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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee
Subject:	<p>Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 and</p> <p>Proposal for a Decision of the European Parliament and of the Council amending Decision (EU) 2015/1814 as regards the amount of allowances to be placed in the market stability reserve for the Union greenhouse gas emission trading scheme until 2030</p> <p>- Preparation for the trilogue</p>

I. INTRODUCTION

1. On 14 July 2021, the Commission submitted three proposals to the European Parliament and to the Council, as part of the 'Fit for 55 package', relating to the Emissions Trading System (ETS):
 - a) a proposal to amend the Directive on the EU Emissions Trading System, the Decision on the Market Stability Reserve (MSR) and the Regulation on monitoring, reporting and verification (MRV) in the maritime transport sector (general ETS);

- b) a separate proposal to amend the Decision on the Market Stability Reserve (MSR Decision); and
- c) a proposal to amend the Emissions Trading System Directive with regard to aviation (ETS aviation)¹.
2. The overall aim of the proposals is to ensure that the ETS delivers its share of the increased overall EU ambition of reducing net greenhouse gas emissions by at least 55 % by 2030 and to put the EU on track to meet its objective of becoming climate-neutral by 2050.
3. The European Economic and Social Committee delivered its opinion on 8 December 2021. The Committee of the Regions delivered its opinion at its session from 27 to 29 April 2022.
4. In the European Parliament, on behalf of the Committee on the Environment, Public Health and Food Safety (ENVI), Mr Peter Liese (EPP, DE) was appointed rapporteur for the general ETS proposal, Ms Sunčana Glavak (EPP, HR) for the ETS aviation proposal and Mr Cyrus Engerer (S&D, MT) for the proposal for a separate MSR decision. The European Parliament adopted its negotiation mandate on the general ETS proposal on 22 June 2022, on aviation on 8 June 2022 and on the MSR Decision on 5 April 2022.
5. Within the Council, the three proposals related to the revision of ETS were dealt with together and on 29 June 2022, the Council reached general approaches on all three proposals².
6. Subsequently, the ETS aviation proposal has been dealt with separately.

¹ Informal trilogues with the European Parliament on the ETS aviation proposal are organised separately from the revision of the general ETS directive and the MSR Decision.

² Documents 10796/22, 10800/22 and 10798/22

7. So far two trilogues have taken place on the ETS general proposal, on 11 July and 10 October 2022. On 6 September 2022, a separate trilogue was held on the MSR proposal. The third trilogue on the ETS revision is scheduled for 10 November 2022.
8. A number of Technical Meetings have been held to prepare the trilogues enabling progress on a number of issues.
9. On 27 October 2022, the Working Party on the Environment was informed of the state of play of the preparations for the third trilogue on the ETS revision.

II. PRESIDENCY SUGGESTIONS IN VIEW OF THE TRILOGUE

10. The third trilogue will mostly focus on making progress on ETS 1 in particular on market functioning, free allocation (including the interaction with CBAM), scope, and financial mechanisms, by taking stock of progress made at the technical level as well as trying to move forward on the pressing political issues.

The trilogue will also aim to confirm agreement on some important texts agreed provisionally at the technical level on the maritime cluster where the positions of both co-legislators converged (i.e. anti-evasion, transfer of costs and other elements).

As regards ETS BRT and ETS1 ambition, the Commission will present its reflections on the possible way forward on the main principles and elements. The Presidency will not ask delegations for a revised mandate before there is more clarity on the way forward on the overall scope but it will express openness to further discuss viable alternative options on other elements if feasibility, implementability and balanced approach are ensured.

11. Given that there appears to be a political will to reach an agreement before the end of the year in a balanced manner as also noted in the Council conclusions on the mandate for COP 27 on climate change, the Presidency proposes that in a constructive spirit the Council should be ready to make a number of concessions on political points to pave the way for agreement under the crucial proviso “nothing is agreed until everything is agreed”.

12. To this end, the Presidency below outlines suggestions for “sub-packages” on A) market functioning, B) free allocation (including the interaction with CBAM) and scope, and C) indications on the approach to be taken on financial mechanisms. It is important to note that these elements should be seen together and aim at providing a careful balance between the Council and the Parliament while at the same time preserving the balance within the Council.

Concretely, the Presidency suggests the following:

A) Sub-Package on market functioning:

- a) Article 29a: maintain Council text but lower the multiplier to 2,25;
- b) Accept the Commission’s text on market monitoring and follow up to ESMA’s final report (articles 10(6), Article 29 and recital – rows 177b-f and 52b). In addition, the Council could be open to additional elements in the Parliament amendments (mention of specific aspects to be monitored and a reference to recommendations) while keeping the overall balance of the text.
- c) The above openness of the Council is predicated upon the Parliament dropping its amendments on restriction of market access.

