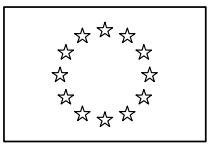

COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 7.7.2004
COM(2004) 500 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND TO THE EUROPEAN PARLIAMENT

on Commission Decisions of 7 July 2004 concerning national allocation plans for the allocation of greenhouse gas emission allowances of Austria, Denmark, Germany, Ireland, the Netherlands, Slovenia, Sweden, and the United Kingdom in accordance with Directive 2003/87/EC

1. INTRODUCTION

Combating climate change is an important objective of the European Union. The EU has decided to do this by implementing its obligations under the Kyoto Protocol, a multilateral agreement to tackle this global problem through multilateral co-operation. Working closely with Member States, industry, civil society and academia a European Climate Change Programme (ECCP) has been developed to help the EU find cost-effective ways of meeting its Kyoto Protocol commitments. A key proposal from the ECCP was the creation of an EU-wide emission trading scheme to help the EU to reduce its emissions of greenhouse gases cost-effectively. In 2003, the Council and Parliament adopted Directive 2003/87/EEC providing for EU-wide emissions trading from January 2005.

The first phase of EU emissions trading covers CO_2 emissions from over 12,000 installations. Each Member State has to draw up a national allocation plan for allocating tradable allowances and notify it to the Commission for assessment. The Directive lays down criteria for the Commission to assess and mandates it to reject a national allocation plan, in whole or in part. In order to help the Member States prepare their plans, the Commission adopted guidance[1] on the implementation of the criteria set out in the Directive.

This Communication sets out the Commission's assessment of 8 plans and is accompanied by decisions addressed to each Member State. One of the reasons why the Commission was given responsibility under the Directive to assess the national allocation plans is to ensure that the Directive's criteria have been correctly applied in the distribution of tradable allowances before trading starts. In a single EU internal market and a single EU emissions trading scheme it is important to guard against distortion of competition through an incorrect application of the Directive or Treaty provisions. This is the first time that the EU engages in EU wide emissions trading and the first trading period, from 2005-2007, has been designed as a "learning phase". However, if more allowances were issued by Member States than the likely quantity of actual emissions from the installations covered, little or no environmental benefit would be provided by the Directive. The development of clean and new technologies would be hampered, and the development of a dynamic and liquid market would be undermined.

2. NUMBER OF NATIONAL ALLOCATION PLANS SUBMITTED

By 25 June 2004, 16 Member States have notified a national allocation plan to the Commission. Of these, 8 (see table 1 below) are sufficiently complete to allow the Commission to take a decision on their compatibility with the Directive. These plans represent close to half of the estimated overall quantity of allowances for the first trading period.

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[1] Communication on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC, COM(2003) 830 final of 7 January 2004. Paragraphs 48 to 64.

Table 1

Member State	Total intended quantity for the period (in tonnes)
Austria	98.242.719
Denmark	100.500.000
Germany	1.499.000.000
Ireland	66.960.000
The Netherlands	285.900.000
Slovenia	26.329.969
Sweden	68.700.000
United Kingdom	736.000.000
Total	2.881.632.688

3. ASSESSMENT OF NATIONAL ALLOCATION PLANS

Each national allocation plan received has been analysed in detail. The Directive requires the Commission to assess them according to the same criteria set out in Annex III of the Directive, and in analysing them, the Commission has identified several issues that were assessed in detail for compatibility with these criteria under the following main headings:

- consistency with each Member State's Kyoto Protocol commitments ("path to Kyoto"),
- ex-post adjustments,
- transfer rules,
- design and management of new entrant reserves,
- other issues specific to individual plans (including consistency with other Community legislation).

Each of these issues is explained in greater detail in the following sections.

3.1. Consistency with a path to Kyoto

The Directive was adopted to contribute to cost-effective compliance with commitments of Member States to reduce greenhouse gas emissions. Hence, criteria 1 and 2 in Annex III are central pillars for the design of a national allocation plan.

In the period 2005-2007 criterion 1 provides that each Member State must submit a plan with a total quantity of allowances "consistent with a path towards achieving or over-achieving each Member State's target under Decision 2002/358/EC and the Kyoto Protocol".

