Legal action on subsidies for fossil fuels

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1 Introduction

An analysis published by the Royal Society, London,[1] warns that, *without radical action, we are likely to pass the threshold between 'dangerous' and 'extremely dangerous' climate change.* The urgency of this warning, which reflects widespread concerns amongst climate scientists, argues *inter alia* for an immediate stop to all forms of support for fossil fuels (see also Appendix A). But worldwide subsidies for fossil fuels exceed subsidies for renewables by a factor of 12,[2] and despite a commitment by G20 countries in 2009 to phase out subsidies for fossil fuels, little has been done.[3]

To encourage change, existing laws designed to ensure fair competition between businesses may serve to reduce or remove subsidies for fossil fuels and to discourage investments in fossil fuels—and thus encourage the development of renewable energy and conservation of energy. These notes expand on that basic idea.

Some people may object that an action of this sort would be too 'political'. But the fossil fuel industry is not shy of being political, working hard to inhibit meaningful action to cut emissions of CO_2. In much the same way that the tobacco industry lobbied against measures to reduce smoking, the fossil fuel industry has been and still is spending large amounts of money to influence politicians and the media, misrepresenting the conclusions of climate science, casting doubt on the feasibility of decarbonising the world's economies, and lobbying for support and protection.

2 Background

Our group, Energy Fair, has submitted a formal complaint to the European Commission (Directorate General for Competition) about State Aid for nuclear power. In essence, the complaint, which has been prepared by lawyers with specialist knowledge of competition law in the EU, is that existing and proposed new subsidies for nuclear power create unfair competition for businesses involved in the alternatives: renewables and the conservation of energy.

Our news release about the complaint, "Legal bid to halt nuclear construction" (January 2012) may be downloaded via bit.ly/Mp9Bfy.

We believe this action is useful for four main reasons:

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[1] "Beyond dangerous climate change: emissions scenarios for a new world", Kevin Anderson and Alice Bows, *Philosophical Transactions of the Royal Society A*, 369 (1934), 20-44, 2011, doi: 10.1098/rsta.2010.0290, bit.ly/dMxIIY.

[2] See "Fossil fuel subsidies are twelve times renewables support", Bloomberg New Energy Finance, 2010-07-29, bloom.bg/bqC2kt.

[3] See "Report: G20 fossil fuel subsidy phase out", Oil Change International and Earth Track, November 2010, bit.ly/dCPVl7.

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- Whether or not our complaint is upheld, it sends a signal to potential investors in nuclear power that they cannot rely on receiving subsidies for their investment. Also, it is likely that, if the complaint were to be upheld, any money that has been received by nuclear investors or nuclear operators would have to be repaid.

  Our complaint has attracted reasonably good coverage in the press (bit.ly/NeKnwH), and is proving to be of some interest in the nuclear trade press. We believe that it is a factor for investors in deciding whether or not to put money into new nuclear power stations in the UK.

- Even if the complaint is rejected, we may take the case to the European Court of Justice. This possibility creates additional uncertainty for potential investors in nuclear power.
- The complaint helps raise awareness amongst politicians of existing and proposed subsidies for nuclear power and may encourage them to reduce or remove those subsidies.
- If the complaint is upheld, or if, in a later action, the ECJ were to rule in our favour, this would have a dramatic impact on subsidies for nuclear power and the building of new nuclear plants in Europe.

3 Proposal

It appears that similar actions may be taken against subsidies for fossil fuels. Here are some points about how that may be done.

3.1 Aims

In line with what was said in Section 2, there would be three main aims in taking legal action:

- To achieve a ruling against one or more subsidies for fossil fuels.
- To send a signal to investors and business people that existing subsidies for fossil fuels are not set in concrete and may be withdrawn at any time. A recognition that subsidies cannot be relied on will help to discourage investments in fossil fuels.
- To back up campaigns such as the “End Fossil Fuel Subsidies” campaign by 350.org, sending a signal to politicians and the general public that subsidies for fossil fuels are not justified and should be removed. In particular, it would provide an incentive to strengthen the EU Emissions Trading System (see Section 4.1).

