ENERGY TRANSITION PARTNERSHIP

REPORT

Assessment of the Legal and Policy Landscape for Preparing the Philippines Carbon Pricing Instrument

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Introduction

The Philippines, in pursuit of sustainable development and climate resilience, is considering the adoption of a carbon pricing instrument (CPI) to curb greenhouse gas (GHG) emissions and foster a greener economy. Carbon pricing is a tool for achieving emissions reduction targets, and it generally manifests in two principal forms - a carbon emissions trading system (ETS) and a carbon tax. Each instrument operates on a different principle; the ETS, also known as cap-and-trade, sets a maximum allowable level of emissions and allows entities to buy or sell permits to emit carbon dioxide within that cap. On the other hand, a carbon tax directly sets a price that emitters must pay per ton of carbon dioxide released, functioning as a straightforward fiscal policy.

These instruments require distinct legal frameworks to be effective. An ETS necessitates a complex regulatory setup that includes tracking emissions, issuing and trading permits, and monitoring compliance. This system depends on robust legal mechanisms to enforce caps and manage the trading scheme credibly. Conversely, implementing a carbon tax is relatively simpler, focusing on tax collection mechanisms and ensuring compliance through existing fiscal systems.

The aim of this report is to evaluate the Philippines' policy landscape and institutional frameworks to determine their suitability for adopting a CPI. It will identify alignments and conflicts within the existing policies, particularly in relation to introducing an ETS or a carbon tax. The analysis focuses on the compatibility of current national fiscal policies and sector-specific regulations in key areas such as power, transport, and industry, offering insights into the country's readiness to implement a CPI.

Emissions Trading System

Carbon emissions trading is a market-based approach that allows the market to determine the most cost-effective path to achieve emissions reductions. This differs from a “command and control" approach, where governments impose specific limits or standards on the amount of pollutants that can be emitted by companies, industries, or other entities.

The classic emissions trading mechanism is a “cap-and-trade” system. A cap-and-trade system establishes an overall limit on emissions, which determines the total number of allowances available. Each allowance grants the holder the right to release a specified amount of a particular type of emission. These allowances are typically distributed directly to participating entities, though they may also be allocated differently or auctioned. Entities covered by the program are required to hold enough allowances to match their emissions, with the flexibility to trade allowances among themselves.[1]

[1] David Harrison Jr. et al., 'Using Emissions Trading to Combat Climate Change: Programs and Key Issues' (2008) 38(6) Environmental Law Reporter News & Analysis 10367

An emissions trading system can also include a voluntary carbon market (VCM), which allows companies, organizations, and individuals to offset their carbon emissions by purchasing credits that fund climate-positive projects. Credits are generated by specific projects that remove or reduce emissions, such as: afforestation or reforestation (planting trees to absorb carbon dioxide, CO_2), renewable energy projects (solar, wind, hydropower), energy efficiency projects (improving energy use in buildings or factories), and carbon capture and storage (technology that captures CO_2 before it enters the atmosphere). Many companies with regulatory obligations in an emissions trading system also choose to go beyond compliance by offsetting additional emissions through voluntary carbon credits. For example, a company might purchase credits to offset emissions that are not covered under the emissions trading system.

Legal Framework Governing the Establishment of a Carbon Emissions Trading System

Enabling and Synergistic Policies

Power of the Government to Protect the Environment

Under the concept of "police power," the state has inherent authority to enact laws, regulations, and measures to promote public health, safety, morals, and general welfare. It is one of the fundamental powers of the government.

There is constitutional basis for the government to impose a cap on emissions. Article I, Section 16 of the Constitution provides that:

> Section 16. The State shall protect and advance the right of the people to a balanced and healthful ecology in accord with the rhythm and harmony of nature.

The sovereign right of the government to regulate the country's resources is found in Article XII, Sec. 2, which provides:

> Section 2. All lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State. With the exception of agricultural lands, all other natural resources shall not be alienated. The exploration, development, and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may enter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations at least 60 per centum of whose capital is owned by such citizens.[2]

[2] Foreign ownership restriction does not apply to renewable energy projects. For the transport sector, Republic Act No. 11659 was issued to amend the Public Service Act to allow 100% foreign

> Such agreements may be for a period not exceeding twenty-five years, renewable for not more than twenty-five years, and under such terms and conditions as may provided by law. In cases of water rights for irrigation, water supply, fisheries, or industrial uses other than the development of waterpower, beneficial use may be the measure and limit of the grant. x x x"

Under the Philippine jurisprudence, the Supreme Court has long upheld the ability of the government to impose environmental restrictions. In *Oposa v. Factoran*,[3] the Supreme Court, recognizing the principle of intergenerational equity, established that the government has a duty to protect the environment for both current and future generations.

Power of the Government to Establish a Trading System

The establishment of a carbon credit trading system is likewise a valid exercise of police power. Under Article XII, Section 1 of the Constitution:

> **Section 1.** The goals of the national economy are a more equitable distribution of opportunities, income, and wealth; a sustained increase in the amount of goods and services produced by the nation for the benefit of the people; and an expanding productivity as the key to raising the quality of life for all, especially the underprivileged.
>
> The State shall promote industrialization and full employment based on sound agricultural development and agrarian reform, through industries that make full and efficient use of human and natural resources, and which are competitive in both domestic and foreign markets. However, the State shall protect Filipino enterprises against unfair foreign competition and trade practices. In the pursuit of these goals, all sectors of the economy and all regions of the country shall be given optimum opportunity to develop. Private enterprises, including corporations, cooperatives, and similar collective organizations, shall be encouraged to broaden the base of their ownership. (emphasis supplied)

The foregoing supports the establishment of an ETS by aligning environmental and economic objectives. It emphasizes industrialization and economic growth that is both competitive and sustainable. An ETS aligns with this by incentivizing industries to adopt cleaner, more efficient technologies. Furthermore, it encourages private enterprises and collective organizations to broaden their ownership base. An ETS creates opportunities for private entities, cooperatives, and local communities to participate in the green economy, through a low-carbon development pathway.

It is important to note that in other jurisdictions, carbon credits are considered commodities rather than securities. This is an important distinction because if carbon credits were to be considered a security rather than a commodity, it would fall under the scope of the Securities Regulation Code, which means that participants would need

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ownership of these sectors are now considered public: telecommunications, railway, expressway, airport, and shipping

[3] G.R. No. 101083 July 30, 1993.

to comply with disclosure, reporting, and other legal obligations under the Securities Regulation Code. It would also mean that the Securities and Exchange Commission ("SEC") would have regulatory oversight. There is a broad definition of a "security" if certain conditions are met, that is, if the security consists of shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character.[4] If, for instance, the carbon credit represents a certificate of participation in a profit-sharing agreement or involves fractional ownership in an environmental project, it could be considered a "security." Thus, it is important that the definition of a carbon credit could not be interpreted as security when eventually drafting a regulatory instrument. This is especially significant if the regulation of the emissions trading system will be assigned to the Department of Environment and Natural Resources (DENR).

Commitments under International Law

The Constitution explicitly recognizes international law as part of the Philippine legal system. Article II, Section 2 states: "The Philippines renounces war as an instrument of national policy, **adopts the generally accepted principles of international law as part of the law of the land**, and adheres to the policy of peace, equality, justice, freedom, cooperation, and amity with all nations. (emphasis supplied)" As such, international treaties that the Philippines have signed and ratified form part of the law of the land.