B) Sub-Package on free allocation (including the interaction with CBAM) and scope:

- 1) On Free allocation:
 - a) Be open to partially accept conditionality based on the approach suggested by the Commission (based on energy audits) and certified energy managements systems (suggested by the Parliament) and only under the conditions that the Parliament drops both the conditionality based on decarbonisation plans and the differentiated reduction levels for free allocation, and while ensuring that:
 - i) The percentage value for reduction is set to 10 %;

- ii) The payback period is set at maximum 3 years (in line with the same condition applied for indirect costs compensation schemes);
- iii) It is specified in the Directive that the Commission shall ensure that the application of the conditionality does not jeopardize a level playing field, environmental integrity and equal treatment between installations across the Union. The Commission shall, without prejudice to the rules applicable under the [Energy Efficiency Directive [2012/27/EU], be empowered to adopt rules to address any issue identified in particular on the above mentioned principles and provide for administratively simple rules for the application of the conditionality. These rules should be part of the general rules for free allocation, using the established procedure for national implementing measures (Art 11(1) of the ETS Directive) and provide timelines, criteria for the recognition of implemented energy efficiency measures as well as for alternative measures reducing GHG emissions.

Linked to conditionality, accept a modified version of bonus/malus system whereby the 10 % best performing installations are possibly exempted from the application of the cross sectoral correction factor, using with priority saved free allocation from the application of conditionality (i.e. a combination of those elements of the Parliament's amendments in rows 181 and 200b).

b) On benchmarks:

- i) Accept the compromise text based on the Parliament's amendment on the review of benchmarks in Article 10a (1) (row 187) and recital 8 (row 18), while also maintaining the Council addition to that recital. Open to consider further clarifications on the inclusion of the circularity principles in the benchmark review;
- ii) Accept a text to accommodate the Parliament's amendment on the hydrogen benchmark (Annex, row 475);

- iii) Keep the agreed text on “hot metal” benchmark (row 195);
 - iv) Maintain the minimum update rate of 0,2 %.
- c) On free allocation for electricity (Article 10c) and district heating, the Presidency suggests keeping the General Approach of the Council. At the same time, delegations are asked to indicate openness to accept the Parliament's amendment on Article 10c under certain conditions. The provision on free allocation for electricity generation is temporary and the Parliament suggests to delete Article 10c and move the remaining allowances to the Modernisation Fund. In order to accept deletion of Article 10c, the Parliament would be expected to drop its amendments on restricting natural gas projects under the Modernisation Fund (for the allowances transferred in accordance with Article 10d (4) and for the original 2 % allocation).
- d) On the interaction with CBAM, including exports:

Given that no additional viable WTO compatible alternative has been presented on exports, the Council insists on maintaining its position on:

- i) The rhythm on the phase out of free allocation to give CBAM sectors, including exporters more time to adjust, and provide more time for the Commission to find solutions, including at the international level;
- ii) Stronger text for special attention for CBAM sectors in the Innovation Fund;
- iii) Review clause (Article 30(2)).

At the same time, the rules on free allocation, including benchmarks, must not disproportionately affect CBAM sectors, which would be hit in particular if the minimum update rate would be increased from 0,2 % to 0,4 % as the Parliament suggests.

- 2) On scope:

Given the progress reached at the technical level and the flexibility already shown from the Council on aspects of review and scope, the Presidency suggests the following:

- a) Agree to the compromise text on CCU in Article 12 (3b) and the review clause on negative emissions³, as well as inclusion of a reference to relevant commitments taken at climate COPs, ensuring alignment with the Union's climate neutrality objective, and to a paragraph on links to other carbon markets (rows 269t-u, 271c) in Article 30;
- b) Agree to extending the 5-year period (row 83) and including the review clause on 20 MW threshold in Article 30;
- c) Agree to start monitoring the incineration of municipal waste from 1 January 2024 (or deadline for transposition of the Directive) combined with a possibility for Member States to opt-in the sector from 1 January 2026 and tasking the Commission to assess and report on the possibility of including the sector in the ETS from 2031;
- d) Maintain Council position on installations using biomass (should be seen in the context of the provisions and impacts on free allocation).

C) Approach on Financial mechanisms:

Negotiations have not reached a mature enough stage to propose an overall compromise and further progress will depend on the constructiveness and flexibility of the Parliament towards the Council also on the issues mentioned above. Therefore, the Presidency rather suggests a cautious approach to the discussions at the next trilogue combined with acceptance of some concrete proposals to be seen in the overall context.

³ For Council, this text is considered to be a compromise covering all of Parliament's amendments related to the CCU/CCS and negative emissions (rows 252a –f, compromise texts in rows 250 and 271d-e on the review).

1) Innovation Fund

The Presidency suggests to maintain Council's position on the two key issues relating to the Innovation Fund (IF), the size and innovative nature (in comparison to Parliament's “upscaling”, linked to the suggested change of name). These are closely interlinked and cannot be assessed separately. Nonetheless, in order to allow for further discussion, and given the developments in the Council especially on the REPowerEU proposal, delegations are asked to indicate whether they could show any openness to transfer to the Innovation Fund some additional limited amounts of aviation allowances and allowances from the increased cap due to inclusion of maritime transport, subject to reaching a well-balanced compromise overall.

