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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 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 five trilogues have taken place on the ETS general proposal, on 11 July, 10 October, 10, 22 and 29 November 2022. On 6 September 2022, a separate trilogue was held on the MSR proposal. The sixth trilogue on the ETS revision is scheduled for 16 December 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 sixth trilogue will deal with all outstanding issues in view of making efforts to reach an overall agreement on the ETS general proposal and the separate MSR decision.
10. In view of the trilogue, the Presidency proposes a revised mandate as set out below.

A. FREE ALLOCATION (INCL. CBAM INTERACTION) AND SCOPE

All flexibility under this section is predicated upon a satisfactory compromise on the Modernisation Fund – priority share and natural gas.

11. On Free allocation (see text in rows 181, 200b and 219 a – g and 39 and rows 197, 221 - 221d):
 - 1) Partially accept conditionality based on the approach suggested by the Commission (based on energy audits) and certified energy management systems (suggested by the Parliament) whereby:
 - a) The percentage value for reduction is set to 10 %.
 - b) The payback period is set at maximum 3 years (in line with the same condition applied for indirect costs compensation schemes).
 - c) Provisions on that the Commission shall ensure a harmonised application of conditionality that does not jeopardize a level playing field, environmental integrity and equal treatment between installations across the Union.

- 2) Accept a Commission suggestion whereby the “worst performers” in addition must draw up climate neutrality plans on the same lines as the conditions to get additional free allocation for district heating. However, that obligation shall only apply to the 10 % worst performers and shall not include additional requirements for concrete action towards just transition. No additional reduction (above the 10% due to energy audits) of free allocation for installations that do not draw up decarbonisation plans shall be made.
- 3) Linked to conditionality, accept a modified version of bonus/malus system whereby the 10 % best performing installations are exempted, where applicable, from the application of the cross sectoral correction factor, using with priority saved free allocation from the application of the energy audits conditionality (i.e. a combination of those elements of the Parliament's amendments in rows 181 and 200b) and “worst performers”.
- 4) Maintain the minimum update rate of 0,2 %.
- 5) On free allocation for electricity (Article 10c) – agree to deletion and to move the remaining allowances to the Modernisation Fund under the condition that for those transfers and for the 2% the possibility of funding natural gas is kept and that waste is not included automatically in the ETS but only after proper assessment of impacts of such inclusion.
- 6) On additional free allocation for district heating, keep the General Approach of the Council.

The Council’s flexibilities on free allocation under this point are conditional on that the Parliament drops its amendment on decarbonisation plans for all ETS installations and the differentiated reduction levels for free allocation.

12. On the interaction with CBAM, including exports (see rows 190 – 190b, 192b, 208 and row 271):
 - 1) Maintain rhythm of phase out as set out in the general approach.

- 2) Continue to reject the Parliament's amendment on free allocation for exports and instead based on the Council position reinforce the text for special attention for CBAM sectors in the Innovation Fund to be provided by the Commission, ensuring continued WTO compatibility, including the following elements: specific mention of projects for production, regardless of intended destination of the goods for the EU market or for export in sectors covered by the CBAM regulation and an obligation to launch calls and possibility for sector specific calls thereafter.
 - 3) Flexible to add additional wording to strengthen the review clause.
13. On scope (see inter alia rows 159a-d and 271a and 456):
- 1) Agree to start monitoring the incineration of municipal waste from 1 January 2024 (or deadline for transposition of the Directive) and tasking the Commission to assess and report by 31 December 2026 on the possibility of including the sector in the ETS from 2031.
 - 2) Maintain Council position on installations using biomass (should be seen in the context of the provisions and impacts on free allocation).

B. FINANCIAL MECHANISMS

14. On the financial mechanisms, the Parliament has so far only showed minimal flexibility on the political aspects of the Innovation Fund, Modernisation Fund and on use of revenues. Any flexibilities from the Council will depend on the Parliament dropping its unacceptable requests and accommodating the Council position on a number of issues, including where the Council has accepted the text of the original Commission proposal.
15. Innovation Fund (IF) (see inter alia rows 171, 206 – 215b)

It is recalled that the Council has shown flexibility on a number of the Parliament's amendments related to the IF.

