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NOTE

From:	General Secretariat of the Council
To:	Permanent Representatives Committee/Council
Subject:	Fit for 55 package a) Revision of Directive (EU) 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading to implement the ambition of the new 2030 climate target and related proposals b) Revision of Regulation (EU) 2018/842 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement c) Revision of Regulation (EU) 2018/841 on the inclusion of greenhouse gas emissions and removals from land use, land use change and forestry in the 2030 climate and energy framework d) Revision of Regulation (EU) 2019/631 setting CO_2 emission performance standards for new passenger cars and for new light commercial vehicles e) Regulation establishing a Social Climate Fund – Progress report – Policy debate

I. INTRODUCTION

1. On 14 July 2021, the European Commission submitted the above-mentioned proposals as part of the 'Fit for 55' package of legislative proposals. The package aims to align the EU's climate and energy policy framework with its new ambitious climate target for 2030 of reducing net greenhouse gas emissions (GHG) by at least 55% and to put it on track to reach its objective of becoming climate neutral by 2050.

2. Within the Council, the proposals are dealt with in four Council formations: Environment, Energy, Transport, and Economic and Financial Affairs.

3. A report containing an overview of progress of the proposals under the 'Fit for 55' package has been prepared by the Presidency (document 13977/21). The report focuses on the horizontal aspects of the package, such as interlinkages between files, and the main issues raised in discussions so far. It has been submitted to the responsible Council formations together with separate progress reports on the individual proposals.

4. The Environment Council held a first exchange of views on the 'Fit for 55' package on 6 October 2021. With a view to the meeting of the Council (Environment) on 20 December 2021, the present report aims at providing more detail on the progress made on the five files under the remit of the Environment Council and, where possible, at setting out in broad terms the preliminary views of delegations on the main issues.

5. These files are at the core of the 'Fit for 55' package, with the increased ambition of the EU Emissions Trading System (ETS) as a main driver, together with updated national targets in the Effort Sharing Regulation (ESR) and measures to enhance natural sinks through the Regulation on Land use, land-use change and forestry (LULUCF). The proposed tightened CO_2 standards for cars and vans aim at helping Member States to reach their increased national targets while stimulating technological innovation in the sector. The proposed new Social Climate Fund (SCF) aims to address the social and distributional impacts of the proposed new emissions trading system for buildings and road transport.

6. As regards the overall progress on these files, the Presidency's assessment is that considerable further technical work will be required on most of them due to their complexity and the introduction of new elements, and additionally, as regards the ETS, the sheer size of the file.

II. <u>WORK UNDERTAKEN DURING THE PRESIDENCY</u>

i) <u>Emissions Trading System (ETS) reform</u>

7. Three proposals are dealt with under ETS reform[1]: a proposal to amend the ETS Directive, the Market Stability Reserve (MSR) Decision and the MRV shipping Regulation ("general ETS"), a proposal to amend the ETS Directive as concerns aviation ("ETS aviation") and a separate proposal to amend the MSR Decision.

[1] Proposal for a Directive 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 (do. 10875/21 + ADD 1-7);
Proposal for a Directive amending Directive 2003/87/EC as regards aviation's contribution to the Union's economy-wide emission reduction target and appropriately implementing a global market-based measure (doc. 10917/21 + ADD 1-3);
Proposal for a Decision 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 (doc. 10902/21 + ADD 1).
In addition, a fourth proposal concerning ETS was submitted on 14 July 2021: Proposal for a Decision amending Directive 2003/87/EC as regards the notification of offsetting in respect of a global market-based measure for aircraft operators based in the Union. The proposal is dealt with separately under TTE (Transport).

The aim of the proposals is to ensure that the ETS delivers its share of the increased overall EU ambition through introducing carbon pricing in sectors not yet covered by the ETS (maritime, and buildings and road transport) and strengthening existing provisions. The "ETS aviation" proposal also has the objective of implementing CORSIA[2]. The proposals should, as concerns the existing ETS, result in an overall emissions reduction of 61% in sectors under the ETS by 2030 compared to 2005, from the current objective of 43%. The proposed separate ETS for buildings and road transport should provide a 43% emissions reduction in these sectors compared to 2005 levels, aimed at contributing to Member States meeting their national targets under the Effort Sharing Regulation.

In the European Parliament, the Committee on Environment, Public Health and Food Safety is in the lead on the proposals. The Committee on Industry, Research and Energy is associated Committee on the "general ETS" proposal. Peter Liese (EPP, DE) has been appointed rapporteur for the "general ETS" proposal, Sunčana Glavak (EPP, HR) rapporteur for the "ETS aviation" proposal and Cyrus Engerer (S&D, MT) rapporteur for the separate MSR Decision proposal. Work on the proposals is at an early stage, and according to available information, no final timetables have been communicated.

The European Economic and Social Committee and the Committee of the Regions have been consulted on the proposals but have yet to deliver their opinions.

The Working Party on Environment held eight meetings during the Slovenian Presidency devoted to examining the three proposals related to ETS reform and their impact assessments. The discussions have been based on thematic grouping of the proposals and contributed to an initial reading focused on clarifying issues to allow delegations to understand better the detail of the proposals. In that regard, delegations have asked for more information on the impact of the proposals at Member State level and sought clarifications on the interlinkages with other proposals in the 'Fit for 55' package. Most delegations are still studying the texts and therefore their comments or positions are mostly preliminary.