On many additional aspects of the Parliament's proposal, further to the flexibilities provided in the mandate for the trilogue on 10 October, concrete suggestions have been examined at the technical level and on that basis the Presidency suggests to:

- a) Accept the compromise suggestions on:
 - i) list of sectors and technologies to be covered (row 208, first part and 208a);
 - ii) medium scale projects (row 209);
 - iii) geographical balance (rows 211a and 210b);
 - iv) selection criteria and knowledge sharing (rows 211 and 210b), while as concerns row 211 on geographical areas further clarifying the text to the reference on scalability criteria is needed;
 - v) reporting and information (rows 201a, 212a, 210c).

On the rest, the Council maintains its position.

b) On the text of competitive bidding (accommodating the Parliament's amendment in row 208b), the suggestion is to be open to a possible compromise while noting that the current text is very complex, lacks legal clarity and thus requires further work and resources that are taken away from other matters. It is to be noted that the Parliament has signalled this amendment as important.

2) On the Modernisation Fund (MF):

The Presidency suggests to link any Council flexibility to reciprocal flexibility expected from the Parliament. Work so far has focused only on clarifications and additions of text on concrete EP's amendments with no progress on main political issues. Nevertheless, the Presidency suggests to continue to be constructive and:

- a) Accept a text on streamlining Parliament's amendments on funding areas (rows 173b-175b, 175e-f);
- b) Continue to be open to cross-border projects (row 171) as per the mandate for the 10 October trilogue but based on a text that the Commission can agree to.

Conversely, the Presidency intends to continue to insist on the Council position on including an additional Member State in the Fund, on the share between the priority and non-priority investments and continued limited funding of natural gas projects, on which a fragile agreement has been reached in the General Approach. The Presidency will also continue to reject the amendments on funding conditions related to climate neutrality at Member State level and rule of law as going too far and out of scope.

3) On the use of auctioning revenues, as part of the overall balanced text, the Council is willing to agree to additional language as suggested in the compromise on streamlining the funding areas (rows 173a-175h). The Parliament continues to insist on its amendments on earmarking of funding for transport and developing countries, conditions of additionality of spending for climate purposes, even more detailed reporting requirements and demands for Member States submitting plans on future spending. The Presidency will continue to reject these amendments and maintains the position on “should vs shall”.

4) Visibility

Given that the Parliament is willing to drop the reference to the Commission having to take all necessary measures if Member States do not comply with the visibility requirements, and in order to be constructive, the Presidency believes that it is acceptable to make a step towards the Parliament by including an additional Article 30ic on visibility of EU ETS funding (row 351k), also given that it is common to have such provisions in texts on EU funds and programmes. However, an adjustment should be made between the Innovation Fund, Modernisation Fund, and the use of Member States revenues as these revenues and the Modernisation Fund are not part of the EU budget. The Presidency suggests a text based on notably the LIFE and Horizon Regulations with wording adjusted to the distinct forms of revenues.

Overall, on the financial mechanisms and in particular on the Modernisation Fund and the use of auctioning revenues, the Presidency's assessment is that no further progress can be made before the Parliament shows willingness to drop its most far-reaching demands that present unacceptable conditions not directly linked to the ambition of the ETS, are legally unfounded and/or add further excessive administrative burdens on Member States and the Commission.

13. As regards ETS maritime, the Presidency suggests to:

- a) Accept the compromise texts on anti evasion (Article 3g (1), 3(wa) and 3ge (2)), recitals 18a and 19 while as concerns Article 3g(1) – rows Rows 28a, 29, 97a-c, 120, 155, 155f+g) clarifying the text so that it is clear that the reference to 300 nautical miles is in relation to any port under the jurisdiction of a Member State. The text of the two co-legislators went in the same direction but the Parliament could agree to work on the basis of the Council approach. The review clause is a merger of the two positions. A reference to the ports in the outermost regions has been added and in the corresponding recital it has been specified that as part of further future potential measures, the surrender obligation could be increased;
- b) Accept the compromise texts on transfer of costs (Article 3gaa and recitals 20 and 20a – rows 151a-e and 130 a-c and 30 and 30a) where the co-legislators positions aim at achieving the same result. Again, the Parliament accepted the Council approach. Upon request of the Parliament an addition to recital 20a has been included on the importance of application of the national transposing measures throughout the Union, to all contractual arrangements for a level playing field. The Presidency considers these texts are overall balanced.

Further, the Parliament has accepted the Council texts on administering authority in respect of a shipping company and on sanctions, in addition to the texts accepted at the last trilogue (notably on EMSA).

On the MRV, good progress has been made at the technical level and only political issues, notably on scope and dates (linked to the phase-in) are outstanding.

Overall, on maritime the discussions have reached a point where almost only the main political points are outstanding, and the Presidency will revert to delegations with an overall approach as soon as possible in light of the following trilogue.

14. On the Market Stability Reserve (MSR) (separate decision and ETS proposal) and Ambition, the mandate remains unchanged. As concerns the separate MSR decision, the Council can be flexible on some of the recitals.
15. The proposed mandate for the third trilogue is set out in detail in the fourth column of the tables contained in ADD 1 and 2 to this note.

III. CONCLUSION

16. The Permanent Representatives Committee is invited to agree to the Presidency's suggestions as set out in this note and its ADD 1 and 2 (the four-column tables) in view of the upcoming trilogue.
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