

Non-paper on reporting requirements for pass-through of ETS2 costs – consultation with stakeholders

1. Introduction

Article 30f(3) of the EU ETS Directive (Directive 2003/87/EC) states that *“From 1 January 2028, Member States shall ensure that, by 30 April each year until 2030, each regulated entity reports the average share of costs related to the surrender of allowances under this Chapter which it passed on to consumers for the preceding year. The Commission shall adopt implementing acts concerning the requirements and templates for those reports. (...)”*

This note sets out the conceptual draft design for developing such reporting rules, with the objective of providing meaningful data to assess cost pass-through while minimising the administrative burden on regulated entities (RE), Member States (MS) and the Commission. This note outlines a **draft framework** regarding the rules of the Implementing Act pursuant to Article 30f(3) on ETS2 RE' reporting of cost pass-through on which **we seek feedback from** stakeholders in order to advance towards a more advanced design.

2. Regulated entities reporting of ETS2 cost pass-through

2.1. Overall approach

The reporting of the cost pass-through (CPT) constitutes an additional reporting requirement for RE, which may impact notably RE with limited administrative capacity and less sophisticated accounting standards and processes. **It is therefore proposed that reporting requirements are differentiated depending on the size of reported emissions.** Large RE would be required to calculate their CPT based on more detailed business & accounting data which would be validated by a financial auditor. Simplified rules for CPT reporting would apply to smaller RE, allowing them to rely on conservative estimates and not require an audit of their reported CPT. In all cases, only the CPT rate would be reported to ensure confidentiality of commercially sensitive information.

Based on a preliminary assessment and a first feedback from MS, the Commission is considering to define as large RE those meeting or exceeding one the following two thresholds:

- 1) A threshold related to the absolute amount of ETS2 emissions.** This threshold would take a market-neutral approach by identifying 'large' REs based on an EU-wide harmonised threshold. However, the market size differences across Member States entail that REs falling under the standard reporting obligation would more likely be located in the larger EU MS.
- 2) A threshold related to the emission share in a national fuel market by 'fuel type' as explained below.** This threshold is set in relation to the market size of each MS and captures REs with a strong supply position in smaller markets.

The combination of the two thresholds would capture both RE with a strong supply position in a certain fuel type and RE supplying volumes of fuels that are deemed significant.

For the definition of the 2nd threshold mentioned above, it would be necessary to categorise the fuel streams reported by RE into aggregated ‘fuel types’ which can be considered to belong to the same ‘market’. This is necessary because different RE might use different names for the same type of fuel streams in their annual emissions report. For example, ‘gasoline’ could be split into multiple fuel streams (e.g. by means through which released for consumption, or scope factor methods, or biofuel content).

The level of aggregation of ‘fuel types’ should be aligned with the use in respective markets. For example, gasoline and diesel are sold at different prices, hence should be considered distinct from each other and not aggregated into one single type of e.g. ‘liquid transport fuel’. While a higher disaggregation may allow for a more nuanced analysis of price impacts, for simplicity and to limit administrative burden, the following aggregation of fuel streams into fuel types could be proposed:

Fuel stream	Aggregated fuel types
Gasoline	Gasoline
E5, E10 etc.	
E85, etc.	
Diesel	Diesel
B7, etc.	
Light fuel oil	Heating oil
Heavy fuel oil	
Natural gas	Natural gas
Liquefied petroleum gas (LPG)	LPG
Hard coal	Coal
Briquetted coal	
Any other fuels (e.g. pure biofuels) or additives (MTBE, etc.)	No CPT reporting required

In order to streamline the aggregation of fuel streams into fuel types and to facilitate the work of competent authorities, the Commission will look into fine-tuning the annual emission report template and the EU ERT.

Questions for stakeholders:

1. Do you have reservations on the overall draft approach?
2. Which values would you consider appropriate for the thresholds (x tons of CO2 for threshold 1 and Y % of emissions share for threshold 2)?
3. Do you agree with the proposed definition of fuel type to determine different fuel markets?

2.2. Conditions for reporting on CPT

2.2.1. Reported data

Cost pass-through arises when a business changes the prices of the products or services it supplies following a change in its incurred costs. With the start of the ETS2 market, the cost pass through of ETS2 costs would be defined as:

$$\text{cost pass through (CPT) rate} = \frac{\text{ETS2 costs passed through}}{\text{ETS2 costs incurred}}$$

In order to minimise the RE's administrative burden and to ensure confidentiality of commercial information, all RE would annually have to report just a single aggregated figure, which is the share of ETS2 costs that are passed through in their fuel sale price (CPT rate).