[2] Carbon Offsetting and Reduction Scheme for International Aviation, agreed by the International Civil Aviation Organisation (ICAO) in 2016.

Delegations continue to view the ETS as being at the heart of the EU's climate policy. While there appears to be general acknowledgement that the ETS will have to deliver its cost-efficient share of the EU's increased ambition, views differ on the proposed changes. In this context, there have been some calls for exploring options for increasing further the ambition of the ETS but also concerns of possible impacts of certain parts of the proposals on both economic sectors and households, underlining the need to take into account the different situations of Member States.

Establishment of a separate ETS for buildings and road transport

Discussions so far have highlighted the strong linkages between the proposed ETS for buildings and road transport and other elements of the 'Fit for 55' package, notably the Social Climate Fund Regulation, the Effort Sharing Regulation, the Energy Taxation Directive, the Regulation on CO_2 emission standards for cars and vans, and the Energy Efficiency Directive.

There is a general acknowledgement that further efforts are needed to decarbonise the buildings and road transport sectors. However, a large number of delegations have raised concerns on the Commission's proposal, with a number of delegations expressing significant reservations as regards the appropriateness of applying emissions trading to these sectors. These concerns pertain in particular to increased energy prices, social and distributional impacts on lower income households, further increasing the risk of energy poverty and leading to a widening of disparities between and within Member States. Against that background, some delegations also challenged the assertion that for these sectors, ETS would be the most effective tool for decarbonisation, arguing that costs might simply be passed on to consumers. Several have raised questions as to whether the Social Climate Fund will be sufficient to mitigate the social and distributional impacts. Some delegations are concerned about the ensuing loss of revenues, referring inter alia to national tax measures in place. Some delegations have also raised issues regarding implementation and administrative burden.

Conversely, a number of delegations have welcomed the proposed introduction of emissions trading for buildings and road transport, stressing its higher potential to decarbonise these sectors in a cost-efficient manner, while supporting Member States meeting their increased national targets under the Effort Sharing Regulation. These delegations acknowledge the need for mitigating measures against social and distributional impacts, with some pointing out that alternative measures will also have similar impacts but that carbon pricing also generates revenues that may be used for such measures. Some have doubts about the Social Climate Fund.

Concerning the proposed scope of fossil fuels covered by the separate ETS, some delegations have been open to a larger scope covering all fossil fuels. On the other hand, others have enquired about a more limited scope of the sectors, e.g. excluding the buildings residential sector.

Given the novelty of the proposed emissions trading for buildings and road transport, initial discussions have to a large extent focused on obtaining detailed clarifications on both impacts of the proposal by sector and per Member State, including auction shares and revenues per Member State, and on various design elements. In relation to the provisions of the separate ETS aimed at ensuring a smooth start of the system, delegations have welcomed their aim with some requesting clarifications in particular on the calculation and breakdown of data with regard to the proposed cap, including emissions share per Member State and per sector, and the proposed 30% frontloading of allowances for auctioning in 2026. While still studying the proposals, some delegations considered that an even smoother start would be more appropriate and wondered whether the frontloading of allowances might lead to problems at a later stage.

With regard to the separate Market Stability Reserve (MSR), various clarifications have been sought by delegations on the rationale behind the proposed parameters and functioning, inter alia on initial size and the thresholds for placing or releasing of allowances in the reserve. As concerns the proposed price increase-based mechanism to counter the risk of excessive price fluctuation, some delegations have raised concerns about its effectiveness, with some requesting clarifications as regards any possible impact of the carbon price under the existing ETS on the carbon price under the proposed emissions trading for buildings and road transport.

Strengthening of the existing ETS and its ambition

Delegations consider the proposals on rebasing of the cap and increasing the linear reduction factor as key elements in strengthening the ambition of the ETS. These have been welcomed by a number of delegations with some in favour of exploring how ambition could be increased further. With regard to the rebasing of the cap, there have been a number of questions as to its calculation, projected value in numbers and its impact, with some concerned that it may lead to a steep carbon price increase in the year when it is introduced (also to be seen in light of the MSR proposals). Initial comments on the addition of 79 million allowances for the maritime sector in the cap have mostly focused on clarifying calculation and methodology. A few question marks have been raised on the impact of the increased linear reduction factor.

As concerns the provisions on carbon leakage/free allocation, delegations have focused on obtaining a very detailed understanding of the implications of the proposed changes. Delegations have welcomed the aim of avoiding the triggering of the cross-sectorial correction factor and, in that regard, several explicitly supported the approach of a more targeted free allocation. Nevertheless, some questions and concerns have been raised on the proposed changes. Notably, the proposal to condition full free allocation to installations on implementing the recommendations in the energy audit provided for in the Energy Efficiency Directive (EED) has given rise to issues for a number of delegations, with some expressing strong reservations thereto. Some have argued that it would lead to a different and unfair treatment of installations under the system, inter alia stating that the purpose of free allocation is not to implement the recommendations in the energy audit under the EED. Some delegations have acknowledged the objective of the proposal but have raised issues related to the possible administrative burden related to its implementation. The increase in the benchmark maximum update rate for free allocation has been questioned by some delegations, concerned about the impact on their industry. Further, issues have been raised on e.g. the scope of free allocation related to maintaining for five years under the ETS certain installations that would otherwise fall out of scope after having implemented measures reducing their energy consumption and emissions.

