EU ETS review: Sandbag's feedback

Response to the public consultation on the EU ETS

On 17 July 2026, the European Commission published its review of the EU ETS Directive and MSR Decision. On 11 September, EU ETS rapporteur MEP Peter Liese published a preliminary draft report of the EU ETS review. Both the Commission and Mr. Liese's proposals increase free allocation, channel revenues from the sale of emission allowances to industry and decrease the system's ambition.

During a public press briefing, Mr. Liese justified this approach with the need for industry to receive those subsidies to fund its decarbonisation. However, this approach fails to acknowledge the key role of the CBAM as provider of long-term revenues for EU manufacturers in EU markets, thanks to the protection it provides against carbon leakage, making those subsidies (at least partly) redundant.

Ambition

Ambition is **not damaging** for industry competitiveness. For the first time ever, both imports and goods made in the EU face carbon costs. The CBAM provides EU plants with **pricing power**, allowing them to increase their selling prices, as illustrated in Figure 1. On this figure, the price of a CBAM good (steel hot rolled coil (HRC)) increases from P0 to P1 as the supply curve shifts upwards. This has been observed in EU markets, with steel market analysts MEPS International reporting a price increase in January 2026 of 13 euros per tonne of flat steel and 9 euros per tonne of long steel,[1] well superior to the increase of net carbon costs (emissions – free allocation) for steelmakers this year.[2]

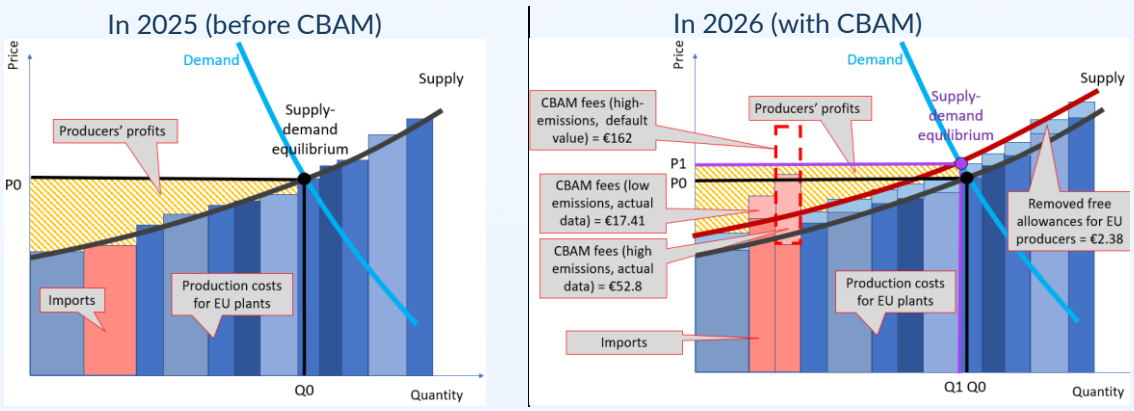


Figure 1: supply-demand curves of steel HRC in 2025 and 2026, including carbon costs for EU installations and imports

The price increase of steel attributed to the CBAM and EU ETS likely exceeds net carbon costs for EU manufacturers because carbon costs are relatively higher for imports than for EU plants. This effect is illustrated in Figure 2, where imports that were near the low-cost end of the merit order before the CBAM are relegated to higher-cost parts, including outside the profitable area, whereas previously unprofitable EU production becomes profitable, and the price climbs up further, to P2.

[1] MEPS International (2026), *Subdued start to CBAM era for EU steel industry*
[2] Source: Sandbag (2026), *The EU ETS money is coming!*

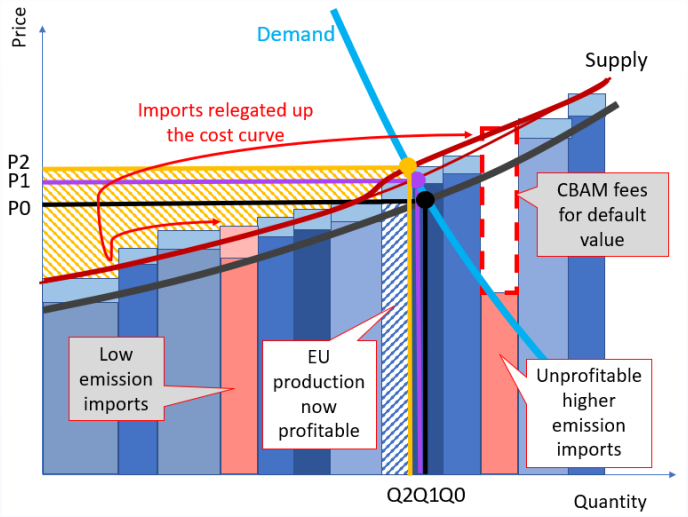


Figure 2: supply-demand curve with some imports priced out of the EU market

Installations covered by the EU ETS also benefit from EU ETS funding through the Innovation Fund. In the steel sector, **776 million euros** were received by iron and steel projects and 2.8 billion euros by hydrogen projects (some of which contribute to the iron and steel industry).