2.2.2. Methodology to calculate CPT

In order to report the CPT rate, RE need to determine (i) the costs related to the surrender of ETS2 allowances and (ii) the ETS2 component embedded in their sale price. While ETS2 costs can be defined more clearly and calculated or approximated in a more precise manner, it appears less evident to provide broadly applicable guidance on how the ETS2 price component should be extracted from fuel sale prices.

Rules to define ETS2 costs

To measure and monitor the pass-through of costs, one needs to define which costs can be counted as those 'related to the surrender of allowances', i.e. eligible costs. The costs RE incur when participating in the ETS2 are comprised of the purchase price of the allowances, and ancillary costs which include the cost of developing relevant organisational structures, MRV costs, registry costs, costs related to allowance acquisition and trading. In general, it will be necessary to include the definition of eligible costs in guidance document related to cost pass-through reporting to ensure that RE understand what their reporting refers to and which costs should be taken into account.

Research related to the ETS1 shows¹ that total ancillary costs for ETS1 are generally lower than 1 EUR per allowance (per t of CO₂). However, the entity's size influences the importance of ancillary costs, with small regulated entities generally incurring higher costs per allowance. For the ETS1, for example, one study estimated average ancillary costs of 3.34 EUR/tCO₂e for low emission installations (i.e., installations with less than 25,000t annual CO₂e emissions).²

Due to the similarities between the ETS1 and the ETS2 monitoring, reporting and verification, ancillary costs under the ETS2 could be somewhat comparable to the ETS1 ancillary costs to larger entities. However, ETS2 is likely to cover a significant share of regulated entities with annual emissions that are lower than those from low-emissions installations covered by the ETS1.

One option would be to **define eligible costs as the costs of ETS2 allowances**, without considering any ancillary costs. This would provide an accurate estimate for RE whose ancillary costs are marginal compared to the allowance price (i.e. medium and large RE). In addition, it puts little

¹ [EU ETS Directive Evaluation 2015](#)

² Green, C.; Sharman, A.; Calero, J.; Menadue, H.; Kong, M. A.; Wisniewska, L.; Soleile, S. (2016): Evaluation of EU ETS Monitoring, Reporting and Verification administration costs, Final report, 2016. <https://data.europa.eu/doi/10.2834/640029>

administrative burden on RE, the Commission, and Competent Authorities. However, this option would likely lead to a lack of accuracy, as ancillary costs may be a substantial cost component for some RE, particularly for smaller ones.

Another option would be to **define eligible costs as the allowance costs plus MRV costs**. This option is based on research related to the ETS1 indicating that MRV costs are a major cost component of total ancillary costs and a good proxy for total ancillary costs³. This option would lead to a more accurate reflection of ancillary costs compared to the simplest option of only including the allowance price. However, it would come with an increased administrative burden for the Commission and the Competent Authorities (in terms of data processing) as well as for RE, as they would have to document all activities related to MRV.

Based on the analysis outlined above, it is proposed that:

- a) Eligible costs for large RE are the cost of ETS2 allowances, defined as the average price of ETS2 allowances in the relevant year. This would provide an accurate estimate, as for those regulated entities ancillary costs are expected to be marginal compared to the allowance price. However, a large RE would have the option to add incurred MRV costs as eligible costs.
- b) For small RE the ancillary costs may be a more substantial component of overall ETS2 costs. In order to keep in check the administrative burden of smaller RE, simplified reporting would allow to add to the cost of ETS2 allowances a conservative estimate of MRV costs.

Rules to define pass-through of ETS2 costs

The ability to extract the component of sale price reflecting ETS2 costs may differ substantially across RE, depending on their size, price-setting internal process, accounting standards and administrative capacity. As initial analysis, the following options have been identified, on which we seek feedback from stakeholders.

The option to have no dedicated rules for the calculation of the CPT has been discarded. While this option would leave full flexibility for calculation of CPT at the level of RE and may cater for their heterogeneity, this would make the verification of the calculations more difficult, or even unfeasible. Furthermore, having different methods would limit comparison of the cost pass through data between RE.