Particular attention has been given to the proposed phase-out of free allocation in the ETS for sectors covered by the Carbon Border Adjustment Mechanism (CBAM) aimed at ensuring WTO compatibility of EU measures against carbon leakage. Initial comments have ranged from suggesting to explore a swifter phase-out (allowing a swifter phase-in of CBAM) to requesting a cautious approach, some indicating that the decision on phasing-out should only be taken in a review following the pilot phase of the CBAM. Delegations have inter alia sought clarifications on issues related to the equivalence between the treatment of products produced by installations under the ETS and imported products, underlining the need to ensure that the CBAM mechanism will provide the same protection from carbon leakage as free allocation. Many questions have been posed on the impact of the phase-out on EU producers' competiveness on export markets.

As regards the maritime and aviation sectors, emphasis has been on fully assessing the proposals, notably in terms of their contribution to emissions reductions, their impacts on the sectors and competitiveness, while looking at the international context and national circumstances (e.g. connectivity issues). With regard to interlinkages with other files, some delegations have called for an assessment of the cumulative impacts of the proposals on ETS, ReFuelEU Aviation, FuelEU Maritime, and on energy taxation.

Delegations generally recognise the need for maritime transport to contribute to reducing greenhouse gas emissions. In general, there has been support for the inclusion of the maritime transport in the ETS while at the same time the importance of safeguarding the competiveness of the EU shipping industry and taking into account specific national and geographical circumstances has been underlined. Nevertheless, for some, the inclusion and decarbonisation of the maritime sector pose particular challenges and risks. A number of delegations have requested to look closely at the modalities for inclusion (e.g. phase-in of the system, distribution of auction rights, and the entity responsible for surrendering allowances) while ensuring adequate support to research and innovation and dedicating auction revenues to the greening of the sector.

Concerning the proposed scope and ambition level of the ETS extension to maritime transport, delegations have requested clarifications on the proposed 50% coverage of extra-EU voyages and some wished to explore increasing ambition (e.g. non CO_2 emissions and inclusion of ships under 5000 tonnes).

A number of delegations also expressed doubts whether the proposed measures to counter the attempts by market actors to reduce their exposure to carbon pricing, notably by favouring non-EU ports close to Member States or shifting to other modes of transport ("carbon evasion"), are sufficient and called for further measures. In that context, many delegations have underlined the need to ensure a level playing field for the EU shipping industry.

Some delegations have inquired whether the review clause allowed for the possibility of fully aligning with a future market-based measure agreed within the International Maritime Organization, insisting on the need to react to any relevant developments in that regard.

Some delegations have requested further information on the proposed provisions regarding the regulated entity, the administrative authority, as well as enforcement and penalties, and in particular whether the latter are proportionate and aligned with international procedures. In addition, issues have been raised on the impact on maritime transport prices and the potential increase in administrative burden for companies and authorities.

As regards the "ETS aviation" proposal, the initial examination has focused on rather detailed and technical questions to clarify various provisions of the proposal and its impact, including on competitiveness and consumers. The aim of further decarbonising the sector while ensuring a fair level playing field for European airlines in a global market, is generally supported. Specifically, on the two main features of the proposal, namely a gradual phase-out of free allocation for aviation and the implementation of CORSIA:

– General acknowledgement that free allocation should be phased out, however, with some favouring a slower phase-out, also in light of COVID-19, and calling for adequate support to the sector. Several other delegations supported the proposal for the transition to full auctioning, or prefer a swifter or even immediate phase-out.

– On the proposal to apply CORSIA as appropriate through the ETS Directive, a few queries have been made on the option chosen as regards scope (i.e. applying CORSIA for extra-EEA flights and continued application of the ETS on intra-EEA flights and departing flights to the UK and Switzerland). Comments have focused on seeking clarifications on the modalities for implementation, in particular on the coherence with the ambition of the Paris Agreement and alignment with CORSIA. Questions have centred inter alia on quality of credits and terminology related to credits, countries covered and baseline.

Initial comments on the proposals on the Market Stability Reserve (MSR) have concentrated inter alia on the impact of the proposals on carbon pricing. Comments have on the one hand centred on ensuring a strong price signal to underpin an ambitious ETS, and, on the other hand, on mitigating against price shocks, in particular sharp price increases, with some also querying the cumulative impacts of the rebasing of the cap and the changes to the MSR in the year of rebasing. To this end, some questions have also been posed as to the proposed changes to the design parameters, including the threshold level for triggering MSR intervention and why in that regard the thresholds are not being reduced. Others have asked whether other criteria, notably carbon price levels, for triggering intervention would be more appropriate. One delegation suggested that the MSR should be seen as an instrument to address imbalances between the revenues and the costs paid by the ETS installations in Member States that are beneficiaries of the Modernisation Fund.

On the separate proposal for a MSR decision continuing the double intake rate of 24% until 2030, several delegations have explicitly expressed their support for the proposal, recalling the need to continue to remove the historical surplus, while some delegations have indicated that they have significant concerns on its impact.

Against the background of the recent spike in energy prices, a number of delegations have underlined the need to, as a priority, strengthen Article 29a on "Measures in the event of excessive price fluctuations" (not part of the Commission's proposal) to make it more reactive. Some have also called for addressing possible speculation in the ETS market. Others have cautioned against measures that could weaken or even undermine the functioning of the ETS. A number of delegations consider that the discussion on the increase in energy prices should not take place in the framework of the 'Fit for 55' package.