3.2 Procedure

Initially, the action would be a formal complaint to the Directorate General for Competition of the European Commission. If the complaint is rejected but the reasons given for the rejection are weak, the issue may be taken the European Court of Justice.

Since we have already gained experience with competition law in Europe, this might be the best place to start. However, at some stage, it would be very interesting to mount a similar action in the USA, especially since a US court has now recognised greenhouse gases as pollutants.[4]

To avoid making things too complicated, it is probably best to start with one country. In what follows, I’ll assume that it is the UK. Some spur to action is certainly needed since, as noted in Appendix A, the Government’s Committee on Climate Change say that the UK needs to make a fourfold increase in its efforts to cut emissions of industrial greenhouse gases.

[4] See, for example, “US court upholds EPA’s greenhouse gas rules”, The Guardian, 2012-06-27, bit.ly/N89YJq.

Although the legal arguments are likely to be the most important in any formal complaint to the EC, it seems likely that the EC will also pay attention to political, social, technical and other aspects of subsidies for fossil fuels. So I believe it is important that each complaint contains some discussion of those other aspects.

3.3 Publicity

With regard to the second of the two aims (above), a key part of any action would be good publicity:

- The novelty of this legal challenge is, in itself, likely to attract attention from the media.
- A group of NGOs is likely to have more impact with the media than one acting on its own.
- The positive aspects of the action need emphasis:
    - The action will strengthen renewables and conservation of energy in the UK, helping the country to compete in the worldwide expansion of those industries,[5] and reap the commercial benefits and jobs of the green revolution.
    - There is no need for anyone to suffer hardship from the reduction or elimination of subsidies for fossil fuels. Money that is saved by reducing subsidies (or raised by ensuring that a proper price is paid for environmental damage) may be ploughed back into zero-carbon eco-renovation of houses and other measures to reduce costs to consumers, with a particular emphasis on the needs of low-income households.

3.4 Costs

There is no charge for submitting a formal complaint to the Directorate General for Competition of the European Commission (see bit.ly/M3DpuG). But the complaint really does need to be prepared by lawyers who are familiar with European competition laws and there may be associated costs.

4 Subsidies for fossil fuels

This section describes, in decreasing order of their apparent sizes, what appear to be the main subsidies for fossil fuels that apply in the UK. Any or all of them may be the subject of a complaint.

Where appropriate, each subsection includes possible counter-arguments that may be made, including arguments that the given subsidy is not a subsidy, that the subsidy is justified, or that the subsidy is offset by taxes, regulations or other measures.

4.1 Release of CO_2 into the atmosphere

To a large extent in the UK, and throughout the world, the atmosphere is still being used as a free disposal area for CO_2. Although failure to charge for the environmental damage caused by CO_2 has not traditionally been recognised as a subsidy for fossil fuels, it means real money in the pockets of businesses in the fossil-fuel industries, and it gives them a substantial commercial edge in the competition which exists between those businesses and other businesses concerned with renewables and the conservation of energy.

[5] Around the world, the average annual growth of wind power in recent years has been more than 27% (bit.ly/A5fWmx) and the annual growth in solar power has been about 30% (bit.ly/zFs1W1). In 2010, the worldwide growth of solar power was an impressive 70% (reut.rs/wWhSoi).

