Council of the European Union

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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee
Subject:	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 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 - Preparation for the trilogue

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 28 June 2022, the Council reached general approaches on all three proposals[2].

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 three trilogues have taken place on the ETS general proposal, on 11 July, 10 October and 10 November 2022. On 6 September 2022, a separate trilogue was held on the MSR proposal. The fourth trilogue on the ETS revision is scheduled for 22 November 2022.

8. A number of Technical Meetings have been held to prepare the trilogues enabling progress on a number of issues.

II. PRESIDENCY SUGGESTIONS IN VIEW OF THE TRILOGUE

9. The fourth trilogue will focus on making substantial progress on:

   - ETS maritime (main outstanding political points);
   - ETS for buildings and road transport / ETS BRT (main parameters),
   - ETS 1 Ambition.

10. Following the progress made at the trilogue on 10 November and based on reflections provided by the Commission, the Presidency proposes that in a constructive spirit the Council should show flexibility on a number of points to pave the way for a balanced agreement under the crucial proviso "nothing is agreed until everything is agreed". To this end, the Presidency below outlines suggestions for "sub-packages" on the main outstanding political points on ETS maritime and on the main parameters of ETS BRT (including the link to the Social Climate Fund).

11. On **ETS maritime**, the Presidency suggests the following:

    a) On phase-in of surrendering obligations (Article 3ga – rows 123 – 129[3]) a compromise on the following lines:

       - 2024: 30 % of verified emissions reported;

[3] Row numbers as set out in the four-column table previously distributed to delegations.

- 2025: 60% of verified emissions reported;

- 2026: 100 % of verified emissions reported;

b) On the <u>scope of greenhouse gases</u> (Annex – row 481) to accept automatic inclusion of methane and nitrous oxide emissions in the ETS but only from 2027;

c) On the <u>scope of vessels</u> – MRV and ETS:

- accept inclusion of offshore vessels of 5000 GT and above in the MRV from 2025 together with small cargo ships as in the Council text with review on inclusion in the ETS by end of 2026;

- on smaller vessels other than general cargo ships to maintain the Council position.

d) On the <u>geographical scope</u> (Article 3g(1) – row 119) to maintain the Council position. It is noted that as part of the review following the possible adoption of a global measure within the framework of IMO, the Commission may also consider changes to the scope.

e) On <u>exemptions/derogations</u>:

- maintain the derogation on islands (Article 12 (3-d) – row 246d) while clarifying that only islands that have no road and rail connection are included, but accept a limited adjustment downwards of the population threshold;

- continue to reject the Parliament's amendment on PSO derogation as too broad and likely leading to increase in PSO routes and with unknown impacts. The amendment also addresses connectivity but the Council's approach with the island derogation is better targeted;

- maintain the targeted PSO derogation of the Council's general approach (Article 12 (3-c) – row 246e);

- maintain in principle the Council text on outermost regions (Article 12 (3-b) – row 246g) but if needed be flexible on an exclusion of cruise ships;

- maintain the Council text on ice class ships (Article 12 (3-c) – row 246c);

- accept partially in principle the derogation for humanitarian voyages (Parliament amendment in row 481) by clarifying that the ETS applies only to commercial voyages for transporting passenger or cargo and as concerns MRV to voyages for servicing offshore installations (i.e. voyages solely for search and rescue or humanitarian purposes are not covered by the MRV and ETS). Search and rescue operations carried over as part of a commercial voyage shall not be exempted from the ETS obligations, in light of the duty under international law to assist persons in distress at sea.

f) On the use of revenues:

- maintain the Council text on redistribution of allowances from the increased cap due to the inclusion of maritime transport in the ETS (Article 3g (2) – row 121);

- be open to include some clear and dedicated maritime topics in the Innovation Fund calls with the view to support maritime projects with clear European added value;

- be open in the Innovation Fund text to include maritime specificities (e.g. to electrify transport, to address its full climate impact, as well as to take biodiversity protection, noise and water pollution issues into account, the latter as a way to take a step towards the Parliament's request that a part of ETS revenues should be used for biodiversity actions.). However, continue to reject funding of purely biodiversity actions;

As concerns the issue of additional allowances from the increased cap due to the inclusion of maritime in the ETS to the Innovation Fund, this will have to be seen in the overall context of the size of the Innovation Fund. In this context, and if useful in order to move negotiations forward, consider to include specific maritime issues in Article 10(3) on the use of revenues not overlapping with the scope of the Innovation Fund and possibly inspired by the Parliament's suggestions for funding areas in an Ocean Fund.

12. On **ETS BRT**, the Presidency suggests the following:

a) Continue to reject any split between commercial and private actors suggested originally by the Parliament as unworkable (row 274b);

b) On the start of the ETS BRT (Article 30c and following articles), continue to reject Parliament amendment on the start of the system in 2025 (for commercial actors) and possibly 2029 (for private actors), but provided that the Parliament drops its request for a split scope be open to discuss a start in 2026 combined with a possible time-limited emergency brake mechanism in case of exceptionally high energy prices based on a proposal outlined by the Commission (parameters set out in the Annex), which could delay the start by one year.