With regard to the ETS financial provisions, discussions have mainly focused on the size, sourcing, scope and distribution of the Modernisation Fund and the Innovation Fund, as well as the provisions on earmarking.

Several delegations have welcomed the proposed increase of the Modernisation Fund with some suggesting a further increase, while others have been calling for an assessment of the use of the funding, including the expected effects of such increase on climate mitigation. The proposed exclusion of the support to investments related to any fossil fuels (not only solid fossil fuels) from funding under the Modernisation Fund is explicitly supported by several delegations, while a number of delegations have expressed strong reservations, with some recalling the reference in the European Council conclusions of December 2020, on the role of transitional technologies such as gas.

The increase of the Innovation Fund has been welcomed by several, whereas others have questioned it. Some have raised concerns on the sourcing of the Innovation Fund, in particular from allowances from the separate ETS on buildings and road transport, and allowances resulting from the reduction in free allocation to sectors included in the CBAM.

In general, delegations welcome the clarification that all sectors under the ETS can benefit from the Innovation Fund, as well as the extension of the scope to allow it to provide support to projects through competitive tendering mechanisms such as Carbon contracts for difference. Some considered that in particular the maritime transport sector as a new sector under the ETS needs to benefit from adequate funding, for example through earmarking. A suggestion for setting up a specific fund for supporting the green transition of the maritime sector has also been made. Some have called for more geographical balance in the distribution of projects under the Innovation Fund.

Several delegations have sought clarifications on the compulsory earmarking of all auction revenues for climate and energy-related purposes, highlighting issues of compatibility with national budgetary principles. Many have underlined that the financial provisions have to be assessed in light of the upcoming Commission proposal on the Own Resources Decision and its implications on Member States' share of auction revenues. Similar remarks have also been made for the revenues expected from the proposed separate ETS for buildings and road transport, including their earmarking.

As regards other issues, it is noted that installations using biomass are a particular priority for some delegations. In that context, a few delegations have expressed concerns that the proposed lower threshold value of 95% for zero-rated biomass combustion will create incentives for these installations to use fossil fuels.

ii) Effort Sharing Regulation (ESR)[3]

8. The main aim of the Commission proposal is to increase the contribution of the ESR to the EU's overall climate ambition for 2030 by setting a new EU-level target for greenhouse gas emission reductions in the sectors covered by the ESR of 40% (from the current 29%), compared to 2005, and to update the Member States' national targets accordingly.

The European Parliament has appointed Ms Jessica Polfjärd (EPP, SE) as Rapporteur for the Committee on the Environment, Public Health and Food Safety (ENVI). Work on the file is at an early stage and according to available information, no final timetable has been communicated.

The European Economic and Social Committee and the Committee of the Regions have been consulted on the proposals but have yet to deliver their opinions.

During the Slovenian Presidency, the Working Party on the Environment has examined the proposal and its impact assessment at three meetings, which have enabled the completion of a preliminary first reading of the proposal. While there is general overall support for the increased overall ambition of the proposal, most delegations are still studying the proposal in more detail and therefore their views or positions are preliminary at this stage. The discussions have thus focused on clarifying the new elements of the proposal compared to the existing ESR. During the meetings held so far, the Commission has tried to provide clarifications and answers to the questions asked by delegations which relate in particular to the proposed targets, flexibilities and additional reserve, including in relation to other 'Fit for 55' proposals.

[3] Proposal for a Regulation amending Regulation (EU) 2018/842 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement (doc. 10867/21 + ADD 1-4)

The proposal maintains the current scope of the ESR, which includes road transport and buildings. Delegations in principle welcome the fact that the scope has not been changed but have called for additional information on the interaction between the ESR and the proposed new emissions trading for buildings and road transport. According to the Commission, the simultaneous extension of emission trading to these two sectors under the proposed revision of the ETS Directive will support Member States in meeting their ESR targets instead of substituting them.

The approach used to update the proposed national targets of Member States continues to be based on GDP per capita with limited corrections to take account of cost-efficiency concerns. While some delegations welcome that GDP per capita remains the basis for the calculation, some others are concerned that the methodology used does not sufficiently reflect the criterion of cost-efficiency or contribute to convergence over time in particular given that the target range of 40 percentage points is unchanged from the existing ESR. Some delegations have indicated that they see their respective new targets as very challenging. At the request of delegations, the Commission has provided some additional information and references to data on the calculation of the national targets.

In addition, some delegations have expressed concerns that the proposed review of emissions data from national inventories, proposed to take place in 2025, and subsequent readjustment of the Member States' annual emission allocations for the years 2026-2030 may lead to uncertainty for the Member States. The readjustment, as part of the technical update of the framework for setting the Member States' annual emission allocations, is proposed for the reason that the impacts of the COVID-19 pandemic and the recovery from it on the EU's economy and level of emissions are unknown and cannot yet be fully quantified. According to the Commission, the readjustment aims at ensuring that the amount of annual emission allocations still allows transfers between Member States and takes into account a possible rebound while avoiding the accumulation of excessive surpluses.