Further, it should be noted that following the (provisional) agreement on ETS maritime, approximately an additional 20 million allowances will flow into Innovation Fund. In addition and as part of the overall compromise package on ETS aviation, the Council could accept a limited transfer of additional allowances from the Aviation sector³.

Nevertheless, the Presidency maintains its call for further flexibility on the size of the Innovation Fund both considering the Council's position on taking 50 million allowances otherwise dedicated to the IF and transferring them into the Social Climate Fund and its position on RePowerEU. However, any additional sourcing of IF should be expressed in number of allowances and not as a percentage (as proposed by the Parliament in row 171).

The Presidency suggests to remain sceptical on the Parliament's amendment on funding for upscaling considering the limited size of IF and that such projects can get funding from other sources. The Commission's current suggestion for clarification, including its confirmation that the IF scope is thereby not extended, is welcome and could be considered as part of an overall compromise if it is clear that the support to breakthrough innovative technologies will always be prioritised over such projects.

The Council continues to reject Parliament's 12 % earmarking for renewables both out of principle but also as projects related to renewables based on calls hitherto make up for more than 40% of funding.

The Parliament has a reservation on the reference to low carbon technologies in the IF (row 206) but the Council will continue to insist on that reference here and throughout the text.

In addition to the flexibilities already shown, the Presidency suggests to:

- accept to include a recital with a factual statement that the rule of law conditionality applies to the IF;

³ See document 14979/22 (paragraph 27).

- as concerns competitive bidding, accept a text that includes the necessary safeguards setting the maximum financial liability for the Union budget and the minimum provisioning rate as well as the necessary justification for the derogations from the Financial Regulation (Regulation 2018/1046). The Presidency concretely suggests that a maximum of 20% of the revenue from auctioning for the Innovation Fund shall be available for the Commission to use for provisioning for carbon contracts for difference and contracts for difference and a provisioning rate of 50%. The text will be circulated separately.

16. Modernisation Fund (MF) (see inter alia rows 171, 221c-d, 224 -236c):

On the MF, the Parliament has so far shown very little flexibility and maintains its position on conditionality as regards rule of law and climate neutrality at Member State level. It also maintains its position on 100% share for priority projects but has shown some minimal flexibility on continued funding for natural gas projects (only until end of 2024 though).

Against this background, the Presidency suggests to maintain a very cautious approach and make any further flexibility conditional upon the Parliament moving away from its rigid position (including on rule of law and climate neutrality).

To prepare the ground for an overall agreement, the Presidency suggests that the Council can be open to discuss the share of priority projects for the 2,5% top-up provided that the Parliament moves on natural gas.

The Presidency suggests to accept the text in row 225 on funding for cross-border projects (accommodating the Parliament's amendment in row 271) while continuing to insist that this is voluntary for the beneficiary Member States.

17. Use of revenues (see inter alia rows 173a-h, 175, 175a-b, e-h, l, 351k)

The Council has already taken steps towards the Parliament, notably as regards expanded list of funding areas, including on biodiversity related issues, climate financing for developing countries and visibility of Member States use of revenues.

Further, the Presidency suggests to accept stronger wording on reporting as set out in the text in row 1751 in order for the Parliament to drop its request on additionality and ex-ante plans.

The Presidency will continue to maintain the position on “should vs shall”.

18. Do no significant harm principle/taxonomy

The Parliament has suggested to apply the minimum safeguards and “do no significant harm” (DNSH) principle set out in the taxonomy regulation, horizontally to IF, MF and to the use of revenues (212, 232a, 1751).

While it continues not to be clear how exactly applying the minimum safeguards and DNSH would be operationalized in concrete terms, the Presidency suggests some openness to discuss DNSH in the context of IF and MF while staying firm that this should not apply to Member States’ revenues.

C. ETS 1 AMBITION, INCLUDING MARKET STABILITY RESERVE (MSR)

19. This issue will be among the final issues to be resolved and for the Parliament it seemed to be linked to them being able to move on ETS BRT/ETS2.