In relation to climate change, the Philippines has obligations under the following treaties: the United Nations Framework Convention on Climate Change (UNFCCC), the Kyoto Protocol, and the Paris Agreement. Under the UNFCCC and the Kyoto Protocol, the Philippines, as a developing country and a Non-Annex I Party, does not have binding GHG reduction targets. The UNFCCC recognizes the principle of common but differentiated responsibilities and respective capabilities (CBDR), acknowledging that developed countries (Annex I Parties) bear greater responsibility for reducing emissions due to their historical contributions to climate change. While the Kyoto Protocol imposed binding emission reduction targets only on Annex I countries, the Philippines' obligation as a Non-Annex I country focuses on reporting and transparency rather than mandatory GHG reductions. The Philippines is required to periodically submit National Communications and Biennial Update Reports, which include information on its GHG emissions, mitigation measures, and adaptation strategies. The country is also encouraged to implement mitigation actions voluntarily, aligned with sustainable development goals, though these actions are not legally binding under either the UNFCCC or the Kyoto Protocol.

On the other hand, under the Paris Agreement, all State Parties, regardless of their level of development, are committed to taking action to limit global temperature rise to well below 2°C above pre-industrial levels, with efforts to limit the increase to 1.5°C. The central mechanism for achieving this goal is through Nationally Determined Contributions (NDC), which are the commitments that each country sets for GHG

[4] Section 3.1 of the Securities Regulation Code ("SRC")

emissions. Unlike previous agreements like the Kyoto Protocol, where only developed countries had binding reduction targets, the Paris Agreement requires all countries to participate by submitting and updating their NDCs every five years.

Under the Paris Agreement, the Philippines submitted its NDC in 2021 ("PH NDC 2021"), committing to a 75% reduction and avoidance in greenhouse gas (GHG) emissions by 2030, with 2.71% as unconditional and the remaining 72.29% contingent on international support in the form of finance, technology, and capacity-building. The Philippines' NDC 2021 provides that "the benefits of market and non-market mechanisms under Article 6 of the Paris Agreement shall continue to be explored, consistent with national circumstances and sustainable development aspirations." This is reinforced under the Implementation Plan for the Republic of the Philippines Nationally Determined Contribution 2020-2030 with the Climate Change Commission stating that "the Philippines intends to take advantage of the benefits of market mechanisms and non-market approaches under Article 6 of the Paris Agreement, where these are consistent with national circumstances and sustainable development aspirations."

Climate Change Act

Republic Act No. 9729 or the Climate Change Act provides the policy framework of the government in dealing with the challenge of climate change. Under the National Framework Strategy on Climate Change[5], mitigation opportunities shall be optimized toward sustainable development and mitigation actions shall be pursued as a function of adaptation. The National Framework Strategy on Climate Change provides that while it is true that the Philippines contributes only a small fraction to GHG emissions – equivalent to 0.4% of global emissions – the country has committed to implementing mitigation strategies as part of the global effort to curb emissions. The National Climate Change Action Plan (NCCAP) 2011 - 2028 recognizes that mitigation is also an adaptation approach. There are adaptive mitigation measures such as reforestation, forest protection and rehabilitation, that have twin goals of mitigation and adaptation. As such, mitigation is an essential component of the adaptation strategy, and thus, CPIs present opportunities for adaptation financing as well.

Clean Air Act

Under Republic Act No. 8749 or the Philippine Clean Air Act of 1999, the State declared a policy to pursue balancing development and environmental protection. To achieve this end, the State encourages cooperation and self-regulation among citizens and industries through the application of market-based instruments.[6]

Philippine Development Plan

The Philippine Development Plan 2023-2028 states that the government "will foster an enabling policy environment to leverage private sector investments in green

[5] Climate Change Commission, National Framework Strategy on Climate Change 2010-2022.
[6] Republic Act No. 8749, s 3.

technologies and circular business models that generate green jobs. This includes exploring the feasibility of adopting CPI as a cost-effective means to encourage the transition to clean energy and improve energy efficiency in high-emitting sectors i.e., energy and industry, raise state revenues, and address environmental concerns. Local carbon markets will also be established to tap private sector financing, including foreign investments, particularly for the agriculture and forestry sectors." An ETS is a form of CPI that encourages energy efficiency as it imposes a cap on emissions. It may also raise revenues in the form of penalties for those companies that exceed the cap. Fees may also be imposed on the trading of allowances.

Complementary and Countervailing Policies

Development of the Renewable Energy Industry

The state has adopted a policy of accelerating development of renewable energy resources. In this regard, Republic Act No. 8513 or the Renewable Energy Act has provided numerous incentives to the renewable energy industry such as the Feed-in-Tariff (FIT), Renewable Portfolio Standard (RPS), Green Energy Option (GEOP) as well as tax incentives.[7] An ETS complements the efforts of the state to develop the renewable energy industry insofar as carbon credits can be generated from renewable energy projects.

A policy consideration, however, for the State is to ascertain whether all types of renewable energy will be considered as a valid source of carbon credits. Another policy consideration is for the state to review whether the current incentives should remain if renewable energy projects will be considered as a source of tradeable carbon credits and can generate income from this activity. The Department of Finance (DOF)should consider, for instance, whether tax incentives will extend to income generated from the sale and trade of carbon credits.

Energy Efficiency and Conservation

Under the Energy Efficiency and Conservation Act or Republic Act No. 11285, the government institutionalized a policy of energy efficiency and conservation, which includes the adoption of a market-driven approach to energy efficiency, conservation, sufficiency, and sustainability. Under Chapter VI of the Energy Efficiency and Conservation Act, certain establishments are obliged to integrate energy management system policies. They are also required to set up programs to develop and design measures that promote energy efficiency, conservation, and sufficiency; set up annual targets, plans, and methods of measurements and verification for the implementation of energy efficiency and conservation projects; and keep records on monthly energy

[7] By way of example, the renewable energy industry enjoys a zero percent (0%) tax rate. Section 108 (B) (7) of the National Internal Revenue Code provides that the sale of power or fuel generated through renewable sources of energy such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy and other emerging energy sources using technologies such as fuel cells and hydrogen fuels.

consumption data and other energy-related data. Initially, these establishments, called Designated Establishments are:

> (a) Type 1 designated establishments are those with an annual energy consumption of 500,000 kilowatt-hours (kWh) to 4,000,000 kWh for the previous year; and
> (b) Type 2 designated establishments are those with an annual energy consumption of more than 4,000,000 kWh for the previous year.

Establishments with an annual energy consumption of at least 100,000 kWh but less than 500,000 kWh are required to submit an annual energy consumption report to the Department of Energy (DOE) and integrate an energy management system policy into then-business operations. Energy efficiency projects shall be entitled to fiscal and non-fiscal incentives.

A policy consideration is to consider whether energy efficient projects shall be considered a valid source of carbon credits. Another policy consideration is for the state to review whether the incentives will extend to income generated from the sale and trade of carbon credits generated from energy efficient projects

Accounting Frameworks

The Philippine Ecosystem and Natural Capital Accounting System (PENCAS), the Philippine Greenhouse Gas Inventory Management and Reporting System (PGHGIMRS), and the Carbon Accounting, Verification, and Certification System (CAVCS) are interrelated in their goals of integrating environmental and climate considerations into policy and decision-making.

- **Philippine Ecosystem and Natural Capital Accounting System (PENCAS) Law**. Republic Act No. 11995 institutionalized the PENCAS within the government bureaucracy. The PENCAS shall be based on internationally accepted environmental-economic accounting frameworks. The PENCAS framework shall include, among others, a list of the officially designated statistics on the depletion, degradation, and restoration of natural capital; environmental protection expenditures; pollution and quality of land, air and water; environmental damages; and adjusted net savings. The Climate Change Commission (CCC) declared that the PENCAS law furthers the alignment of "the country's economic policies with sustainable practices to ensure that climate change mitigation and adaptation are at the center of the country's national development plans."
- **Institutionalization of the Philippine Greenhouse Gas Inventory Management and Reporting System**. Executive Order No. 174 (series of 2014) established the Philippine Greenhouse Gas Inventory Management and Reporting System (PGHGIMRS). The overall lead agency under Executive Order No. 174 is the CCC. There will need to be coordination between the CCC and the DENR to determine how the ETS will work with the PGHGIMRS.