The EU Emissions Trading System was meant to solve this problem. But more than 50% of EU emissions are not covered by the EU ETS. And the practice of giving away allowances for nothing, giving away too many of them, and the effects of the current downturn in economic activity, means that there is now a substantial over-supply of allowances.[6] As a consequence, the price of allowances has collapsed by about 60 per cent in the 12 months to June 2012 and is now about €6 per tonne.[7]

4.1.1 Possible counter-arguments

- *The EU ETS is being fixed?* It may be argued that the problem with the EU ETS is temporary and that it will work better in the future. But there have been persistent problems with the workings of the EU ETS over a long period.[8] It seems prudent to assume that, for some time, the price of fossil carbon under the EU ETS will remain too low.
- *The "carbon price floor" fixes the problem?* The UK's Finance Act 2011 introduced a "carbon price floor", ostensibly to compensate for the failings of the EU ETS. But it is simply a tax on fuels used for the generation of electricity (with an exemption for uranium) and does nothing to raise the price of fossil carbon that is used for space heating, aviation, transport by road and rail, industrial processes, and so on.
- *Carbon capture and storage (CCS) will solve the problem?* CCS has not yet been demonstrated on a commercial scale. If it can be shown to work effectively, and if it is actually installed and used, then objections to the use of fossil carbon would be much reduced. But these are big 'ifs' and the problems of fossil carbon remain in areas such as aviation where CCS cannot be applied.

4.1.2 What is the proper price of fossil carbon?

In order to determine the size of the subsidy arising from the under-pricing of fossil carbon, we need to know what the proper price should be. With the EU ETS as it is now, €6 per tonne is clearly too low.

With greater discipline in the rationing of fossil carbon, as in the Kyoto2 proposals,[9] and with the auctioning of permits to extract coal, oil and gas from the ground, a more realistic price would be revealed. Pending the introduction of such a system, the price must be estimated.

As an example of the kind of figure we should be considering, the UK's Department of Energy and Climate Change (DECC) provides a 'central' estimate that, in 2012, the price of 'non-traded' carbon (ie carbon that is outside the EU ETS) would be, at 2011 prices, £56 per tonne of carbon (€69.7/tC).[10] The non-traded price appears to be the most appropriate figure to use because of the deficiencies in the EU ETS.

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[6] See, for example, "Emissions trading scheme could be oversupplied until 2024", Business Green, 2012-06-12, bit.ly/NveJhz.
[7] See, for example, "EU must take 'decisive action' to shore up carbon price", Business Green, 2012-05-30, bit.ly/LFdq9V.
[8] See, for example, "EU emissions trading scheme on course to make tiny savings, says report", The Guardian, 2010-09-10, bit.ly/az4wy1; "EU Emissions Trading System: failing at the third attempt", PDF, Corporate Europe Observatory, April 2011, bit.ly/Lmq9VX.
[9] See www.kyoto2.org and www.k2support.org.
[10] "A brief guide to the carbon valuation methodology for UK policy appraisal", Department of Energy and Climate Change, October 2011, bit.ly/LStl5d.

Taking the difference between €69.7/tC and €6/tC (the current price of carbon under the EU ETS, mentioned earlier), we arrive at a figure of €63.7/tC as the size of the subsidy for fossil carbon arising from the failure of the EU ETS to internalise the environmental cost of emissions of CO_2.

4.1.3 How to remove the subsidy

Since, as suggested in Section 3, the complaint would be about one country—let's assume that it would be the UK—the implication of a favourable ruling would be that the UK government should introduce new taxes to compensate for the failings of the EU ETS.

This is not impossible (see the remarks about the "carbon price floor" in Section 4.1.1) but it would make much more sense to reform the EU ETS to ensure that the cost of environmental damage is included in the price of fossil carbon.[11]

Either way, legal action against subsidies for fossil fuels, including the under-pricing of emissions, will create pressure to reduce or remove the subsidies.

4.2 Reduced rate of VAT on fuels used for space heating

In the UK, gas, heating oil and solid fuels, used in domestic, residential, charity and other non-business premises, attract VAT at the 'reduced rate' of 5%, a substantial discount compared with the standard rate of 20% and a clear subsidy for fossil fuels.

Since the same reduced rate is charged for electricity that is used in the same kinds of premises, and since much electricity is generated via the burning of fossil fuels, there is a further indirect subsidy for fossil fuels (but see the remarks about the "carbon price floor" in Section 4.1.1).