Criteria 1 to 5 need to be observed when determining the total quantity of allowances. The total quantity shall not be more than is likely to be needed for the strict application of the criteria of Annex III, and a Member State should not allocate more than is needed, or warranted, by the most constraining of the criteria. Any application of optional criteria or elements may not lead to an increase in the total quantity.

Where use of Kyoto mechanisms is integrated in the determination of the path to Kyoto, the Guidance Document states: "a Member State must substantiate any such intentions to use the Kyoto mechanisms. The Commission will base its assessment notably on the state of advancement of relevant legislation and implementing provisions at the national level".

In assessing consistency with a path, the Commission has taken into account:

- The actual and projected progress of the Member State;
- The reliance and state of preparation and implementation of measures for the government-funded purchases of Kyoto units;
- The reliance and state of preparation and implementation of measures in non-trading sectors, incl. transport.

Four of the assessed plans intended government-funded purchase of Kyoto units. Austria, Denmark, Ireland, and the Netherlands intend to purchase up to 172 million Kyoto units[2].

In accordance with the Guidance Document the Commission has assessed whether the intended use of the Kyoto mechanisms is substantiated, basing its assessment notably on the state of advancement of relevant legislation and implementing provisions at the national level. The Commission has evaluated the state of advancement against the following aspects:

(a) Does the plan indicate how many Kyoto units the Member State intends to purchase for the period 2008-2012?

(b) Does the plan indicate which Kyoto units (JI, CDM, and International Emission Trading) will be used to what extent?

(c) Does the plan present information on the state of advancement of relevant legislation?

(d) Has the Member State established and notified to the UN a designated national authority?

(e) Does the plan show that implementing provisions (operational programmes, institutional decisions) are in place at the national level?

[2] Austria – 35 million; Denmark – 18.5 million; Ireland – 18.5 million; the Netherlands – 100 million.

(f) Have any credit purchase contracts been signed or any credit purchase tenders been initiated?

(g) Has the Member State set up or made any financial contributions to carbon purchase funds?

(h) Does the plan specify how much money has been committed at this stage?

The results are summarised in table 2 below.

Table 2

	1	2	3	4	5	6	7	8
	Total quantity (Mt)	**Split indicated**	**Law in place**	**National Authority designated**	**Operational programme**	**Contracts**	**Contributions to JI/CDM funds**	**Budget committed (& implied price per tonne)**
Austria	35	**No**	**Yes**	**Yes**	**Yes**	**Yes**	**No**	€ 288 Mn (€ 8.20)
Denmark	18.5	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	€ 126 Mn (€ 6.70)
Ireland	18.5	**No**	**No**	**No**	**No**	**No**	**No**	**No**
Netherlands	100	**No**	**Yes**	**Yes**	**Yes**	**Yes**	**Yes**	€ 736 Mn (€ 7.30)

The Commission finds that the intended use of the Kyoto mechanisms is not substantiated where a Member State has not signed any contracts or initiated any carbon purchase tenders, has not designated a national authority, has no operational programme in place, and has not committed any or sufficient budgetary resources.

Where a Member State does not substantiate the intended use of the mechanisms this contravenes criterion 1 for the element of the intended total quantity of allowances that is built into the path and allocated as a result of the intended use. To determine this element, the proportion of overall emissions that the trading scheme represents is relevant in comparison with emissions from sources not covered by the Directive.

The Commission finds that Austria, Denmark and the Netherlands have substantiated the intended use of the mechanisms.

Ireland, while stating its intention to purchase 18.5 million Kyoto units, has not indicated which mechanism(s) will be used to what extent, has no legal base in place, has not designated a national authority, has no operational programme in place, has not signed any

contracts or initiated any carbon purchase tenders, has not made any contributions to carbon purchase funds, and has committed no budgetary resources yet. The Irish authorities have notified to the Commission on 6 July the commitments to establish an operational programme by 30 November 2004, to establish and notify to the UN Climate Secretariat a designated national authority by 30 November 2004, and to commit financial resources in the budget for 2005. Taking into account the above described changes and the reduced total quantity of allowances, the Commission finds the Irish plan to be in line with criterion 1.