The Presidency suggests to maintain the general approach on the 61% reduction, however, the Presidency suggests openness to discuss how this ambition is expressed, i.e. the combination of rebasing and linear reduction factor.

It is recalled that there is agreement on continuing the 24 % intake rate for the MSR beyond 2023, which for the Council is based on the overall balance of the package and not changing the MSR thresholds. The Presidency suggests to accept the compromise suggestions on the recitals of the MSR Decision as set out in ADD 3 to this note.

D. ETS BRT

20. The proposal to establish a separate ETS for the buildings and road transport sector and its interlinkage with the proposal on the Social Climate Fund (SCF) remains the single most problematic issue in the negotiations. While the Council has signalled willingness to discuss the ideas of an emergency brake in the ETS directive and vouchers in the SCF, the Parliament has so far not reciprocated this openness and continued to insist on the proposed split scope between commercial and private users and on integrating the SCF in the Multiannual Financial Framework. While acknowledging difficulties with the implementation of the ETS BRT split scope, the Parliament argues that it is not impossible and that it is rather a question of political will.
21. Against this background, the Presidency will continue to work to find compromise solutions while continuing to reject any split between commercial and private actors as unworkable (row 274b).
22. For the Council, the scope and start of the ETS BRT in 2027 combined with a strong price mechanism in Article 30h and the SCF as set out in the general approaches of the Council remain the preferred balanced solution to reconcile the need for ambition and cushioning the negative social impacts.
23. Nevertheless, the Presidency suggests to continue to show openness towards discussing the emergency brake suggested by the Commission that could delay the start of the ETS BRT from 2026 to 2027 combined with the suggested vouchers scheme as long as the vouchers remain voluntary and provided the Parliament can move away from its request on split scope and is willing to consider the approach suggested by the Commission, as well as to accept the Council's budgetary architecture of the Social Climate Fund.
24. That said, in light of the reticence of the Parliament to accept the suggestions brought forward by the Commission with the Council conditions as above, it is necessary to explore alternative avenues based on the general approach while accommodating some of the Parliament's concerns, in particular on the protection of vulnerable groups.

25. Further, the Presidency suggests the following:

- 1) 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) but depending on progress on the overall architecture and start of the ETS BRT (as above) be willing to consider viable and well-defined alternatives, if part of an overall balanced package also with the Social Climate Fund.
- 2) The Presidency suggests a compromise on avoiding double counting (Article 30f (4)), based on the Commission's suggestions while opting for an implementing act for detailed rules on the issue – see text in the Annex.
- 3) Maintaining 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 but accepting the Commission's suggestion for a clarification and simplification in relation to Own Resources (see row 326g).
- 4) Maintain the mechanism on excessive price fluctuations in Article 30h as set out in the Council's position.
- 5) 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.
- 6) As regards the adjustment of the compliance cycle accept the Commission's suggestions – as set out in the Annex to this note.
- 7) Accept the simplified LRF formula as set out in the Annex to this note.

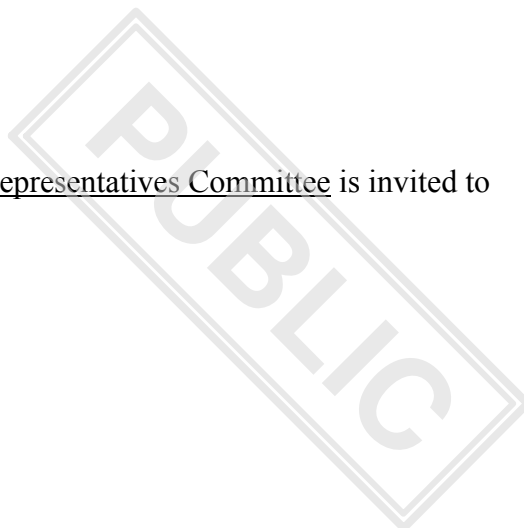
E. OTHER (to be completed)