4.2.1 Possible counter-arguments

- *People have grown used to cheap fuel*. Householders, charities and other beneficiaries have grown used to the concession and may protest if it were to be removed. But that in itself is not a reason for retaining the subsidy. It is very inefficient to have a blanket subsidy like that when it is just low-income households that need protection.

  The existence of this subsidy simply encourages the continued use of fossil fuels for space heating and discourages the development of alternatives including zero-carbon eco-renovation,[12] heat pumps, geothermal district heating,[13] the production of biogas via the anaerobic digestion of waste organic matter,[14] and more. Given the urgent need to cut emissions, this perverse incentive should be removed.

  Removing this subsidy, and the under-pricing of CO_2 emissions (Section 4.1), would raise a lot of money. Some or all of that money may be used to sweeten the political pill, via grants or soft loans to help the creation of comfortable, affordable, zero-carbon homes, with a particular emphasis on households with smaller incomes.

[11] To ensure that all fossil carbon is covered (not under 50% as the EU ETS is now) and to achieve the necessary discipline in carbon budgets, it makes sense to use "upstream" controls on coal, oil, and gas, at or near the point where they are extracted from the ground (see "'Upstream' reform of the EU Emissions Trading System", PDF, Kyoto2 Support Group, bit.ly/LiQvlq; and "Turn off greenhouse gases at source", PDF, Kyoto2 Support Group, bit.ly/MJYc9a). Border-levelling measures in the proposals protect high-emissions businesses from unfair competition.
[12] See, for example, "Zero-carbon eco-renovation", bit.ly/O5tS5m.
[13] See, for example, "E.ON heats up plans for five deep-geothermal power plants", Business Green, 2012-07-03, bit.ly/P4vm5S.
[14] See, for example, "Ban food waste from landfill for renewable energy, urges thinktank", The Guardian, 2012-07-03, bit.ly/MrMr87.

- *The Green Deal will solve the problem?* It may be argued that removal of the subsidy is unnecessary since the Government has already introduced a scheme, the 'Green Deal', to encourage the upgrading of homes with insulation, heat pumps, and the like. But considerable doubts have been expressed about the scheme as it is now, with the Government's own impact assessment suggesting that, under the scheme, the number of new projects to install loft and cavity wall insulation is likely to drop dramatically.[15]
- *Replacing one subsidy with another?* Another possible objection is that funnelling new money into subsidies for insulation, renewable heat, and so on, is simply replacing one kind of subsidy with another. But it is widely accepted that subsidies for fossil fuels are not justified, whilst there is a well-established principle that governments are justified in providing support for new technologies and new industries, especially if their development has strategic importance for the country and for the health of the planet.

4.3 A possible tax break for fracking

It has been reported (2012-12-02) that "George Osborne is expected to use his Autumn Statement this week to announce tax breaks for companies that carry out controversial fracking ...".[16]

4.4 A subsidy for oil and gas prospecting in the UK

In the UK budget of March 2012, the Government introduced a £3bn tax break for offshore gas fields,[17] with an additional £500m announced later.[18] The later report says "Greenpeace ... attacked what it said was a 'bonkers' decision to give the gas industry more support than offshore wind power, which was cleaner and would also provide many jobs."

It has also been reported that, in the same budget, the Government introduced a new subsidy to support drilling for oil in the waters to the West of the Shetland Islands.[19] It appears from this report that the Government might try to justify that subsidy as compensation for an earlier increase in taxes on oil and gas.

Given the urgent need to cut emissions, there is no justification of any kind for subsidising the drilling of new oil or gas wells. As with the other subsidies for fossil fuels described above, encouragement for old, dirty sources of power work against the development of the new technologies and new industries that are now urgently needed in the fight against climate change.