- **DENR Administrative Order No. 2021-43 Carbon Accounting, Verification, and Certification System (CAVCS) for Forest Carbon Projects in the Philippines**. This DENR issuance provides for establishing a CAVCS for forest carbon projects to encourage and support investments in activities that sequester carbon dioxide and avoid emissions from deforestation and forest degradation. By specifically addressing carbon sequestration and emissions reduction in forest ecosystems, the CAVCS supports mitigation projects providing mechanisms for verification and certification of carbon credits.

Reducing Emissions from Deforestation and Forest Degradation (REDD+)

REDD+ is a global initiative under the UNFCCC that aims to mitigate climate change by reducing greenhouse gas emissions from deforestation and forest degradation in developing countries. In 2010, the Philippines was one of the early countries to develop a National REDD+ Strategy (PNRPS), which provides a framework for managing REDD+ activities. The DENR has supported REDD+ projects and has integrated them into its forest management strategies. Further, Executive Order No. 881 s. 2010 authorizes the Climate Change Commission to include the coordination of actions and plans related to REDD+ within the scope of its activities.

Regime Overlap: Issues to Consider in Countervailing and Complementary Policies

While the development of the Renewable Energy industry and Energy Efficiency and Conservation support the overarching goal of the reduction of greenhouse gas emissions, there is a risk of regime overlap as regard to existing mechanisms. The following should be considered in the design of an ETS:

- **Renewable Energy Certificates.** Renewable Energy Certificates (RECs) are certificates that may be traded in the RE Market for compliance with the RPS requirements to the Mandated Participants. The RE Market is a facility operated under the Wholesale Electricity Spot Market (WESM).

- **Green Energy Option Connection Agreements.** Section 9 of Energy Regulatory Commission's (ERC) Resolution No. 8, series of 2021, a GEOP end-user or any person or entity that sources 100% of its electricity requirement for renewable energy resources shall enter into a connection agreement with an authorized RE Supplier.

- **REDD+ Framework.** While the Philippines has a comprehensive policy and institutional framework on natural resources management, a dedicated national legal framework for REDD+ has yet to be established. Instead, the PNRPS has sections on governance; resource use, allocation and management; and measurement, reporting verification (MRV). There are various proposals in the PNRPS such as the establishment of national and sub-national institutional

arrangements and benefit-sharing schemes with local government units and communities.

Some of the issues to consider are the following:

- *Considerations for the power sector agreements and their interactions with ETS.* Whether RECs and GEOP Connection Agreements shall be considered as carbon credits under the ETS, and if so, whether they may be traded in the ETS.

- *Additionality and double counting*. If RECs and GEOP Connection Agreements are to be integrated into an ETS, it is necessary to ensure that credits represent real, measurable, and additional emission reductions that would not have occurred without the project. There is a risk of double counting or inflating emission reductions. Double counting occurs when the same emissions reduction or removal is counted more than once toward fulfilling climate goals or commitments. This undermines the integrity of carbon markets by inflating the perceived amount of emissions reductions, leading to misleading climate claims and hindering actual progress in lowering global greenhouse gas levels.

  The same issue of additionality exists as regards with REDD+ projects. Additionality in REDD+ projects ensures that emissions reductions are new and would not have occurred without the project, but challenges like establishing accurate baselines and preventing leakage complicate its verification. Both issues threaten the credibility of REDD+ projects, requiring robust monitoring and clear rules to maintain integrity in carbon markets.

  Because of the risk of undermining the integrity of carbon markets, there is a need to ensure that processes are established to avoid double-counting, and to ensure that the requirement of additionality is complied with.

  The issue on double cunting was addressed by the DOE Secretary in an advisory issued.[8] In this advisory, the DOE recognised the possibility of RECs generated by Philippine-based renewable energy facilities being traded in international voluntary markets and interposed no objection thereto. However, the DOE advised that the RECs to be traded should not include the energy output covered by RPS compliances. More importantly, the DOE emphasized that there will be no double counting or double claim of RECs traded in the international voluntary market vis-a-vis compliance with RPS and that REC transactions should "contribute to a net increase in global RE generation and emissions reductions of the companies utilizing them."[9] A similar advisory opinion will be required in the establishment of an ETS and that any carbon credit to be generated for purposes of trading in the ETS should not include the energy output covered by RPS compliances. The same principle would apply to other activities to be generated for purposes of the trading in an ETS. The carbon credits should not cover the

[8] Department of Energy Advisory 2024-04-003-SEC dated 5 April 2024.
[9] Ibid.

same energy output generated for the purpose of RPS compliance. Any carbon credit to be traded in an ETS should correspond to net increase in global RE generation and emissions reductions.

- *Diminished economic effectiveness of additional policies in the same sector*. From an economic perspective, it has been posited that imposing cap-and-trade systems in sectors that already have policies enacted to reduce emissions, such as RPS, can work against the goal of reducing emissions.[10] The interaction of these different policies may possibly undermine allowance prices. Emission reductions achieved through these supplementary programs are likely to be offset by corresponding increases in emissions in other areas, assuming the cap remains binding. Consequently, the primary impact of these additional policies is a reduction in allowance prices within the cap-and-trade system, coupled with an increase in the overall economic cost of achieving emission reductions.[11] While an economic analysis of the interaction of these different policies is beyond the scope of this legal analysis, there are studies such as by the World Bank on Carbon Pricing Instruments for the Philippines that provide initial insight.[12] Policymakers might consider expanding this study to include an analysis of the economic effect of the interaction between an ETS or carbon taxes with the RPS.

Sectoral Issues

A significant policy consideration for the Philippines is to determine which sectors to include in an ETS. [13]

1. Agriculture and Food Security

Article XII, Section 1 of the Constitution provides that the State shall promote industrialization and full employment based on sound agricultural development. The Philippine Development Plan 2023 – 2028 emphasizes the importance of agriculture and food security.

In some jurisdictions, such as the New Zealand Emissions Trading Scheme, the agriculture sector is covered by the ETS program and biological emissions from agriculture, including methane from livestock and nitrous oxide from soil management are regulated. A similar mechanism whereby emissions from agricultural activities

[10] Gilbert E. Metcalf, 'Carbon Taxes in Theory and Practice' (2021) Annual Review of Resource Economics 245, 251.
[11] Gilbert E. Metcalf, 'Carbon Taxes in Theory and Practice' (2021) Annual Review of Resource Economics 245, 251.
[12] World Bank Group, 'Preparing Carbon Pricing Instruments for the for the Philippines: Technical Working Group Introduction to Carbon Pricing' (December 2023).
[13] The European Union ETS ("EU-ETS"), by way of comparison, covers large installations in the sectors of power generation, refining, iron and steel, cement, glass, lime, bricks, ceramics, pulp and paper, as well as other combustion activities with a rated thermal input of 20 megawatts. It does not cover households, agriculture or road transport.

would be capped and permits are required to be obtained may work to reduce agricultural output and have run-on effects on food security.

2. Transport

Under the National Transport Policy 2017, the state recognized the important role of transportation as an enabler and driver of socioeconomic development towards achieving inclusive and sustainable growth, and attaining the national development goals and objectives. Furthermore, the National Transport Policy 2017 embodied a vision of a safe, secure, reliable, efficient, integrated, intermodal, affordable, cost-effective, environmentally sustainable, and people-oriented national transport system that ensures improved quality of life for the people. Should emission caps apply to the transportation sector, the impact thereof should be considered as regards to the goal of providing cost-effective transportation options.