By comparison, the amount of free allocation removed by the CBAM from iron and steel installations in 2026 is only worth about **230 million euros**.

ENVI draft (September 2026)	Suggested change
Article 9 The linear factor shall be ~~**3.7%**~~**3.4%** from 2031 to 2035 and ~~**1.7%**~~**2.3%** from 2036.	**Article 9** The linear factor shall be ~~**3.4%**~~**4.4%** from 2031 to 2035 and ~~**2.3%**~~**[2.7%][1.7%]** from 2036.
Article 9b 1. ~~**Up to**~~ 260 million allowances from the Union-wide quantity of allowances referred to in Article 9 shall be made available to the facility for the purchase of ~~**up to**~~ 260 Mt of high quality and high integrity international credits, out of the international credits provided in Regulation 2021/1119/EU, to contribute to the climate ambition of the activities listed in Annex I from 2036 to 2040. All purchases shall be subject to the criteria of Regulation 2021/1119/EU being fulfilled.	**Article 9b** 1. **Up to** 260 million allowances ~~**from the Union-wide quantity of allowances referred to in Article 9**~~ shall be made available **pursuant to Article 29a** to the facility for the purchase **of up** to 260 Mt of high quality and high integrity international credits, out of the international credits provided in Regulation 2021/1119/EU, to contribute to the climate ambition of the activities listed in Annex I from 2036 to 2040. All purchases shall be subject to the criteria of Regulation 2021/1119/EU being fulfilled.
~~**4. Subject to the report in paragraph 3, by way of derogation from Article 9, in the event that high-quality and high-integrity, cost-effective international credits referred to in paragraph 1, are not available, the linear factor shall revert to 2.7% from 2036.**~~	***(keep deletion)***

Article 29a	Article 29a
1. If the average allowance price for the ~~six~~ **three** preceding calendar months is more than ~~2,4 times~~**25% higher than** the average allowance price for the preceding ~~two~~**one**-year reference period, ~~75~~**25** million allowances shall be released from the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814.	1. If the average allowance price for the ~~three~~ **six** preceding calendar months is more than ~~25% higher than~~ **2,4 times** the average allowance price for the preceding ~~one~~**two**-year reference period, **the Union-wide quantity of allowances referred to in Article 9 shall be increased by 75~~25~~** million allowances ~~shall be released from the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814~~**. These allowances will be used to purchase international credits pursuant to Article 9b. This operation may be repeated to the extent that the number of allowances issued under this article and the number of international credits purchased under Article 9b do not exceed 260 million.**

Justification

While free allocation and allowance revenue recycling provides only temporary funding, lowering the ETS ambition reduces long-term revenues for projects like Stegra, mentioned by Mr. Liese in his press briefing, as low carbon prices will reduce their revenues from the above-mentioned price effect. A higher ambition would enable the company to build its business case well beyond the early years when it is subsidised, which is what heavy industry needs, to match its much longer investment horizon.

The two proposals (Commission and rapporteur draft) lead to similar caps that are respectively 89% and 90% below their 2005 level in 2040, which is consistent with an EU-wide limit of 85% below 1990 emissions. However, one should not confuse ETS cap and emission target. Depending on the amount of surplus allowances in the system, the 2040 cap may or may not drive emissions down to that cap. When choosing a cap, the **surplus/emissions ratio** is a key indicator of whether that cap is likely to be met.

The current total surplus (allowances in circulation + in reserves) represents **1.7 times the 2025 emissions** covered by the ETS[3]. In a scenario of 85% EU-wide domestic emissions reduction compared to 1990 level (-88% from 2005 for ETS-covered installations), the full Commission proposal, assuming no removals are purchased, would create a **total surplus of 4.4 times the level of emissions in 2040**. The rapporteur's proposal (including removals) would take that ratio up **to 5.1x**. These levels of surplus have never been reached in the EU ETS, even when the EUA price crashed to €3 in 2013. A growing surplus/emissions ratio would not keep the carbon price at levels needed to drive emissions down to their cap.

LRF	2040 surplus	Surplus / Emissions
COM (3.7% - 1.7%), no removals	1,309	4.4x
ENVI (3.4% - 2.3%), w removals	1,529	5.1x
4.4% - 1.7% (no removals)	662	2.4x
4.4% - 2.7% (no removals)	350	1.3x

An LRF of 4.4% until 2035 and 1.7% after would still leave a comfortable surplus in 2040 of 2.4 times the level of emissions that year in the -85% scenario. It should be noted that, to comply with the EU Climate Law, this cap must be met whilst **buying a pro-rata share of 5% international credits without issuing extra allowances**, otherwise the extra allowances would drive emissions further up.

[3] Source: Sandbag (2026), *EU ETS review : impact on the market balance*

Neither the Commission's approach, nor the rapporteur's proposal would meet this objective. In addition, the Commission's proposal, which consists of changing the cap depending on the availability of "high-quality international credits", is a source of market uncertainty and price instability.

Our proposal is to change the supply of international credits into a "safety net". It would set the LRF at a level consistent with an 85% domestic reduction, and only release allowances to buy international credits on the condition of excessive prices, under Article 29a. The activation of this safety measure should remain exceptional, so the current threshold of 2.4 times the average price should not be changed.