When it comes to the flexibilities provided for in the ESR, delegations in general agree that flexibilities will play an important role in terms of helping Member States reach their national targets in a cost-effective manner while respecting environmental integrity. The Commission proposal maintains the general flexibilities (banking and borrowing, trading of annual emission allocations between the Member States) while some changes are proposed to the ETS flexibility (increased access for Malta) and the LULUCF flexibility which allows Member States to use a limited amount of net removals from the LULUCF sector towards their target compliance under the ESR. Concerning the latter, several delegations have requested further clarification of the proposed changes to the LULUCF flexibility and the rationale for splitting the use of the total maximum amount of the flexibility between the two five-year compliance periods without providing any possibility for carryover from the first period (2021-2025) to the second (2026-2030). According to the Commission, this is linked to the change in the accounting methodology proposed in the LULUCF Regulation for the period 2026-2030 as well as to the European Climate Law.

The proposal also contains a new, voluntary reserve that would be composed of any LULUCF credits that remain unused at the end of the second compliance period. Member States could have access to the reserve in order to comply with their ESR 2030 target on condition that the EU has achieved its overall 2030 target taking into account the maximum limit for the contribution of net removals under the European Climate Law. Several delegations have also requested more information about the aim of the new additional reserve, its expected functioning and potential to help Member States comply with their ESR targets, while some regret the lack of predictability for Member States given that they will not know about its availability until the end of the compliance process.

In addition to the questions about the concurrent functioning of the flexibilities provided for in the ESR and LULUCF proposals, a few delegations have enquired whether it would not be possible to increase the use of or access to the one-off flexibility between the ETS and ESR to enhance the cost-efficiency of emission reductions.

iii) Regulation on Land Use, Land Use Change and Forestry (LULUCF)[4]

9. The main aim of the Commission proposal is to strengthen the contribution of the LULUCF sector to the EU's increased overall climate ambition for 2030 by setting an EU-level target of 310 million tonnes of CO_2 equivalent in net greenhouse gas removals in the LULUCF sector in 2030.

In the European Parliament, the Committee on the Environment, Public Health and Food Safety (ENVI) is the lead committee, with Mr Ville Niinistö (Greens/EFA, FI) appointed as Rapporteur. Mr Norbert Lins (EPP, DE) has been appointed as Rapporteur for the Committee on Agriculture and Rural Development (AGRI), which is associated committee with shared competence on specific provisions (Art. 2(3) and Art. 4(4)). Work on the file is still at an early stage and according to information currently available, no final timetable has been communicated.

The European Economic and Social Committee and the Committee of the Regions have been consulted on the proposals but have yet to deliver their opinions.

4 Proposal for a Regulation amending Regulations (EU) 2018/841 as regards the scope, simplifying the compliance rules, setting out the targets of the Member States for 2030 and committing to the collective achievement of climate neutrality by 2035 in the land use, forestry and agriculture sector, and (EU) 2018/1999 as regards improvement in monitoring, reporting, tracking of progress and review (doc. 10857/21 + ADD 1-4).

During the Slovenian Presidency, the Working Party on the Environment has examined the proposal and its impact assessment at four meetings, which have enabled the completion of a preliminary first reading of the proposal. At this stage, the views expressed by delegations are mostly preliminary and the discussions at technical level on the Commission proposal have mostly focused on the clarification of the proposed amendments to the existing Regulation, in particular in the context of the significant changes to the overall regime from 2026 onwards. Most of the questions and concerns expressed so far relate to the national targets for 2030, the envisaged post-2030 framework, the flexibilities designed to help Member States comply with their targets (including the interaction with flexibilities and the additional reserve proposed in the ESR), the compliance and penalty mechanism as well as the monitoring and reporting requirements.

From 2021 to 2025, the proposal maintains the current 'no-debit' rule, which means that Member States have to ensure that the sum of total emissions does not exceed the sum of total removals generated by the sector after the application of the relevant accounting rules and the flexibility with the ESR sector. For the period 2026-2030, the proposal sets out an EU-level target of 310 million tonnes of CO_2 equivalent of net removals in the LULUCF sector by 2030. That target is distributed between Member States as binding national targets based on the current mitigation performance of their LULUCF sector and their share of managed land area in the EU. In 2025, the Commission proposes to adopt an implementing act determining annual targets for each Member State, based on a linear trajectory. From 2031 onwards, the Commission proposes to merge agriculture non-CO_2 sector emissions with the removals and emissions under the LULUCF Regulation scope to create a new single pillar covering Land Use, Forestry and Agriculture. In addition, the proposal sets out the aim of climate neutrality by 2035 at EU level in the combined sector. Furthermore, the proposal defines a process whereby, by the end of 2025, the Commission will submit a legislative proposal setting out the Member States' contributions to the climate neutrality target in the combined land sector.

Delegations generally acknowledge the important role of the LULUCF sector in the EU's climate policy and its increased overall ambition. However, in their initial views, a number of delegations have raised concerns about the national targets proposed for 2030, including their level of ambition, the criteria used in their calculation, and the proposed new compliance mechanism. Many have questioned how national characteristics such as natural geographical conditions and forest age structure, as well as the need to ensure the long-term enhancement of sinks, were taken into account in the target distribution. A majority of the delegations are concerned that the proposed process for the subsequent setting of annual targets for the years 2026-2029 based on a linear trajectory is not suitable for a sector characterized by large inter-annual fluctuations and that for this same reason it would not be appropriate to check compliance against a single year. Several delegations have also expressed concerns about the application of the proposed mechanism of technical corrections and asked for more information about the envisaged process and outcomes. At this stage, there are still numerous questions about the envisaged post-2030 framework, which some delegations consider may be premature to include in this proposal.