Safeguards

The Indigenous Peoples' Rights Act (IPRA) of 1997[14] recognizes and promotes the rights of Indigenous Cultural Communities/ Indigenous Peoples. It is probable that some projects to be implemented to generate carbon credits for purposes of trading in an ETS would encroach on ancestral domains, particularly if they involve land-based mitigation activities like afforestation, reforestation, improved forest management, or renewable energy development. In the development of projects and activities in order to generate carbon credits, proponents should be mindful of the safeguards set out under the IPRA. No project can proceed within an ancestral domain without the free, prior, and informed consent (FPIC) of the affected indigenous community.[15] An FPIC ensures full disclosure of project details and allows communities to accept or reject proposed activities. The process is facilitated by the National Commission on Indigenous Peoples (NCIP) and should be culturally appropriate and community-led[16]. The IPRA also provides for the following rights of indigenous peoples:[17] (1) The right to Reject Projects: If a project is deemed harmful or inconsistent with indigenous rights, the community can refuse it. (2) The Right to Compensation and Benefit-Sharing: If an indigenous group allows a project, they must equitably benefit from revenues generated. (3) Protection from Displacement: No indigenous community can be removed from their ancestral domain without their consent and due process.

[14] Republic Act No. 8371.
[15] Ibid sections 32-33, 58-59.
[16] Ibid section 46.
[17] Ibid section 7.

Potential Legal Challenges to an Emissions Trading System

Due Process and Taking

An ETS might face challenges under the constitutional protection against deprivation of property without due process of law. Article III, Section 9 of the Philippine Constitution provides, “Private property shall not be taken for public use without just compensation.” Stakeholders may argue that setting emissions caps constitutes a regulatory taking without just compensation.

Deterrent to Power Generation

In programs that have been implemented elsewhere, allowances have been allocated initially to covered sources free of charge, based on emissions during some historical period before the program's commencement.[18] As such, participants should have available allowances or credits to sell. It would be unclear, however, how allowances would be allocated to new entities or as regards to the expansion or establishment of new plants. This could raise the argument that the ETS is a deterrent towards the establishment or development of industries. Power generation, for example, is a long-standing issue in the Philippines, and it is likely to be argued that an ETS would deter industry development and could result in an unreliable and less secure energy system.

Social Justice Considerations

The Philippine Constitution contains social justice provisions under Article XII. Specifically, Sections 1 and 2 provide:

> Section 1. The Congress shall give highest priority to the enactment of measures that protect and enhance the right of all the people to human dignity, reduce social, economic, and political inequalities, and remove cultural inequities by equitably diffusing wealth and political power for the common good.

To this end, the State shall regulate the acquisition, ownership, use, and disposition of property and its increments.

> Section 2. The promotion of social justice shall include the commitment to create economic opportunities based on freedom of initiative and self-reliance.

[18] David Harrison Jr. et al., 'Using Emissions Trading to Combat Climate Change: Programs and Key Issues' (2008) 38(6) Environmental Law Reporter News & Analysis 10367

While it can be argued that an ETS advances social justice by creating economic opportunities and incentivizing environmental protection through emission reductions, critics may contend that it could also lead to higher energy prices, disproportionately affecting low-income households and exacerbating economic inequality. Moreover, the imposition of a cap on power generation might hinder the expansion of electrification in underserved rural areas, potentially delaying access to basic services and development in these regions.

Non-impairment of Contracts

Article III, Section 10 of the 1987 Philippine Constitution states: "No law impairing the obligation of contracts shall be passed." A legal challenge against an ETS based on the Non-Impairment Clause could argue that the ETS impairs existing contracts.

Power Generation Companies

Power generation companies must secure approval from the ERC for Power Supply Agreements they enter into with distribution utilities (DUs) or other buyers of electricity. The ERC ensures that these contracts follow competitive rules and protect consumers from overpricing. Opponents could argue that the ETS impairs ERC-approved Power Supply Agreements by raising operational expenses through the need to purchase emission credits, which could be seen as interfering with their contractual obligations to suppliers or clients.

Opponents could also advance the argument that permits and licenses granted by the ERC and DOE to power generation companies are contract-like agreements between them and the government. These permits and licenses define the legal and operational conditions under which a company can operate, including cost structures, environmental compliance, and technical standards. Furthermore, as an ETS is likely to impose additional costs and regulatory requirements, it could be argued that this alters the terms under which the company agreed to operate, thus impairing the rights and obligations established under existing permits or licenses. It may be advanced that the new financial burdens or operational constraints may interfere with the company's ability to operate profitably or in compliance with previously issued permits.

The government could argue, as a defense or counterargument, that the ETS is an exercise of its police power to regulate activities for the benefit of public welfare. Police power can override the Non-Impairment Clause when the public interest is at stake. The Supreme Court has consistently upheld laws that impair contracts when they are passed as legitimate exercises of police power, particularly when protecting the environment or public health. In addition, while permits grant power generation companies the right to operate under certain conditions, they are often not seen as contracts in the traditional sense. Instead, they are administrative authorizations subject to changes in the law. The government retains the authority to impose additional regulations, such as the ETS, even if these regulations impose new compliance requirements. Courts may view permits and licenses as being inherently

subject to evolving regulatory frameworks, particularly when it comes to environmental protection and public welfare. The government could also argue that no contract, including an ERC-approved Power Supply Agreement, can be considered immune from legislative changes, especially those involving significant public interests like climate change mitigation. Power generation companies are generally expected to comply with new regulations even if these regulations impose additional burdens on their operations.

Power Distribution and Transmission Companies

An ETS can potentially include power distribution companies and the National Grid Corporation of the Philippines (NGCP) as the latter is entity responsible for the transmission of electricity on a national scale. While power generation companies are more directly responsible for greenhouse gas emissions, distribution and the NGCP could be included in an ETS if the system is designed to cover the entire electricity supply chain. Distribution companies do not directly emit significant greenhouse gases in the way that generation companies do. However, they are responsible for the transportation and delivery of electricity, and inefficiencies in this process can result in higher emissions upstream. An ETS could hold distribution companies and the NGCP accountable for the indirect emissions associated with energy losses during transmission and distribution. For example, if electricity losses occur in the grid (due to outdated infrastructure or inefficiencies), this results in more electricity generation upstream, increasing overall emissions. Distribution and transmission companies may argue that their franchises, permits and licenses establish a contract-like relationship with the government, defining the conditions under which they are authorized to operate. As a defense, the government could argue that the ETS is a legitimate exercise of its police power, which allows it to regulate activities for the public welfare, including the protection of the environment and public health. The Supreme Court has consistently upheld laws that affect contracts when they are justified by the public interest. It has also recognized that contracts, including franchises and licenses, can be subject to laws passed in the exercise of police power, especially when the legislation is aimed at addressing important public concerns like climate change.

The following table summarizes the challenges and defenses that could be raised in the implementation of an ETS.

Table 1. Summary of the legal challenges and defense to ETS

	Challenge	Defense
Due process and taking	ETS emissions caps constitute a regulatory taking without just compensation, contrary to Article III, Section 9 of the Philippine Constitution that states private property shall not be taken for public use without just compensation.	Valid exercise of police power. Purpose is for protection of environment and climate change mitigation.

	Challenge	Defense
Public policy	By setting caps, ETS is a deterrent to power generation and against the public policy that promotes electrification.	Valid exercise of police power Public policy on environmental protection & climate change mitigation
Social justice considerations	Imposing caps on energy production will lead to higher energy prices, exacerbate economic inequality and hinder expansion of electrification in underserved rural areas	ETS advances social justice by creating economic opportunities and incentivizing environmental protection through emission reductions Principle of intergenerational equity – protection of natural resources for future generations
Non-impairment of contracts	Permits and licenses granted by the ERC and DOE to power generation companies are contract-like agreements between power generation companies and the government. ETS is likely to impose additional costs and regulatory requirements. This alters the terms under which the company agreed to operate and new financial burdens or operational constraints may interfere with the company's ability to operate profitably.	Police power can override the Non-Impairment Clause when the public interest is at stake. Permits and licenses are not contracts per se and are subject to changes in legislation.