Option 1 makes reference to EU/ international accounting principles, but no explicit rules prescribed. The following elements could be considered:

- International Financial Reporting Standard (IFRS) 14⁴ for a requirement of disclosure of costs deferred (e.g. network charges) and recovered from consumers later
- IFRS 15⁵ for rules on identifying performance obligations (e.g. fuel supply to each consumer), to determine the transaction prices and allocating the transaction costs

³ Green, C.; Sharman, A.; Calero, J.; Menadue, H.; Kong, M. A.; Wisniewska, L.; Soleile, S. (2016): Evaluation of EU ETS Monitoring, Reporting and Verification administration costs, Final report, 2016. <https://data.europa.eu/doi/10.2834/640029>

⁴ <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-14-regulatory-deferral-accounts/>

⁵ <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/>

This option still leaves flexibility to the RE by requiring the application of internationally recognized accounting principles but not prescribing which. It should also allow to leverage RE's existing accounting, at least to some extent. It is not fully clear to what extent this guidance would be broadly applicable to and implementable by all RE.

Option 2 would be to require that the CPT is based on detailed relevant information, which could include:

- **Time-series of product prices:** e.g. [quarterly] average product price over the last [5] years.
- **Product price differentiated by type of consumer, to the extent available:** e.g. by type of sectoral use (CRF category), by households or commercial purposes, etc. Such distinction would be limited to the respective methods applied to determine the 'scope factor' for monitoring emissions.
- **Product prices decomposed into their relevant cost components:** e.g. energy component, taxes and levies, ETS2 compliance costs, , etc.

While this option significantly increases data quality and strengthens the Commission's ability to detect any improper behaviour, it would also impose a higher administrative burden on RE.

Questions for stakeholders:

4. Feedback on analysis of expected ancillary costs.
5. Feasibility of reporting option 1 from a stakeholder point of view.
6. Feasibility of reporting option 2 from a stakeholder point of view, and feedback on which type of detailed product price information is more appropriate and/or readily available.
7. Feedback on using different reporting options for large and small RE.
8. Extent to which reporting would depend on the RE being a part of a wider group of companies or part of a corporation and their related reporting requirements.
9. Are IFRS standards widely used by ETS2 RE?
10. Do you identify alternative options, accounting standards or national accounting rules that can be used to define cost pass-through?
11. Do you know any examples of similar exercises aiming at isolating the impact of one variable cost component in the sale price? E.g. cost pass-through of a specific tax?

2.3. CPT Audit

As it is proposed that only the CPT rate is reported by RE, some safeguards on large RE need to be in place to ensure quality and accuracy of reported data. Third-party verification is widely regarded as a means to enhance the robustness and reliability of reported data. Therefore, the CPT report should undergo some form of verification.

For large RE under standard reporting, it is proposed that the methodology as well as the detailed data and information used to calculate the reported CPT rate is subject to third-party audit. It is proposed that such audit is carried out by an independent financial auditor, as the reported data falls under a company's financial information. The corresponding requirements for verification

(‘materiality threshold’, ‘level of assurance’, etc.) could be incorporated directly in the forthcoming implementing act pursuant to Article 30f(3). These elements need to provide auditors with a clearly defined framework against which data can be verified.

The independent auditor would need to have access to the full data underpinning the calculation of the CPT rate by the RE. It would provide a statement describing the methodology and type of data used, and certifying their compliance with the methodological requirements. This statement could be annexed to the RE’ annual emission report.

In the case of REs subject to simplified reporting, it is proposed not to impose any verification requirements in order to keep in check additional administrative costs for small RE.

Questions for stakeholders:

- 12. What are your views on how to ensure data quality and accuracy for reported data on cost-pass through? Do you see alternative options to the one proposed?
- 13. Feedback on audit by a financial auditor based on the chosen options above.
- 14. What would you consider as suitable thresholds for materiality and level of assurance?

2.4. Summary of proposed options

	Standard reporting for large RE	Simplified reporting for smaller RE
Definition of RE size in the context of CPT reporting	Above/equal [XX%] share in a national fuel market or above/equal [YYY] kt ETS2 emissions	Below [XX%] share in a national fuel market and [YYY] kt ETS2 emissions
Data reported to CA	CPT rate	
Methodology for eligible cost	EUA 2 costs + option to add incurred MRV costs	EUA 2 costs + option to add conservative estimate of MRV costs
Methodology for CPT	Options with different flexibility; possible differentiation for large/small REs	
CPT audit	Yes	No