26. Further, the Presidency suggests to accept the following texts provisionally agreed with the Parliament at the technical level:
- A new Article on the role of the Scientific Advisory Board (row 351i).
 - Provisions on accounting of emissions (rows 271 and 23b).
 - on a number of general recitals as set out in rows 11, 11a, 13, 14, 16 and 17 agreed provisionally. In addition, the Presidency suggests a compromise text to accommodate the Parliament's amendment in row 13a on a recital on updating NDCs.
27. In addition, delegations are invited to confirm their acceptance of the following texts as set out in the four column document agreed provisionally in previous trilogues while it being understood that this is without prejudice to the confirmation of an overall final agreement on the ETS proposal:
- ETS maritime (including the separate text on the MRV Regulation set out in ADD 2). As regards phase in of maritime, the Council's acceptance is to be seen in light of an overall balanced agreement on the ETS.
 - Market Functioning (notably recital 42b - row 52b and provisions in row 177b and d).
 - Visibility (row 351k).
 - Climate financing (row 175h).
28. The proposed mandate for the sixth trilogue is set out in detail in the **fourth column** of the tables contained in ADD 1 and 3 to this note, supplemented by the texts set out in the Annex to this note and ADD2 (consolidated text of the MRV Regulation).

III. CONCLUSION

In view of the upcoming trilogue, the Permanent Representatives Committee is invited to agree to the Presidency's suggestions as set out in:

- the Annex to this note; and
- ADD 1 to 3.



1. ETS BRT – avoiding double counting

Changes compared to the Council text:

a) Recital 52 [row 62 of 4-column document]

“In the small number of cases where double counting between emissions in the existing ETS and the new system for the road transport and buildings sectors cannot be excluded, *or where cost arise due to surrender of allowances for emissions outside sectors included in this Directive*, Member States should use such revenue to compensate for the unavoidable double counting *or other such costs outside the road transport and building sectors* in accordance with Union law and implementing powers should therefore be conferred on the Commission to ensure uniform conditions.

b) The cap adjustment [row 300a and 302a of 4-column document]

Article 30c – Total quantity of allowances

3. The Union-wide quantity of allowances issued under this Chapter shall be adjusted *for each year from [year after the start of auctioning]* to compensate for the quantity of allowances surrendered in cases where it was not possible to avoid double counting of emissions *or where allowances have been surrendered for emissions not covered by this Chapter* as referred to in Article 30f(4). The adjustment shall correspond to the total amount of allowances covered by this Chapter which were compensated for in the relevant reporting year pursuant to the acts referred to in Article 30f(4).

c) Source of revenues for compensating double counting [row 312a and last sentence of row 336b of 4-column document]

Article 30d(5) – Auctioning of allowances for the activity referred to in Annex III

5. [...] Member States should use those revenues, or the equivalent in financial value of these revenues, for one or more of the activities referred to in Article 10(3) or for one or more of the following:

(c) providing financial compensation to the final consumers of the fuels in cases where it was not possible to avoid double counting of emissions *or where allowances have been surrendered for emissions not covered by this Chapter* as referred to in Article 30f(4).

d) Avoiding or limiting the issue of double counting [row 336]

Article 30f(4) first subpara (Monitoring, reporting, verification of emissions and accreditation)

4. Member States shall ensure that the regulated entities are able to identify and document reliably and accurately per type of fuel, the precise volumes of fuel released for consumption which are used for combustion in the buildings and road transport sectors as identified in Annex III, and the final use of the fuels released for consumption by the regulated entities. The Member States shall take appropriate measures to [...] limit the risk of double counting of emissions covered under this Chapter and the emissions under Chapters II [...] and III, *as well as the risk of allowances being surrendered for emissions not covered by this Chapter.*

e) Secondary legislation on double counting

There are 2 aspects of this issue:

1) Both EP and Council agree that detailed rules on double counting should be established in an implementing act. However, while EP asks to have those rules as part of existing MRV Regulation, the Council is not strict on this and allows flexibility to have a separate implementing act.