Carbon Tax

Carbon tax imposes a fixed price on a unit of GHG emissions.[19] A tax is levied on fossil fuels in accordance with their carbon content, or on other goods in accordance with the emissions produced in production processes. The World Bank defines a carbon tax as: "a tax that places a price on GHG emissions or that uses a metric directly based on carbon that is, price per tCO_2e."[20]

Legal Framework Governing the Imposition of Carbon Taxes

Enabling and Synergistic Policies

The power of taxation is one of the inherent powers of the state, allowing the government to collect taxes from individuals and entities to fund public services and promote the general welfare. In Commissioner of Internal Revenue v. Algue,[21] the Supreme Court stated:

> "Taxes are the lifeblood of the government and so should be collected without unnecessary hindrance. On the other hand, such collection should be made in accordance with law as any arbitrariness will negate the very reason for government itself. It is therefore necessary to reconcile the apparently conflicting interests of the authorities and the taxpayers so that the real purpose of taxation, which is the promotion of the common good, may be achieved."

Article VI, Section 28 of the 1987 Philippine Constitution recognizes the power of taxation, viz: "The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation." This provision mandates that taxes must be applied uniformly and equitably and that the tax system should ideally be progressive, where the tax burden increases with the taxpayer's ability to pay.

In the case of Tio v. Videogram Regulatory Board, the Supreme Court ruled on the government's power to impose taxes to regulate behavior. The case involved Presidential Decree No. 1987, which imposed a tax on the sale, lease, and distribution of videograms. The Court held that taxation may be made to implement the state's police power. Taxation is also a tool for regulation.[22]

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[19] World Bank Group, *Carbon Tax Guide: A Handbook for Policy Makers* (2017)
[20] Ibid.
[21] G.R. No. L-28896, February 17, 1988
[22] In this decision, the Supreme Court recognized that taxes can be imposed not only to raise revenue but also to regulate certain activities. The imposition of taxes was seen as a way to regulate the video rental and sale industry, which the government believed could negatively affect public morality and the movie industry.

An example of taxes for the conservation of the environment in the Philippines is the Environment User Fees System (EUFS) implemented by the Laguna Lake Development Authority (LLDA).[23] Following the "Polluters Pay Principle," the EUFS is paid for the amount of pollution discharged into the tributary rivers within the Laguna de Bay Region. The EUFS is an industrial wastewater effluent fee program intended to create economic incentives to reduce discharges and to raise revenues for environmental activities by local governments. Another example is the Department of Energy's rule under ER 1-94 that requires all power generation facilities to set aside one centavo per kilowatt hour (P0.01/kWh) of total electricity sales as financial benefits of host communities of that generation facility. The purpose of this rule is to recognize and provide recompense to the host community, and to ultimately promote harmony and cooperation among the local communities, the local government and the power producer.

As mentioned above, the Philippine Development Plan 2023-2028 states that the government "will foster an enabling policy environment to leverage private sector investments in green technologies and circular business models that generate green jobs. This includes exploring the feasibility of adopting carbon pricing instruments as a cost-effective means to encourage the transition to clean energy and improve energy efficiency in high-emitting sectors (i.e., energy and industry), raise state revenues, and address environmental concerns. Local carbon markets will also be established to tap private sector financing, including foreign investments, particularly for the agriculture and forestry sectors." Carbon taxes is a form of CPI that will directly raise state revenues. It also encourages energy efficiency as an emitter can pay lower taxes if it lessens its emissions.

Countervailing Policies

TRAIN Law

The Tax Reform for Acceleration and Inclusion (TRAIN) Law was enacted in July 2017. Under the TRAIN Law, the following was declared as the policy of the state:

(a) To enhance the progressivity of the tax system through the rationalization of the Philippine internal revenue tax system, thereby promoting sustainable and inclusive economic growth;
(b) To provide as much as possible, equitable relief to a greater number of taxpayers and their families in order to improve disposable levels of income and increase economic activity; and
(c) To ensure that the government is able to provide for the needs of those under its jurisdiction and care through the provision of better infrastructure, health, education, jobs and social protection for the people.

[23] See Laguna Lake Development Authority, Environmental Users Fee System <https://llda.gov.ph/environmental-users-fee-system-eufs/>

Section 43 of the TRAIN Law[24] amended Section 148 of the National Internal Revenue Code (NIRC) and imposed a greater excise tax on petroleum products. The following table shows the excise tax rates on petroleum products in Philippine Peso per liter or kilogram.

Table 2. Excise Tax Rate on Petroleum Products (in Php per Lietr or Kilogram) 2018, 2019, 2020

Product Type	Effectivity of RA 10963			
	Jan. 1, 2018	Jan. 1, 2019	Jan. 1, 2020	Increase in Excise Tax
Lubricating oils and greases (L)	8.0	9.0	10.0	2.0
Processed gas (L or kg)				
Waxes and petrolatum (kg)				
Denatured alcohol (L)				
Asphalt (kg)				
Naphtha, regular gasoline, pyrolysis gasoline and other similar products of distillation (L)	7.0	9.0	10.0	3.0
Unleaded premium gasoline (L)				
Kerosene(L)	3.0	4.0	5.0	2.0
Aviation turbo jet fuel, aviation gas (L)	4.0	4.0	4.0	-
Kerosene when used as aviation fuel (L)				
Diesel fuel oil, and on similar fuel oils having more or less the same generating power	2.5	4.5	6.0	3.5
Liquefied petroleum gas used for motive power (kg)				
Bunker fuel oil, and on similar oils having more or less the same generating power (L)				
Petroleum coke (MT)				
Liquefied petroleum gas (kg)	1.0	2.0	3.0	2.0

Source of basic data: BIR Website

The TRAIN Law also increased the excise tax on mineral products such as imported coal (effective 2020, PhP150 per metric ton) and indigenous petroleum (6% of the fair international market price).

In accordance with Section 2 of the TRAIN Law or the first policy declaration, the TRAIN Law is intended to rationalize the Philippine internal revenue tax system. The intention of the law was to simplify the country's tax system to make it more efficient, equitable, and easier to administer. Additional taxes in the form of carbon taxes will necessitate further amendments to the NIRC. A consideration for policy makers is whether, as regards to petroleum products and mineral products, carbon taxes will be imposed in lieu of excise taxes or whether they will be imposed in addition to excise taxes.

[24] Republic Act No. 10963

In terms of implementation, Chapter VIII of the NIRC contains the administrative provisions regulating the business of persons dealing in articles subject to excise tax. The carbon tax system will have to consider how it will interact with these provisions. For instance, Section 155 requires manufacturers and/or importers to provide counting or metering devices to determine volume of production and importation. A carbon tax system will need to require covered entities to provide a way to record or measure greenhouse gas emissions.

Electrification and Affordability

Under Republic Act No. 9136 or the Electric Power Industry Reform Act of 2001 (EPIRA), the declared policy of the state are, among others, to ensure and accelerate the total electrification of the country; to ensure the quality, reliability, security and affordability of the supply of electric power; and to ensure transparent and reasonable prices of electricity in a regime of free and fair competition and full public accountability to achieve greater operational and economic efficiency and enhance the competitiveness of Philippine products in the global market.[25] Studies show that a carbon tax may have significant implications for electricity pricing and market behavior.[26]

In the Philippines, the impact may be particularly consequential as energy poverty remains a significant issue. In 2020, approximately 1.6 million households in the Philippines lacked access to electricity, largely due to the high electricity costs, which were approximately $0.20 per kilowatt-hour—among the highest in the ASEAN region.[27] Higher energy costs due to carbon taxes affect state policy to ensure affordability and reasonableness in energy prices.