c) On the scope of fuels (Article 30a), maintain the scope set out in the Council's position with the possibility of an opt-in clause for "all fuels" (Article 30j). Member States are asked to indicate any possible openness to discuss inclusion of fuels used for a strictly targeted and limited additional purposes, if proven feasible, taking into account carbon leakage protection and under the condition that EP drops unworkable amendments such as the split scope, or cost-pass-on;

d) On avoiding double counting (Article 30f (4) work further based on Commission input;

e) Maintain the mechanism on excessive price fluctuations in Article 30h as set out in the Council's position, noting that Article 30h mechanism sets up sufficient control mechanism so price ceiling amendment by the EP is not needed;

f) Maintain the derogation as set out in Article 30e in the Council position, for operators in Member States with national carbon taxes of an equivalent of higher value than the ETS BRT;

g) On cost pass on (row 334a) – continue to reject the amendment to limit cost-pass through but show openness to explore alternatives, e.g. transparency via a monitoring obligation, if they are feasible, legally sound and adjusted to avoid disproportionate levels of administrative burden on regulated entities and national authorities and provided that the Parliament drops its amendment on the split scope.

h) As regards the introduction of compensation for vulnerable households and transport users through a voucher scheme from the Social Climate Fund as presented by the Commission, the Presidency suggests the following:

- show openness to discuss the inclusion of such scheme under the Social Climate Fund provided that further possible details and parameters of any such system are appropriately discussed in the framework of Social Climate Fund negotiations before reflecting on possible ways forward;

- such openness is predicated upon the Parliament dropping its amendments on the ETS BRT split scope and accepting the Council's position on the budgetary architecture of the Social Climate Fund.

13. On **ambition of ETS 1**:

The Parliament has stated that there is a clear link between its position on the ETS BRT and climate vouchers for SCF and the Parliament´s request to increase the ambition in the ETS 1.

The Commission noted there is a possibility to find a middle ground, which could unlock an agreement on the ambition and ETS BRT, with an ETS target of 62%. This could be achieved while maintaining a cumulative cap similar to the one in the Council General Approach, with a split rebasing of the cap between 2024 and 2026 and slight change in the linear reduction factor.

At this stage, the Presidency considers it premature to move away from the General Approach of the Council, which represents a very delicate overall balance on all the issues connected to ambition, including the Market Stability Reserve. This issue will be dealt with in preparations for the next trilogue in light of the aim to achieve an overall balance of the text.

III. CONCLUSION

14. The Permanent Representatives Committee is invited to agree to the Presidency's suggestions as set out in this note in view of the upcoming trilogue.

Contribution by the Commission on the parameters on the energy price conditionality/emergency brake in case of prevailing high energy prices in the context of ETS BRT/ETS2

A conditional limited postponement of one year seems also the best solution to mitigate impacts on the Social Climate Fund. In order to provide clarity on the use of the SCF as well as predictability for market participants, the Commission should publish whether the conditions have been met on 30 June (cut-off date) of the year preceding the expected start of ETS2. The publication could take place by 15 July, in order to allow a time margin for the publication procedures. This should allow MSs more information for the planning of their payment request as well as in case agreed distribution over time of resources from national co-financing of the SCF. The Council's general approach already proposes that 50 million allowances from ETS1 would be auctioned to cover the costs of SCF. Assuming a robust ETS1 price, the amount collected from the auctioning of 50 million ETS1 allowances would be sufficient to cover the first SCF expenses before the ETS2 auctioning.[2]

In practical terms, using wholesale energy market prices has the advantage that reference price data is immediately publicly available (e.g. TTF[3] for gas in EUR per MWh, Brent for oil in USD per barrel), that it is a key driver of future end use price changes and that is not impacted by nationally determined network charges and taxes. It is essential to use a benchmark price which is the most relevant for the ETS2. A well-established TTF benchmark is especially relevant for gas since it reflects the additional costs that come with getting the gas into the national grid and out of the national grid to the consumer. At the same time, a **focus on gas and oil wholesale price**s_(instead of also including coal or other fuels) is a justified simplification, as these drive prices for more than 90% of fossil fuel use in both residential buildings and road transport. The trigger condition could allow for the possibility of increasing oil prices compared to March 2022 prices, as oil price levels at that date were not exceptionally high compared to historic prices (if inflation is taken into account) and are generally expected to increase in the future. Further **considerations on the concrete trigger prices** are:

- Separate trigger conditions for natural gas and oil prices, no averaging between the two. The delay would apply **if one or both** of the triggers are met.
- As in EP proposal, comparison of an actual price period with a historical reference.
- The actual reference price is determined based on the first six months of the year preceding the start of auctioning, as proposed by EP, this could be sufficient to iron out short-term oscillations.
- The historical reference for oil should be expressed in a dynamic way, e.g. the average oil price during the five preceding years. In case of a cap applying from 2026, the average prices in the first half of 2025 would be compared to the average prices 2020 to 2024.
- As for gas, the price situation remains exceptional, so it might also be considered to accept EP's condition of a reference to recent gas prices, e.g. of March 2022.

- The trigger for oil could be 2 times the five-year average 2020-24 of the wholesale reference price (Brent for oil in USD per barrel), acknowledging that oil prices vary a lot and are expected to increase over time, and that only certain price peaks in 2022 were exceptional, but not average prices.

[2] Frontloading of ETS1 50 million will likely generate more than in COM proposal (EUR 2.495 bn in 2025).

[3] The new LNG benchmark would be published by ACER as of 1/1/2023. There are uncertainties on how it will develop and whether it will be accepted by the market. As EP refers to 2022 data, this might not be available in terms of the new benchmark.