4.5 A 'brown field' tax allowance for work in existing offshore oil fields

The Guardian reports on 2012-10-24 that "The government unveiled a 'brown field' tax allowance last month after a long period of lobbying from an [oil] industry that has seen drilling levels plunge despite high oil prices."[20]

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[15] See, for example, "Green deal would see home insulation rate plummet", The Guardian, 2012-06-11, bit.ly/LMrK4c.
[16] See "Osborned to offer tax breaks for shale gas", The Independent, 2012-12-02, ind.pn/WBlSx5.
[17] See, for example, "Budget 2012: oil and gas industry gets £3bn tax break to encourage drilling", The Guardian, 2012-03-21, bit.ly/GCIAOU.
[18] "Coalition spat on energy set to resume", Financial Times, 2012-07-25, on.ft.com/MnuFPD.
[19] See "North Sea oil wins subsidies", City AM, 2012-03-22, bit.ly/M6Ioe4.
[20] See "North Sea tax break expected to create thousands of jobs", The Guardian, 2012-10-24, bit.ly/UDgQnC. See also "Budget 2012: upstream oil and gas taxation ('North Sea tax')", Department of Energy and Climate Change, bit.ly/RGULzL; and DECC's web page on the taxation of oil and gas exploration and production in the UK at bit.ly/RXoSCk.

4.6 New subsidies for shale gas?

It appears that the Government is considering the possibility of providing a "generous new tax regime" to encourage investment in shale gas.[21]

4.7 Free allocation of allowances under the EU ETS

The free allocation of allowances under the EU ETS, mentioned Section 4.1, has proved to be another kind of subsidy for fossil fuels. Although allowances have been given to companies for nothing they have, in many cases, been able to make windfall profits by passing on the supposed cost of those allowances to their customers.[22]

5 Conclusion

I believe that this proposed action is likely to be cost effective. Its impact is likely to be quite large, and the likely cost is, relatively speaking, quite modest.

With good publicity, the action will add usefully to the growing pressure to remove subsidies for fossil fuels.

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[21] See "UK may lift curbs on shale gas, offer tax help", Reuters, 2012-10-08, reut.rs/QOPwzN.

[22] See, for example, "EU Emissions Trading System: failing at the third attempt", PDF, Corporate Europe Observatory, April 2011, bit.ly/Lmq9VX.

Appendix A. Additional evidence of the urgency of the need to cut emissions of CO_2

- Climate scientist James Hansen and colleagues argue that, to minimise the risks of dangerous climate change, the concentration of CO_2 in the atmosphere should be no higher than 350 ppm.[23] The present concentration is 394 ppm.
- The German Advisory Council on Global Change (WBGU) argue from peer-reviewed climate science that, to minimise the risk of dangerous climate change, there must be a global limit (a 'budget') for emissions of CO_2. According to their calculations, the budget will be exhausted within a few years unless there are sharp cuts in emissions.[24]
- According to the UK government's Committee on Climate Change, the UK needs to make a fourfold increase in its efforts to cut emissions of industrial greenhouse gases.[25]
- Apart from adding to the risk of dangerous climate change, the extraction of fossil fuels can pose risks for sensitive ecosystems such as the Arctic or tropical rainforests.[26]

Although there is still a lot of resistance, attitudes are beginning to change. According to the Carbon Disclosure Project's Global 500 Climate Change Report 2012, 37% of the world's top 500 companies see the physical risks of a changing climate as a real and present danger, up from just 10% two years ago.[27]

[23] "Target atmospheric CO_2: where should humanity aim?", James Hansen *et al*., *The Open Atmospheric Science Journal*, 2, 217-231, 2008, bit.ly/Tj2DJ2.
[24] "Solving the climate dilemma: the budget approach", German Advisory Council on Global Change (WBGU), 2009, bit.ly/PGDqUa.
[25] See "UK needs "fourfold increase" in emissions-cutting efforts", Business Green, 2012-06-29, bit.ly/LjKDK3.
[26] See, for example, "World's conservation hopes rest on Ecuador's revolutionary Yasuni model", The Guardian, 2012-09-03, bit.ly/TbMqpN.
[27] See, for example, "Rising number of top firms believe climate change is threat to business", The Guardian, 2012-09-12, bit.ly/Qj38Re.