Potential Legal Challenges to Carbon Taxes

Argument that Carbon Taxes are Regressive

Article VI, Section 28 of the Constitution provides that, "The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation." Existing literature on the regressive or progressive nature of carbon taxes yield varying results and can depend on the specific design of the carbon tax and on the existence of mitigating measures. However, an argument may be made that there is sufficient

[25] Republic Act No. 9316, Section 2.
[26] Jin Boon Wong and Qin Zhang, 'Impact of Carbon Tax on Electricity Prices and Behavior' (2022) 44 Finance Research Letters 102098.
[27] Lopez N.S.A., Tayag C.R.C., Gue I.H.V., 2023, Energy Poverty and Carbon Emissions: The State of Luzon, Philippines, Chemical Engineering Transactions, 103, 157-162

evidence that carbon taxes are regressive,[28] and therefore violate the constitutional requirement that there be a progressive system of taxation in the country.

Taxes are also usually challenged before courts on the basis of the Equal Protection Clause, that is that they are discriminatory or impose an unequal burden on certain sectors or individuals; and the Due Process clause, or an argument that a tax is unfair or arbitrary, violating the constitutional right to due process. Depending on the design of the carbon tax, the scope, any exemptions, and the specific language of the provisions, these arguments may be brought up against it.

Social Justice Considerations

As mentioned above, taxes may be imposed as a form of police power to regulate behavior. The implementation of carbon taxes on power generation would serve to disincentivize power generation. With the Philippines experiencing an energy crisis,[29] a challenge to carbon taxes may be mounted on the right to human dignity, and the reduction of social and economic inequalities.

Another critical aspect to consider is the broader distributional impact of carbon taxes, particularly how these taxes affect various socio-economic groups. Existing literature point to varying results. Studies on Mexico[30] and Indonesia,[31] for example, conclude that there are less distributional impacts than expected. However, a study on British Columbia and Quebec argue that women may bear a disproportionate burden of the increased prices created by carbon taxes, and that policies designed to mitigate the impact of carbon taxes on low-income households do not address income disparities between women and men.[32]

The Philippine Constitution contains social justice provisions under Article XII, Sections 1 and 2[33]. While it can be argued that carbon taxes advances social justice by protecting the environment through expected emission reductions, critics may contend that it

[28] See e.g., Jules Linden, Cathal O'Donoghue & Denisa M. Sologon, 'The many faces of carbon tax regressivity—Why carbon taxes are not always regressive for the same reason' (2024) 192 Energy Policy 114210; Julius Andersson & Giles Atkinson, 'The distributional effects of a carbon tax: The role of income inequality' (2020) Centre for Climate Change Economics and Policy Working Paper No. 378; Aaqib Ahmad Bhat, 'Are Carbon Taxes Regressive in India? Evidence from NSSO Data' (2020) 67 (1) The Indian Economic Journal.

[29] Alvin Elchico, 'Power Situation Now a Calamity Says DOE,' ABS-CBN News (25 April 2024).

[30] Fidel Gonzalez, 'Distributional Effects of Carbon Taxes: The Case of Mexico' (2012) 34 (6) Energy Economics 2102.

[31] Arief A. Yusuf & Budy P. Resosudermo, 'On the distributional impact of a carbon tax in developing countries: the case of Indonesia' (2014) 17 Environmental Economics and Policy Studies 131.

[32] Nathalie J. Chalifour, 'A Feminist Perspective on Carbon Taxes' (2010) 22(1) Canadian Journal of Women and Law 169.

[33] Quoted in Part II of this Report.

could also lead to higher energy prices, disproportionately affecting low-income households and exacerbating economic inequality.

Non-impairment of Contracts

Power generation companies could argue that a carbon tax directly affects their operational costs by imposing a financial burden on emissions from fossil fuel-based electricity generation. They may claim that ERC-approved Power Supply Agreements (PSA) contractually bind them to deliver electricity at agreed-upon prices to distribution utilities, which could be impaired by the introduction of a carbon tax. These agreements were negotiated based on a specific cost structure that did not include a carbon tax. By increasing the cost of production, the carbon tax may prevent power generation companies from fulfilling their obligations under the PSAs, particularly if the terms do not allow for the adjustment of prices in response to new taxes.

By way of defense, the government could argue that the Non-Impairment Clause is not absolute and that the imposition of a carbon tax is a legitimate exercise of its police power aimed at addressing climate change and protecting the environment. Power generation companies typically enter into PSAs knowing that future regulations and taxes might be imposed. Many contracts contain clauses that account for changes in law, which might include provisions for passing through additional costs to consumers, subject to ERC approval. Furthermore, the carbon tax is a general tax imposed for the public good, and courts generally uphold such taxes as long as they are reasonable and applied uniformly across the industry.

The following table summarizes the challenges and defenses that could be raised in the implementation of carbon tax.

Table 3. Summary of the legal challenges and defense to carbon tax

	Challenge	Defense
Regressive taxation	Argument could be that carbon taxes will violate Article VI, Section 28 of the Constitution provides that, "The rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation." Regressive taxes impose a disproportionately higher burden on lower-income individuals or households.	Defense will rely on the design of the taxes and whether there are mechanisms included to mitigate regressivity - Exemptions - Revenue recycling; cash transfers

	Challenge	Defense
Equal Protection Clause	Argument will be that carbon taxes are discriminatory or impose an unequal burden on certain sectors or individuals (e.g. energy sector)	Sufficient distinction between industries that have major GHG emissions and those that do not. Defense will also depend on design of carbon taxes, including amount and scope
Social Justice Considerations	Argument is that carbon taxes will lead to higher energy prices, exacerbate economic inequality, and hinder expansion of electrification in underserved rural areas	Carbon tax advances social justice by incentivizing environmental protection through emission reductions Principle of intergenerational equity – protection of natural resources for future generations
Non-impairment of contracts	Carbon taxes directly affect their operational costs by imposing a financial burden on emissions. ERC-approved PSAs contractually bind power generators to deliver electricity at agreed-upon prices to distribution utilities, which could be impaired by the introduction of a carbon tax.	Police power can override the Non-Impairment Clause when the public interest is at stake. Power generation companies typically enter into PSAs knowing that future regulations and taxes might be imposed. Many contracts contain clauses that account for changes in law, which might include provisions for passing through additional costs to consumers, subject to ERC approval. Carbon taxes would be a general tax imposed for the public good, and courts generally uphold such taxes as long as they are reasonable and applied uniformly across the industry.

Government Mandates

This section discusses the legal mandates of government agencies that would be involved in CPI implementation.

Department of Environment and Natural Resources

The DENR under EO 192 s. 1987 is the primary agency responsible for the conservation, management, development, and proper use of the country's environment and natural resources as well as the licensing and regulation of all natural resources as may be provided for by law in order to ensure equitable sharing of the benefits derived therefrom for the welfare of the present and future generations of Filipinos. Its mandate positions it as the most suitable department to oversee the ETS framework, which includes establishing emissions reduction targets, monitoring emissions, and enforcing compliance among covered entities. For carbon taxes, its role would be limited as it is not the agency mandated to collect and enforce taxes but it is still likely to play a crucial role in monitoring, reporting, and verification (MRV). The DENR, particularly through its Environmental Management Bureau (EMB) could be mandated to monitor emissions from industries subject to the carbon tax. This involves establishing MRV systems to track greenhouse gas emissions effectively. The DENR can work with the DOF in setting up revenue recycling and explore how revenue generated from the carbon tax can be reinvested into environmental conservation, adaptation, and sustainable development projects.

