financial incentive is intended to promote environmentally beneficial measures in an economically efficient manner.

Exemption from the CO₂ tax

In order to meet its commitment under the Kyoto Protocol, Switzerland has – among other things – enacted the Federal Act on the Reduction of CO₂ Emissions (CO₂-Gesetz; "CO₂-Act"), which requires a

reduction in CO₂ emissions of 10% by the year 2010 compared to the 1990 level. It is also the legal basis of the CO₂-tax on fossil fuels (CO₂-Abgabe) levied since 1 January 2008. The CO₂-tax is an incentive tax (*Lenkungsabgabe*) aiming to promote an economical use of fossil fuels. The proceeds of the tax will be redistributed proportionally to individuals and businesses.

In order to avoid any negative consequences for the competitiveness of Swiss businesses in the international arena, businesses can be exempted from the CO₂-tax if they commit to restricting their CO₂ emissions. Businesses wishing to be exempt from the CO₂-tax must submit a proposal for an emissions cap to the Federal Office of Environment ("FOEN"). The FOEN then decides and determines the individual emissions cap applicable during the compliance period (i.e. starting in the year of exemption until 2012).

The National Emissions Trading Registry

A business exempt from the CO₂-tax must open an account in the National Emissions Trading Registry (*Emissionshandelsregister*; "National Registry") and this account will be credited with emission allowances corresponding to the emissions cap for that year. The emission allowances issued by the FOEN are free of charge, rather than being auctioned. In the EU ETS, however, the free issuance of allowances has been heavily criticised because it may permit businesses to realise windfall profits by passing on the market value of freely obtained emission allowances as costs to consumers.

The National Registry is essentially an online accounting system. Emission allowances exist only as electronic bookkeeping entries, not as securities. However, neither the CO₂-Act nor the corresponding regulations specify the legal character of emission

allowances issued by the FOEN. This is regrettable because questions about the legal status of emission allowances traded in the EU ETS have been a source of debate.

The allocation, surrender and transfer of emission allowances by the FOEN, as well as the assessment of compliance with the emissions caps are effected via the National Registry. Businesses which received emission allowances from the FOEN must annually surrender an amount of allowances equivalent to their actual CO₂ emissions in the previous year. To cover actual emissions in excess of their emissions cap, businesses must cover the shortfall by purchasing the necessary emission allowances from other participants on the market. In the event of non-compliance, the CO₂-tax is to be paid retroactively for each ton of CO₂ emitted since the exemption was granted. Surplus emission allowances, however, can be carried over to the post-2012 compliance period.

The National Registry also allows for the trade of other CO₂ emission allowances recognized by the Kyoto Protocol (e.g., emission certificates for projects in developing countries). These foreign emission allowances also can be used by businesses exempted from the CO₂-tax to offset a maximum of 8% of their emissions burden. The remaining amount has to be covered by allowances issued by the FOEN.

Trading of Emission Allowances

The Swiss ETS generally allows Swiss or foreign participants (business organisations or individuals) to trade emission allowances nationally and internationally if they have an account in the National Registry. However, the FOEN does not provide a trading platform nor does it act as a broker. Service providers from the private sector will have to perform such functions.

According to the Regulation on the CO₂-tax (*CO₂-Verordnung*), a trade of emission allowances is only valid if the transfer is recorded in the National Registry. Typically, the parties to such a transaction first sign a sale and purchase agreement and then transfer the emission allowances via the National Registry website. Once the transfer has been initiated, the account holder cannot unilaterally rescind the transaction. Therefore it is advisable for the seller of emission allowances to initiate the transfer only after the purchase price has been received.

As the EU ETS has shown, various forms of transactions are possible for the trading of emission allowances, e.g., spot contracts, as well as forward

contracts traded "over-the-counter" and futures traded on international exchanges, such as the European Climate Exchange or Bluenext.

Link-up of the Swiss ETS to the EU ETS

A key difference between the EU ETS and the Swiss ETS is that the EU ETS is a mandatory scheme. Furthermore, if a business does not surrender sufficient emission allowances to match its actual CO₂ emissions, it faces a penalty of EUR 100/ton of CO₂ and still has to obtain and surrender the required additional emission allowances.

So far, emission allowances issued by the European Union ("EUAs") cannot be traded in Switzerland, because EUAs cannot be 'exported'. However, the EU Directive establishing the EU ETS provides that agreements can be concluded to provide for the mutual recognition of allowances with third countries that have ratified the Kyoto Protocol. In order to increase market liquidity, a link of the Swiss ETS to the EU ETS would be desirable and – according to Swiss federal officials – is intended.

Conclusion

The Swiss ETS has just been launched. At present it is not known how the market will develop and when the link to the EU ETS will be established. Given regulatory and other uncertainties, it is advisable to carefully plan an exemption for the CO₂-tax. In order to maximize the opportunities provided by the Swiss ETS, particular attention should also be paid to the drafting of transactional contracts used for trading emission allowances.

The ww&p NewsLetter provides comments on new developments and significant issues of Swiss law. These comments are not intended to provide legal advice. Before taking action or relying on the comments and the information given, addressees of this NewsLetter should seek specific advice on the matters which concern them.

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