Discussions on the flexibilities have thus far focused on clarification of their technical aspects and the changes to the existing flexibilities after 2025, as well as on gaining a better understanding of the links between the flexibilities in the ESR and LULUCF proposals, including in the context of the European Climate Law. From 2026, the banking of the surplus removals from the period 2021-2025 to the period 2026-2030 will no longer be possible. Member States can, however, continue to trade their surpluses. The existing land use flexibility will be made more comprehensive in the second period by enlarging the scope from Managed Forest Land to all land reporting categories. The total possible quantity of the flexibility will be divided in two and its use will be subject to compliance at EU level with the targets for both periods. In the second period, the land-use flexibility is intended to function as a single flexibility instrument and can be used to level out fluctuation between years. Furthermore, an additional mechanism could be used under certain conditions to help Member States faced with natural disturbances in both of the periods.

In general, delegations recognise that flexibilities, in particular for natural disturbance events, will be very important to facilitate the Member States' compliance with the increased ambition after 2025. However, they have expressed concerns about whether the proposed flexibilities will be adequate in this respect, in particular where the availability of the flexibility is conditional on the achievement of the overall EU target. Questions have been raised about the discontinuation of the possibility for Member States to bank surplus LULUCF removals from the 'no-debit' period of 2021-2025 for use in the period 2026-2030, as well as about the fact that the proposal does not allow banking of surplus removals within the second compliance period in the context of the annual targets.

The proposal includes amendments to the Energy Union Governance Regulation (EU) 2018/1999[5], which contains the rules for monitoring and reporting of greenhouse gas emissions and removals and for tracking the Member States' progress towards their targets under the LULUCF Regulation. These amendments include measures to increase the accuracy of monitoring and reporting and requirements for monitoring and reporting of emissions and removals using advanced technologies available under Union programmes such as Copernicus, and digital data collected under the Common Agricultural Policy. Helped by the new data made available following the application of the new requirements to the inventory systems, Member States will also be required to provide additional information in their compliance reports relating to the two periods, respectively in 2027 and 2032, including an assessment of synergies and trade-offs between national policies and measures, with a view to moving to more policy-oriented measures instead of only ensuring coherence at the level of accounting.

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5 Regulation (EU) 2018/1999 of the European Parliament and of the Council of 11 December 2018 on the Governance of the Energy Union and Climate Action, amending Regulations (EC) No 663/2009 and (EC) No 715/2009 of the European Parliament and of the Council, Directives 94/22/EC, 98/70/EC, 2009/31/EC, 2009/73/EC, 2010/31/EU, 2012/27/EU and 2013/30/EU of the European Parliament and of the Council, Council Directives 2009/119/EC and (EU) 2015/652 and repealing Regulation (EU) No 525/2013 of the European Parliament and of the Council (OJ L 328, 21.12.2018, p.1).

Delegations have expressed concerns that the new monitoring and reporting requirements risk to increase significantly the complexity of the greenhouse gas inventory, some indicating that the required information should be limited to that necessary to ensure the monitoring of progress and the review of emissions and removals in the sector. Several delegations are also concerned that the new requirements may lead to additional costs, administrative burden or duplication of work. In general, delegations consider that more discussion at technical level is required to understand better the requirements and their implications.

iv) Regulation on CO_2 emission standards for cars and vans[6]

10. The proposal aims to contribute to the EU's increased overall ambition by increasing the 2030 CO_2 emissions reductions targets for new cars and vans and by introducing a 100% target for 2035, thereby stimulating innovation and ensuring that the European automotive industry maintains and strengthens its global competiveness. The increased ambition will inter alia support Member States in meeting their binding national targets under the Effort Sharing Regulation.

In the European Parliament, the Committee on Environment, Public Health and Food Safety is in charge of the proposal. Jan Huitema (Renew, NL) has been appointed rapporteur. Work on the file is at an early stage and according to available information, no final timetable has been communicated.

The European Economic and Social Committee and the Committee of the Regions have been consulted on the proposal but have yet to deliver their opinions.

[6] Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2019/631 as regards strengthening the CO_2 emission performance standards for new passenger cars and new light commercial vehicles in line with the Union's increased climate ambition (doc. 10906/21 + ADD 1-5).

During the Slovenian Presidency, three meetings were held at the Working Party on Environment to examine the proposal and its impact assessment, including one article-by-article examination. While initial discussions have clarified a number of issues, most delegations are still studying the proposal and therefore their views or positions are mostly preliminary. Nevertheless, initial discussions have revealed preferences as concerns the ambition for the target levels. It should, however, be noted that some delegations have not or only partly provided even preliminary indications on the proposed target levels.

There is a general understanding that the automotive sector has to contribute to the increased overall EU climate ambition for 2030 and 2050. For a number of delegations, the proposal is key for achieving the overall ambition and to fulfil their increased national targets under the Effort Sharing Regulation. A number of delegations underlined that the ambition should be looked at in a coherent manner with other proposals in the ‘Fit for 55’ package and in particular with the proposal on the Alternative Fuel Infrastructure Regulation (AFIR).

The focus of discussions has been the increased targets, including in particular the 100% target for 2035, which requires all new cars and vans to be zero-emission vehicles by that date and de facto entails a phase out of the internal combustion engine.