Climate Change Commission

The CCC, under Republic Act 9729, is the agency tasked with coordinating, monitoring, and evaluating the government's programs and initiatives related to climate change adaptation and mitigation. It is tasked to coordinate, monitor and evaluate the programs and action plans of the government relating to climate change pursuant to the provisions of the Climate Change Act. The CCC would be instrumental in developing the overarching policies related to the ETS and carbon taxes, ensuring they align with the country's commitments under international agreements such as the Paris Agreement and the NDC. It would also help define the scope and objectives of the CPI, including setting specific emissions reduction targets. The CCC is suited to facilitate coordination among various government agencies involved in the CPI, including the DENR, DOF, and DOE, to ensure a cohesive approach to emissions reduction. The CCC could serve as an advisory body to the President (to which it is attached) and other government bodies on the effectiveness and efficiency of the CPI, making recommendations for improvements or adjustments as necessary based on emerging data and best practices from other countries.

Department of Finance

Under EO 127, s. 1987 and EO 292., s 1987, the DOF is responsible for the sound and efficient management of the financial resources of the government by formulating, institutionalizing, and administering fiscal policies in coordination with other agencies of the government; generating and managing the financial resources of government; supervising the revenue operations of all local government units; and reviewing, approving, and managing all public sector debt, domestic or foreign. It is also responsible for the rationalization, privatization, and public accountability of corporations and assets owned, controlled, or acquired by the government.

- **Carbon Tax.** For carbon taxes, it is the DOF that would have primary authority. The DOF, including the Bureau of Internal Revenue, would design the carbon tax structure, determine rates, and ensure proper revenue collection and management. It would also assess the economic impact of the tax and coordinate with other agencies on fiscal policies related to carbon pricing. The BIR, specifically, would be tasked with the administration and enforcement of the carbon tax, including collection processes and compliance checks.
- **Emmission Trading Scheme**. The DOF is most suitable to be involved in the financial aspects of the ETS, particularly in establishing mechanisms for revenue generation through the auctioning of carbon credits or allowances. It would assess how the ETS can contribute to government revenues and how these funds can be utilized for climate-related projects and initiatives. The DOF is the agency that would be responsible for designing a comprehensive fiscal incentive framework to encourage participation in the ETS.

Department of Energy

Under Republic Act No. 7638, the DOE shall prepare, integrate, coordinate, supervise, and control all plans, programs, projects, and activities of the Government relative to energy exploration, development, utilization, distribution, and conservation. The DOE would likely coordinate with the DENR on energy sector emissions targets and support the transition to cleaner energy sources as part of the ETS framework. It would also likely coordinate with the DOF to design and implement the carbon tax framework. In both an ETS and carbon tax framework, the DOE is most suited to engage with stakeholders – energy producers, distributors, and large energy consumers – to understand the implications of the system to be implemented.

Under the DOE, the ERC would be involved in determining the impact of the ETS on electricity rates and tariffs and may also establish mechanisms for cost pass-through from compliance with the ETS. As regards carbon taxes, as the ERC responsible for regulating electricity rates, the ERC is the agency responsible for evaluating how the carbon tax impacts operational costs of energy companies. This is especially relevant in the likely scenario that energy companies file applications for rate adjustments. The ERC will determine whether these rate adjustments based on carbon taxes are justifiable and reasonable for inclusion in the pricing structure. The ERC's mandate includes

protecting consumers from unfair pricing while also ensuring the viability of the energy industry. This balancing act is relevant in the context of a carbon tax, which may lead to increased costs for energy producers and the pass through of carbon tax costs to consumers leading to higher energy prices for consumers.

A table summarizing the foregoing is provided below. Please note that this analysis is based on existing legislative mandates. It is possible for future legislation, such as a Carbon Pricing Instrument law, to provide for specific responsibilities for each agency:

Table 4. Summary of Government agencies' mandates CPI Implementation

	Responsibilities in ETS	**Responsibilities in carbon tax**
DENR	Establishing emissions reduction targets; monitoring emissions; enforcing compliance among covered entities.	Through EMB, monitor emissions from industries subject to the carbon tax and establish MRV systems to track GHG emissions; work with the DOF in setting up revenue recycling and reinvestment of revenues generated from carbon taxes.
DOF	Most suitable to be involved in the financial aspects of the ETS, particularly in establishing mechanisms for revenue generation through the auctioning of carbon credits or allowances. Assessment of how the ETS can contribute to government revenues and how these funds can be utilized for climate-related projects and initiatives. Would be responsible for designing a comprehensive fiscal incentive framework to encourage participation in the ETS.	DOF would have primary authority and would be responsible for: • designing the carbon tax structure • determining rates • ensuring proper revenue collection and management • Assessing the economic impact of the tax • Coordinating with other agencies on fiscal policies related to carbon pricing. The BIR, specifically, would be tasked with the administration and enforcement of the carbon tax, including collection processes and compliance checks.
CCC	In charge of coordinating, monitoring, and evaluating the government's programs and initiatives related to climate change adaptation and mitigation.	

	Responsibilities in ETS	Responsibilities in carbon tax
	Instrumental to developing the overarching policies related to the ETS and carbon taxes, ensuring they align with the country's commitments under international agreements. Contribute to defining the scope and objectives of the CPI, including setting specific emissions reduction targets. Suited to facilitate coordination among various government agencies involved in the CPI, including the DENR, DOF, and DOE, to ensure a cohesive approach to emissions reduction. Would serve as an advisory body to the President (to which it is attached) and other government bodies on the effectiveness and efficiency of the CPI, making recommendations for improvements or adjustments as necessary based on emerging data and best practices from other countries	
DOE	Coordinate with the DENR on energy sector emissions targets and support the transition to cleaner energy sources as part of the ETS framework; engage with energy producers, distributors, and large energy consumers to understand the implications of an ETS and build support for its implementation.	Coordinate with the DOF to design and implement the carbon tax framework; engage with energy producers, distributors, and large energy consumers to understand the implications of carbon taxes and build support for its implementation.
ERC	Determine the impact of the ETS on electricity rates and tariffs and establish mechanisms for cost pass-through from compliance with the ETS; rule on applications for rate adjustments.	Evaluate how the carbon tax impacts operational costs of energy companies; review rule on applications for rate adjustments.

Internal Carbon Fund

A query was raised on the viability and legality of any iteration of an internal carbon fund for corporations and whether the government may compel private corporations to set aside funds only to be spent on a specific purpose, by reason of their failure to comply with emissions caps.

A carbon fund, *per se,* to be funded by private corporations is not contrary to law and falls within the scope of police power. As discussed above, under the concept of "police power," the state has inherent authority to enact laws, regulations, and measures to promote public health, safety, morals, and general welfare. The enactment of any law that requires private corporations to contribute to a special fund should comply with legal requirements such as the equal protection clause found under Article III, Section 1 of the Constitution. The Equal Protection Clause states: "No person shall be deprived of life, liberty, or property without due process of law, nor shall any person be denied the equal protection of the laws." The Equal Protection Clause guarantees that individuals and entities should be treated equally under the law. The exception is that the law can make reasonable classifications provided specific criteria are met. The elements of a valid classification are:

Substantial Distinction. The law may differentiate between individuals or entities as long as the classification is reasonable. A classification is considered reasonable if it is based on substantial distinctions that make a real difference between those included and those excluded from the classification.

Relevance to the Purpose of the Law. The classification must be germane to the purpose of the law. This means that the distinctions made by the law must have a direct and legitimate relationship to the objective it seeks to achieve.