2) EP is suggesting that rules on financial compensation to be given to operators in cases of double counting are established in a delegated act. This would mean 2 separate acts on double counting in ETS2, an implementing act on rules to limit double counting and a separate delegated act for the financial compensation.

Article 30f(4) – second subpara (Monitoring, reporting, verification of emissions and accreditation)

The Commission shall adopt *implementing acts* concerning the detailed rules for avoiding double counting and *allowances being surrendered for emissions not covered by this Chapter, as well as* for providing financial compensation to the final consumers of the fuels in cases where such double counting *or surrender* may not be avoided. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 22a(2). *The calculation of the financial compensation to the final consumers of the fuels shall be based on the average price of allowances in the auctions carried out in accordance with the act adopted under Article 10(4) in the relevant reporting year.*

2. ETS BRT – compliance cycle

Comment: The proposed change to ETS2 calendar cycle would affect the articles of the ETS Directive and MSR Decision. The MRV deadline is not set in the Directive, hence it would be necessary to set it in the Monitoring and Reporting Regulation.

Depending on the outcome of the co-decision, the changes would also have to be reflected in the amendments proposed by co-legislators (e.g. lines 300b, 326e, 326f of the 4-column document).

Article 30d (line 306)

Auctioning of allowances for the activity referred to in Annex III

2. The auctioning of the allowances under this Chapter shall start in [...] 2027 with a volume corresponding to 130 % of the auction volumes for [...] 2027 established on the basis of the Union-wide quantity of allowances for that year and the respective auction shares and volumes pursuant to paragraph 3, 4 and 5 [...]. The additional volumes to be auctioned shall only be used for surrendering allowances pursuant to Article 30e(2) and may be auctioned **until 30 April 31 May 2028.**[...]

Article 30e (line 326)

Transfer, surrender and cancellation of allowances

2. From 1 January [...] 2028, Member States shall ensure that, ~~by 30 April~~ **31 May each year**, the regulated entity surrenders a number of allowances covered by this Chapter, that is equal to the total emissions, corresponding to the quantity of fuels released for consumption pursuant to Annex III, during the preceding calendar year as verified in accordance with Articles 15 and 30f, and that those allowances are subsequently cancelled.

Article 30f (line 335)

Monitoring, reporting, verification of emissions and accreditation

2. Member States shall ensure that each regulated entity monitors for each calendar year as from 2025 the emissions corresponding to the quantities of fuels released for consumption pursuant to Annex III. They shall also ensure that each regulated entity reports these emissions to the competent authority in the following year, starting in 2026, in accordance with the acts referred to in Article 14(1).

3. Member States shall ensure that each regulated entity holding a permit in accordance with Article 30b on 1 January 2025 report their historical emissions for year 2024 by ~~30 March~~ **30 April 2025**.

Article 1a (line 371)

Operation of the Market Stability Reserve for the buildings and road transport sectors

4. The Commission shall publish the total number of allowances in circulation covered by Chapter IVa of Directive 2003/87/EC each year, ~~by 15 May~~ **1 June** of the subsequent year separately from the number of allowances in circulation under Article 1(4). The total number of allowances in circulation under this Article in a given year shall be the cumulative number of allowances covered by Chapter IVa of Directive 2003/87/EC issued in the period since 1 January 2026, minus the cumulative tonnes of verified emissions covered by Chapter IVa of Directive 2003/87/EC for the period between 1 January 2026 and 31 December of that same given year and any allowances covered by Chapter IVa Directive 2003/87/EC cancelled in accordance with Article 12(4) of Directive 2003/87/EC. The first publication shall take place by ~~15 May~~ **1 June 2027**.

3. ETS BRT – Simplified LRF adjustment formula in Annex IIIa (row Row 524 on Annex, point (2), amending provision, numbered paragraph (2), first paragraph:

$$\text{LRF}_{\text{adj}} = 100\% * [\text{MRV}_{[2024-2026]} - (\text{ESR}_{[2024]} - 6 * \text{LRF}_{[2024]} * \text{ESR}_{[2024]})] / (5 * \text{MRV}_{[2024-2026]})$$