According to Council Decision 2002/358/EC, Denmark is legally obliged to reduce emissions by 21% during 2008-2012 in relation its 1990 emissions. The Danish plan states that on the basis of current knowledge, this corresponds to average annual emissions of 54.9 million tonnes CO_2 equivalent in 2008-2012. However, Denmark has expressed assumptions to which a joint statement by the Council and the Commission to Decision 2002/358/EC refers, on the basis of which an alternative target amounting to an annual average of 59.7 million tonnes CO_2 equivalent is calculated[3]. In case Denmark's assumption with respect to the target is not realised, Denmark has undertaken to accomplish the further reductions needed through domestic measures or the use of flexible mechanisms.

Where a Member State has based its national allocation plan on projected emissions development in the 2005-2007 period for activities covered by the scheme, the Commission has carefully assessed these projected developments, including major assumptions made.

The Commission has made a comparison of production and emissions growth rates for the trading sector with overall economic growth rates as indicated in the plan or available from reliable independent sources. Where a growth rate for the trading sector was in excess of the overall economic growth rate, the Commission has assessed the justification for assuming faster growth in the trading sector compared to the overall economy, in view of the ongoing structural shift in many Member States from the secondary to the tertiary sector.

The Commission has made great effort to compare data in an equitable manner across the Member States, in spite of the differences in the data quality between different plans.

Where projected developments show an increase in output and emissions from activities in the scheme, the Commission has assessed how many allowances are intended to be allocated to existing installations in relation to recent actual emissions, how many allowances are intended to be allocated to known new entrants in accordance with paragraph 54 of the Guidance Document, and how many allowances are foreseen to be allocated to a new entrant reserve.

Where such an assessment has shown that the Member State intends to allocate more allowances to existing installations than emissions were in the base period, the Commission has assessed in how far the projected growth in output and emissions in existing installations is realistic and substantiated in view of the actual and implied average degree of capacity utilisation at activity level to realise the expected growth.

The Commission finds that all assessed plans, including the plan of the Netherlands with the changes notified to the Commission on 23 June, are based on sufficiently justified projections.

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[3] See Table 0.1 in the Danish NAP.

The Commission has assessed whether the plans unduly favour certain undertakings or activities contrary to the requirements of the Treaty. On the basis of the information provided by the Member States, the Commission considers that the measures confer a selective advantage to certain undertakings which has the potential to distort competition and affect intra Community trade. The measures also appear to be imputable to the Member States and to entail the use of State resources to the extent that more than 95% of allowances are given for free. While the Commission cannot therefore exclude that the plan implies State aid pursuant to Article 87(1) of the Treaty, any potential aid granted under the plans (other than a plan which is rejected as contravening criterion 1) is consistent with and seems to be necessary to achieve the overall environmental objective of the Directive expressed in criteria 1 and 2. Beneficiaries will still have an incentive to improve their environmental performance. Any potential unequal treatment was justified by the Member States on objective and transparent grounds.

3.2. Ex-post adjustments

The Directive foresees in Annex III, criterion 10, and Article 11 that a Member State has to decide up-front (before the trading period starts) about the absolute quantity of allowances allocated in total and to each installation's operator. This decision may not be re-visited and no allowances may be re-allocated by means of adding to or subtracting from the quantity determined for each operator on the basis of a government decision or a pre-determined rule. The Directive expressly allows for ex-post adjustments in case of *force majeure* subject to the procedure laid down in Article 29. In addition:

- these Decisions allow corrections to be made to intended allocations in respect of data quality at any time before the decision on allocation under Article 11(1) is taken;

- the Directive does not exclude, where an installation is closed during the period, that Member States determine that there is no longer an operator to whom allowances will be issued; and

- where allocation takes place to new entrants from a reserve, the exact allocation to each new entrant will be decided upon after the decision on allocation under Article 11(1) is taken.