Not Limited to Existing Conditions. The classification must not be confined to existing conditions only. It should be open and flexible enough to apply to future circumstances that may fall within the same category.

Applies Equally to All Within the Class. The law must apply equally to all persons or entities belonging to the same class. There should be no undue or arbitrary favoritism or discrimination within the class.

A requirement on all power generation companies to contribute to a carbon fund may be upheld as valid as long as this imposition is applied equally.

The proposal to extract funding from only those corporations that fail to comply with emissions caps may raise potential issues specifically, under the Equal Protection Clause on the element of a valid classification based on substantial distinctions. It may be

argued that the failure to meet the emissions cap does not constitute sufficient criteria to distinguish and identify those who will be required to contribute to the fund.

If the contributions to the fund were to be characterized as a penalty, then the requirements for a valid imposition of penalties should be complied with. Under Philippine administrative law, the penalty must have a clear and explicit legal or statutory basis. It must be authorized by law, regulation, or valid administrative issuance. An administrative agency cannot impose a penalty unless it is expressly allowed or implied by law. The law or regulation authorizing the penalty must be within the scope of the administrative agency's jurisdiction and must not exceed its delegated powers. The imposition of the penalty should also follow due process. In terms of substantive due process, the penalty must be reasonable, proportionate, and appropriate to the violation committed. It should not be arbitrary, oppressive, or discriminatory. In terms of procedural due process, the affected party must be given a fair opportunity to be heard before the penalty is imposed. This includes notice of the charges, the opportunity to present evidence and arguments, and a fair hearing or proceeding conducted by an impartial authority. An essential component of a valid penalty is the availability of remedies, such as an appeal or administrative/judicial review. Affected parties must have the right to challenge the imposition of the penalty before a higher administrative body or a court of law.

Comparison with other Funds

Renewable Energy Trust Fund

The Renewable Energy Trust Fund (RETF) was established under Renewable Energy Act of 2008 (RA 9513) to provide financial support for the promotion, development, and acceleration of renewable energy projects in the country. The RETF aims to mobilize resources to achieve the law's objectives, such as increasing the share of renewables in the energy mix and ensuring energy sustainability and security. The RETF is collected from emission fees imposed on all generating facilities. The imposition is not limited to those which do not meet a certain criterion. The RETF also requires government contributions. Under Section 28 of the Renewable Energy Act of 2008, the RETF shall be funded from: (a) Proceeds from the emission fees collected from all generating facilities consistent with Republic Act No. 8749 or the Philippine Clean Air Act; (b) One and a half percent (1.5%) of the net annual income of the Philippine Charity Sweepstakes Office; (c) One and a half percent (1.5%) of the net annual income of the Philippine Amusement and Gaming Corporation; (d) One and a half percent (1.5%) of the net annual dividends remitted to the National Treasury of the Philippine National Oil Company and its subsidiaries; (e) Contributions, grants and donations; (f) One and a half percent (1.5%) of the proceeds of the Government share collected from the development and use of indigenous non-renewable energy resources; (g) Any revenue generated from the utilization of the RETF; and (h) Proceeds from the fines and penalties imposed under the RE Act.

FIT-All Charge

A mechanism is now being implemented by the ERC called the FIT-All charge. The Feed-In Tariff Allowance (FIT-All) charge is a uniform charge imposed on all electricity consumers in the Philippines. It is collected as part of their monthly electricity bills and is used to fund the incentives given to renewable energy developers under the country's Feed-In Tariff (FIT) System. The Renewable Energy Act of 2008 establishes the policy framework for the development and promotion of renewable energy sources in the Philippines. One of the mechanisms introduced is the Feed-In Tariff (FIT) System, which guarantees a fixed tariff for electricity generated from renewable energy sources over a period of time. Section 7 of RA 9513 specifically mandates the establishment of the FIT System to accelerate the deployment of renewable energy technologies and ensure energy security and sustainability. Under the Implementing Rules and Regulations (IRR) of RA 9513, the FIT-All Fund is established to centralize the collection and disbursement of the FIT-All charge.

The FIT-All charge varies from the contemplated internal carbon fund in the way that the FIT-All charge is approved as a pass-through cost to consumers. It is collected from all electricity end-users as part of their monthly electricity bills to fund the feed-in tariff payments to eligible renewable energy developers.

Coco Levy Fund

Although highly controversial because of corruption and misuse, the Coco Levy Fund can be examined as a similar fund. Republic Act 1145 under President Ramon Magsaysay called for the creation of the Coconut Development Fund. Thereafter, President Ferdinand Marcos established the Coconut Investment Fund under Republic Act No. 6260. This law aimed to create a special fund to finance the establishment of new coconut-based industries and stabilize the coconut market. Farmers were required to contribute a levy of PHP 0.55 per 100 kilograms of copra sold. Without going deeply into the corruption issues, it is important to note that the fund was legally valid in terms of its creation and is an example of an imposition on private persons to contribute to a fund for a special purpose, specifically the development of the coconut industry.

Conclusion

The evaluation of the legal and policy framework of the Philippines reveals that the existing laws and policies are capable of supporting the introduction of a carbon pricing instrument, whether through an ETS or a carbon tax. The existing policies, as found specifically in the Constitution, statutes and jurisprudence, show sufficient alignment with the foundational principles of carbon pricing mechanisms and the overarching goal of environmental protection. However, careful attention must be paid to integrating these instruments within the current legal landscape to ensure coherence and avoid conflicts such as potential legal challenges before the courts. Policymakers will need to take a balanced approach to mitigate potential challenges, including regime overlap, administrative complexity, and fiscal impacts. While carbon taxes offer the advantage of simpler implementation and may be better suited for rapid deployment, an ETS presents unique opportunities, including carbon offset trading, the promotion of adaptation projects, and potential linkages with international carbon markets.

Overall, the country is positioned to explore these options, but further detailed planning and stakeholder engagement are necessary to move forward successfully. To ensure that the adoption of a carbon pricing instrument aligns coherently with existing policies and facilitates smooth execution by the government, the recommendations below are proposed.

For Carbon Tax

- Enactment of legislation that would amend the National Internal Revenue Code (NIRC). The law should clearly set out whether the carbon tax would replace current excise taxes or will be imposed in addition to them.
- Legislation of a Law, Implementing Rules and Regulations (IRR), or administrative regulations to provide for revenue recycling.
- Establish guidelines for proper monitoring, reporting and verification. These guidelines should establish clear protocols and standards to ensure the accuracy, consistency, and transparency of emissions data, particularly for covered entities required to record or measure their emissions.

For Emissions Trading Scheme

- Legislate a Law, or an IRR where it should clearly set out the mandates of each relevant agency as regards to the following aspects of the ETS:
    - Governance and Oversight
    - Compliance and Enforcement
    - Operation
    - Revenue Management
    - Monitoring, Reporting, and Verification
    - Dispute Resolution
- Legislate a Law or IRR to provide a framework to allow stakeholders to meet and discuss how to reconcile overlaps between the RE Market, and whether to

incorporate RECs, GEOP Connection Agreements, REDD+ credits as tradeable carbon offsets

- Legislate a Law or IRR or administrative regulations to provide for revenue recycling if revenues will be generated from ETS operations
- Establish rules and guidelines to address requirement of additionality and avoid double counting
- Establish how each of the accounting frameworks for natural resources (e.g. PENCAS, PGHGIMRS, and CAVCS) will work to support the ETS
- Issuance of necessary orders, circulars, or regulations by the relevant government agencies in regulating the industries that will be affected by the ETS. These would include, at a minimum:
    - Procedure for ETS registration and allocation of allowances
    - Compliance and enforcement
    - Operational framework for carbon trading
    - Coordination mechanisms with other policies and resolution of potential conflicts/overlaps
    - Disclosure and reporting


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