Several delegations have called for or could support a higher level of ambition, arguing that a swifter acceleration towards zero-emission vehicles is both possible and required in light of the overall ambition. In this context, it is notably pointed out that zero-emission vehicles are already becoming widely available, and their market uptake is expected to increase significantly. Increased ambition would help speeding up both deployment and affordability of those vehicles, including in the second hand market. In particular, these delegations wish to advance the 100% target to 2030. Some have inquired about possibilities for Member States to take additional measures at national level (some Member States have policies/plans for an earlier phase out than proposed by the Commission). Some delegations have suggested increasing the 2025 targets and setting an interim target between 2025 and 2030, also questioning the differentiated targets for cars and vans in 2030.

Conversely, other delegations have supported maintaining the current 2025 targets and the differentiated targets for cars and vans, as proposed by the Commission.

Some delegations have indicated at least preliminary support for the proposed ambition level, albeit some with certain caveats or nuances. A suggestion has been made that the 2035 target of 100% should be accompanied by some type of derogation for the best performing low-emission vehicles until 2039.

For a number of delegations, the proposed ambition level is a source of concern, notably the 2035 target of 100%, which some explicitly deem unacceptable. As concerns the 2030 targets, so far some have indicated that they disagree with the Commission proposal. Concerns expressed centre around whether a phase out of the internal combustion engine is premature and more time is needed, some suggesting that a decision on the phase out should only be taken in the context of the next review that could be advanced to 2026. These delegations have highlighted a number of considerations in this context, notably the need to take into account the different situations of Member States as concerns the uptake of zero- and low-emission vehicles due to disparities in the roll out of charging infrastructure and in purchasing power; and that phasing out the internal combustion engine goes against the principle of technological neutrality. It has also been stressed that the impact of the shift in manufacturing and ensuing job losses should be factored in, requiring substantial action inter alia in upskilling and reskilling of workers. In addition, issues of affordability of electricity and availability of batteries and raw materials have been raised.

There has been a call for considering the impact of the proposal on the <u>second hand cars market</u> of certain Member States, highlighting that the speedier uptake of zero- and low-emission cars in higher income Member States could lead to an increased export of older more polluting cars in low-income Member States. While acknowledging that the issue cannot be dealt with in the present Regulation, it is suggested that the Commission monitor it e.g. in the context of the progress report/review process and look closer into possible solutions.

Some delegations have called for or could support an inclusion of the contribution of renewable and low-carbon fuels when assessing the vehicles manufacturers' compliance with their targets. However, a number of delegations strongly support the Commission's arguments against this, including that these fuels are better directed towards other sectors that are more difficult to decarbonise.

A few delegations wish to end the use of the so-called mass parameter in determining the specific emissions targets for manufacturers and therefore the distribution of efforts among them.

As concerns the mechanism to incentivise the uptake of zero- and low-emission vehicles agreed in the last revision of the Regulation, the Commission proposes to phase it out by 2030 considering the stringency of the target as the main driver for their uptake. Comments made so far show that a number of delegations support this with some advocating an earlier phase out and stating that in its present form it risks undermining ambition. Others argue against the proposed phase out, highlighting that it provides particular incentives to stimulate the uptake of these vehicles in Member States with a current low uptake. A few delegations have expressed reservations on ending the small volume manufacturer derogation given that it has very limited benefits on emissions reduction but takes account of certain characteristics of the market. Others have expressed their support to the proposal.

Initial discussions showed support for advancing the review scheduled in 2028, with delegations putting forward a number of additional issues to be reviewed or included in the envisaged progress report also cf. the discussions related to the proposed ambition.

v) Regulation on the Social Climate Fund[7] (SCF)

11. The proposal aims to mitigate the social and distributional impacts of the emissions trading system for buildings and road transport by establishing a Social Climate Fund (SCF regulation) to support vulnerable households, micro-enterprises and transport users. Based on Social Climate Plans to be developed by the Member States, it supports measures and investments to reduce vulnerable groups' emissions in these sectors and can also cover temporary direct income support.

In the European Parliament, both the Committee on Environment, Public Health and Food Safety (ENVI) and the Committee on Employment and Social Affairs (EMPL) are lead committees in a joint committee procedure. The Committee on Budgets (BUDG) is an associated Committee with exclusive competence on aspects that directly concern own resources. Esther de Lange (EPP, NL) has been appointed rapporteur for ENVI, David Casa (EPP, MT) for EMPL and Margarida Marques (S&D, PT) for BUDG. Work on the proposal is at an early stage and according to available information, no final timetables have been communicated.

The European Economic and Social Committee and the Committee of the Regions have been consulted on the proposals but have yet to deliver their opinions.

[7] Proposal for a Regulation of the European Parliament and of the Council establishing a Social Climate Fund (doc. 10920/21 + COR1 + ADD 1 + ADD1 COR1).

The Ad Hoc Working Party on the Social Climate Fund (AHWP SCF)[8] held three meetings on the SCF regulation during the Slovenian Presidency. The discussions focused on clarifying a number of important general and budgetary aspects of the proposal. While there is a general acknowledgement of the need to ensure a green transition which leaves no one behind and to address the social consequences of the proposed emission trading for buildings and road transport, the proposal has overall received mixed reactions. Some delegations welcomed the general idea of establishing a Fund, while many raised significant concerns and sought clarifications, in particular on the interlinkages with other proposals in the 'Fit for 55' package, the data supporting various calculations in the proposal and the impact at Member State level, with several regretting the absence of a standalone impact assessment. Delegations are still studying the text and therefore their comments or positions have been mostly preliminary. An article-by-article examination of the proposal will start under the French Presidency.