Criterion 10 requires the quantity of allowances to be allocated to existing installations to be stated in the plan prior to the commencement of the trading period. The admissibility of ex-post adjustments has been assessed by the Commission irrespective of whether an intended adjustment, or the magnitude of it, may be attributed to or be independent of the behaviour of the operator that it is proposed to change the allocation for during the period.

On the basis of Annex III, criterion 5, the same principle applies to new entrants. Once a Member State has decided in the course of the trading period the absolute number of allowances to be granted to a new entrant out of a new entrant reserve, it may not re-visit this decision. Otherwise some companies may be unduly favoured or discriminated against by the application of a principle that is not acceptable for existing installations.

Ex-post adjustments would create uncertainty for operators, and be detrimental to investment decisions and the trading market. Ex-post adjustments substitute more efficient solutions found in the market-place by administrative processes that would be cumbersome to implement. Also downward ex-post revisions, that might be argued have a beneficial

environmental effect, are detrimental to the certainty that businesses need in order to make investments that lead to reductions of emissions.

The Commission finds that the intended ex-post adjustments in the plans of Germany and Austria contravene criteria 5 and/or 10.

The Commission finds that the German plan contravenes criterion 10 because Germany intends to adjust or potentially adjust the allocated amount per installation during the period 2005 to 2007 in case (i) existing installations starting operation as of 1 January 2003 experience lower capacity utilisation; (ii) existing installations have annual emissions lower than 40 % of base period emissions; (iii) existing installations receive additional allowances due to a transfer of allowances foreseen for a closed installation; (iv) existing installations or new entrants benefiting from the CHP bonus allocation demonstrate a lower amount of CHP-mode power production than in the base period. The intention of Germany to potentially adjust the allocation of allowances to new entrants contravenes criterion 5 which requires non-discrimination in accordance with the Treaty, because the application of such *ex-post* adjustments would discriminate new entrants compared to the operators of other installations in respect of which no *ex-post* adjustments to their allocation are permitted by the Directive.

The Commission finds that the Austrian plan contravenes criterion 10 because Austria's rules concerning the transfer of the eligibility to be allocated a certain amount of allowances from existing installations that close down imply an adjustment of the allocated amount to an existing installation during the period 2005-2007.

3.3. Transfer rules

Given differing expectations of the time it will take to establish a large and liquid market, the Directive allows Member States a certain discretion to decide how new entrants will be able to begin participating in the trading scheme. Furthermore, Member States have discretion on the treatment of closed installations.

If a Member State does not withhold the issuance of allowances to a closed installation for the remainder of a trading period, the transfer of allowances from a closed installation to a new installation, under the control of the same operator, is in place.

Where a Member State has chosen to withhold the issuance of further allowances to a closed installation for the remainder of a trading period and has established a new entrant reserve, it is necessary to examine the conditions under which this part of the scheme will operate in order to ensure that installations benefiting from a transfer rule are not unduly favoured vis-à-vis those who do not. The application of a transfer rule may be limited in the sense that an operator is only eligible to benefit from it in case both the closed and the new installation are located on the territory of the Member State.

The Commission furthermore notes that retaining allowances following closures is expected to create incentives for investment in clean and efficient installations. The environmental impact of a transfer rule, however, is neutral, unless a Member States would cancel any allowances not issued following closure. Any surplus allowances are likely to be surrendered by another installation, in the same Member State or elsewhere, to cover emissions.

3.4. New entrant reserves

As explained above, the Directive allows Member States some discretion to decide whether to set aside a share of the total quantity of allowances in a new entrant reserve so to allocate allowances free of charge to new entrants starting to operate new installations over the course of the trading period, as specified in paragraphs 48-64 of the Guidance Document.

In accordance with the Guidance Document the Commission has covered the following aspects in its assessment of new entrant reserves:

- justification for its size;
- description of the methodology by which allowances would be granted to new entrants;
- existence of any dedication for specific activities, technologies or purposes;
- use made of any allowances remaining at the end of the period;
- provision upon exhaustion of the reserve during the period.

The 8 plans assessed foresee the establishment of new entrant reserves amounting of 80.8 million allowances in total.[4]

The Commission finds that all assessed plans foresee a reserve of a sufficiently justified size. It has assessed, in particular, to what extent any growth is expected to take place in existing installations (except for capacity extensions that fall under new entrant treatment) as opposed to new installations, taking into account any allocation for known new entrants in accordance with paragraph 54 of the Guidance Document.

The Commission finds that all assessed plans contain some information on the methodology by which allowances are to be granted out of the reserve to new entrants. However, plans do still lack operational detail. The Commission cannot exclude that more detailed rules, when developed, may contravene other criteria or the Treaty unless it has all necessary information. It finds that criterion 6 is not fulfilled when information presented on the manner in which new entrants will be able to begin participating in the trading scheme is insufficient. This is the case for the United Kingdom.

The Commission notes that Austria, Ireland, Sweden and the United Kingdom have chosen some dedication rules for the new entrant reserve by means of priority access for specific technologies (Sweden) or partitioning the reserve into sub-segments (Austria, Ireland and the United Kingdom). The Commission has assessed whether these dedication rules are excessive insofar as they may contravene the freedom of establishment as guaranteed under the Treaty, and finds that no plan contains excessive dedication rules.

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[4] Austria – 1.0 million; Denmark – 3.0 million; Germany – 9.0 million; Ireland – 1.0 million; the Netherlands – 7.5 million; Slovenia – 0.2 million; Sweden – 2.4 million, UK – 56.8 million.

In assessing what use will be made of any allowances remaining in the reserve at the end of the period, Denmark and Germany intend to cancel any remaining allowances at the end of the period. Austria, Ireland, Slovenia, and the United Kingdom[5] intend to sell any remaining allowances. Sweden and the Netherlands have not decided yet whether remaining allowances will be cancelled or sold, but have committed not to transfer to existing installations. The transfer of remaining allowances for free to existing installations contravenes criterion 10 – cf. ex-post adjustments. The cancellation or sale of the remaining allowances are admissible, to the extent that, in accordance with Article 10, not more than 5% of the total quantity allocated for the period 2005-2007 may be sold. The Commission recalls that any sale of any remaining allowances should, as explained in the Guidance Document, take place at the end of the trading period when it is assured that no further new entrants may arise to be eligible for an allocation out of the new entrant reserve.

In assessing what happens if the reserve is exhausted during the period, the Commission notes that Austria, Denmark, Ireland, the Netherlands, Slovenia, Sweden, and the United Kingdom intend to have further new entrants purchase allowances on the market.

3.5. Consistency with other legislation

The Directive states in Annex III, criterion 4, that national allocation plans must be consistent with other Community legislative and policy instruments.

Directive 2001/77/EC on the promotion of electricity produced from renewable energy sources in the internal market[6] requires Member States to set national indicative targets for the share of renewable energy in 2010 and to take measures to fulfil these targets. This will lead to reductions in covered emissions independently of the effect of the emissions trading scheme. The Directive is therefore a Community instrument that should be taken into account in the preparation of national allocation plans. It should be taken into account in the form of a number of allowances provided for the activity of electricity generation that is lower than would otherwise have been the case.

In its assessment of the plans concerned, the Commission has found them all to be consistent with the Directive 2001/77/EC.

3.6. Issues specific to individual plans

The United Kingdom's plan does include a list of installations to be covered, but the list does not include installations in Gibraltar. The list required by criterion 10 is therefore incomplete.

Table 3 below summarises the assessment of the Commission, indicating where criteria have been contravened.

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[5] The UK has committed not to sell more than 5 % of the total quantity of allowances issued by the UK for the period 2005-2007, so as to respect Article 10 of the Directive.

[6] OJ L 283, 27.10.2001, p. 33.

Table 3

	Austria	Denmark	Germany	Netherlands	Ireland	Slovenia	Sweden	UK
(1) Kyoto								
(2) Emissions development								
(3) Potential								
(4) Other legislation								
(5) Non-discrimination			REJECT					
(6) New entrants								REJECT
(7) Early action								
(8) Clean technologies								
(9) Public consultation								
(10) List of installations with quantity for each one	REJECT		REJECT					REJECT
(11) Outside competition								
Article 10								