For most delegations, the SCF regulation is intrinsically linked with the proposed new emissions trading for the buildings and road transport sectors in the revised ETS directive, with some also stressing the social and distributional impacts of other proposals of the 'Fit for 55' package, including the Energy Taxation Directive.

Several delegations emphasised that finalising national positions on the SCF regulation will be subject to assessing the upcoming proposals on the Own Resources Decision and the amendment of the Multiannual Financial Framework (2021-2027). Some delegations raised concerns about reopening the Multiannual Financial Framework and considered that existing funds could be used to address the social consequences of the proposed emissions trading for buildings and road transport. In this context, a number of delegations pointed to an overlap between the scope of the Fund and other instruments, in particular cohesion policy instruments and the Recovery and Resilience Facility, as well as national measures.

[8] Its mandate was approved by the Committee of Permanent Representatives (Part 1) on 8 September 2021 (doc. 11402/2021 + COR1). Under the authority of the Committee of Permanent Representatives, the AHWP SCF reports to the Environment configuration of the Council and, as appropriate, to the Economic and Financial Affairs configuration of the Council.

With regard to the proposed legal bases i.e. Article 91(1)(d) TFEU (transport), Article 192(1) TFEU (environment) and Article 194(1)(c) TFEU (energy), a number of delegations queried their appropriateness and whether it was possible to provide for temporary direct income support under the proposed legal bases. The Council Legal Service provided a preliminary analysis during one of the AHWP SCF meetings.

The direct management of the Social Climate Fund has also been questioned by several delegations, which expressed their preference for shared management. In addition, some delegations also queried the rationale behind the use, as a mandatory tool, of an integrated and interoperable information and monitoring system including a single data-mining and risk-scoring tool.

With regard to the content of the Social Climate Plans, delegations questioned the possible overlaps with other strategies to be set out by Member States, such as the Territorial Just Transition Plans. Furthermore, the fact that the indicators for reporting on the progress and for the purpose of monitoring and evaluation are to be set out by a delegated act, was contested by several delegations, which would prefer to have the indicators as part of the regulatory text in line with the approach for cohesion policy.

In terms of eligibility of actions, delegations sought more detailed analysis concerning the measures and investments eligible for financing, as well as on the distribution between measures and investments, and temporary direct income support under the Fund. delegations also sought clarifications on the principle of ‘do no significant harm’ and looked forward to receiving technical guidance from the Commission on this issue.

Concerning the size of the Social Climate Fund, the proposal foresees a total of EUR 72.2 billion over the 2025-2032 period. This amount corresponds in principle to 25% of the expected revenues of the proposed emissions trading for buildings and road transport. A majority of delegations asked about the Commission’s calibration and requested additional explanations regarding the total volume proposed for the Fund, with several delegations questioning the Fund's size.

Delegations raised concerns with regard to the provisions on co-financing (e.g. Member States should finance at least 50% of the total costs of the Social Climate Plans using part of their expected revenues from the auctioning of allowances under the new system). In this regard, several delegations requested additional explanations on a single 50% national co-financing rate applicable to all Member States, with some considering it too high.

Concerning the proposed allocation methodology for the distribution of the Fund, delegations raised several questions and concerns regarding both the formula used, which was considered too complex, and the allocation criteria, which many delegations did not find appropriate to address their specific national circumstances and to ensure fairness. In this context, the choice of indicators was also questioned.

As regards the duration of the Social Climate Fund, the fact that the Social Climate Fund covers two MFF periods is considered politically sensitive by several delegations and further analysis will be necessary. Some delegations stressed that an 8-year duration starting from 2025 is pre-empting the future Multiannual Financial Framework. In the current proposal, the Fund is set up with no time limit. The budget of the Fund is currently broken down into two parts: 1) a financial envelope for the period 2025-2027 and 2) a financial envelope for the period 2028-2032. For the period 2025-2027, the Commission is going to propose an amendment to the current MFF Regulation, to be agreed at the same time as the basic act setting up the Social Climate Fund and the amendment to the Own Resources Decision. For the period 2028-2032, it is proposed that the amount would only be made available if an agreement is found in the next MFF Regulation to allocate a specific amount of budget to the Social Climate Fund.

In line with the mandate of the AHWP SCF, the Presidency has bracketed the relevant provisions in the proposal and its annexes, on the financial aspects, linked to the Multiannual Financial Framework and the Own Resources of the Union, including inter alia the size and duration of the Fund, and allocation methodology. The bracketed provisions are those most likely to form part of horizontal budgetary negotiations.

III. CONCLUSION

The Permanent Representatives Committee is invited to take note of the present progress report and the questions for the policy debate as set out in the Annex thereto and forward them to the Council (Environment) with a view to its meeting on 20 December 2021.

ANNEX

Questions to ministers for the policy debate of the Council (Environment)

1. *Based on your political assessment of the progress made so far on the five files under the remit of the Environment Council, what could be the level of ambition for further progress on the five climate-related initiatives in the coming months, taking into account the various interlinkages between the proposals, including with other proposals of the 'Fit for 55' package?*

2. *In this context, what do you see as the most sensitive issues in those five files?*