It should be noted that there is no economic or environmental benefit in buying carbon credits at the price of allowances. The purchase of 260 million credits may therefore be matched by a **lower number of issued allowances**.

New Entrants Reserve

COM (Jul 2026)	Suggested change
Article 10a(7) Allowances from the maximum amount referred to in paragraph 5 of this Article which were not allocated for free by 2020 shall be set aside for new entrants, together with 200 million allowances placed in the market stability reserve pursuant to Article 1(3) of Decision (EU) 2015/1814 and 50 million allowances from the quantity of allowances resulting from the reduction of free allocation referred to in paragraph 1a of this Article.	**Article 10a(7)** Allowances from the maximum amount referred to in paragraph 5 of this Article which were not allocated for free by 2020 shall be set aside for new entrants, together with 200 million allowances placed in the market stability reserve pursuant to Article 1(3) of Decision (EU) 2015/1814 and 50 million allowances from the quantity of allowances resulting from the reduction of free allocation referred to in paragraph 1a of this Article. **Of the allowances set aside, up to 200 million shall be returned to the market stability reserve at the end of the period from 2021 to 2030 if not allocated for that period.**
Justification	
The ENVI version is the same as the COM version, but we propose to revert it to the current version of the Directive. It would have a significant impact on the surplus: with the full Commission proposal (including 250m allowances issued for removals), and assuming an invalidation threshold at 650 million allowances, the Commission's proposal would raise the surplus by about 100 million.	

Free allocation

COM (Jul 2026)	Suggested change
Article 10a(5) 5. In order to respect the auctioning share set out in Article 10, for every year in which the sum of free allocations does not reach the maximum amount that respects the auctioning share, the remaining allowances up to that amount shall be used to prevent or limit reduction of free	**Article 10a(5)** 5. In order to respect the auctioning share set out in Article 10, for every year in which the sum of free allocations does not reach the maximum amount that respects the auctioning share, the remaining allowances up to that amount shall be used to prevent or limit reduction of free

allocations to respect the auctioning share in later years. Where, nonetheless, the maximum amount is reached, free allocations shall be adjusted accordingly. Any such adjustment shall be done in a uniform manner. However, installations whose greenhouse gas emission levels are below the average of the 10 % most efficient installations in a sector or subsector in the Union for the relevant benchmarks in a year when the adjustment applies shall be exempted from that adjustment.	allocations to respect the auctioning share in later years. Where, nonetheless, the maximum amount is reached, free allocations shall be adjusted accordingly. **The reduction of free allocations shall first be applied to installations involved in the production of goods covered by Annex I of Regulation 2023/956.** ~~**shall be done in a uniform manner.**~~ **If needed,** ~~**Any such**~~ **any additional** adjustment shall be done **to all other sectors** in a uniform manner. However, installations whose greenhouse gas emission levels are below the average of the 10 % most efficient installations in a sector or subsector in the Union for the relevant benchmarks in a year when the adjustment applies shall be exempted from that adjustment.
Justification	
CBAM sectors are protected by the CBAM against the risk of carbon leakage, and non-CBAM sectors are protected by free allocation. However, with the cross-sectoral correction factor (CSCF) currently applied uniformly, the reduction of free allocation applied to non-CBAM sectors would leave them unprotected. As shown by Sandbag's ETS Simulator, under a uniform adjustment, the CSCF would fall to 0.44 by 2040. By contrast, under a non-uniform adjustment, the CSCF would remain at 1 for non-CBAM sectors.	

COM (July 2026)	Suggested change
Article 10a(1) 8th subparagraph For each sector and subsector, in principle, the benchmark shall be calculated for products rather than for inputs, in order to maximise greenhouse gas emission reductions and energy efficiency savings throughout each production process of the sector or the subsector concerned. In order to provide further incentives for reducing greenhouse gas emissions and improving energy efficiency and to ensure a level playing field for installations using new technologies that partly reduce or fully eliminate greenhouse gas emissions, and installations using existing technologies, the determined Union-wide ex-ante benchmarks shall be reviewed in relation to their application in the period from 2026 to 2030, with a view to potentially modifying the definitions and system boundaries of existing product benchmarks, considering as guiding principles the circular use-potential of materials and that the benchmarks should be independent of the feedstock and the type of production process, where the production processes have the same purpose. The Commission shall endeavour to adopt the implementing acts for the purpose of determining the revised benchmark values for free allocation in accordance with paragraph 2, third subparagraph, as soon as	**Article 10a(1) 8th subparagraph** For each sector and subsector, in principle, the benchmark shall be calculated for products rather than for inputs, in order to maximise greenhouse gas emission reductions and energy efficiency savings throughout each production process of the sector or the subsector concerned. In order to provide further incentives for reducing greenhouse gas emissions and improving energy efficiency and to ensure a level playing field for installations using new technologies that partly reduce or fully eliminate greenhouse gas emissions, and installations using existing technologies, the determined Union-wide ex-ante benchmarks shall be reviewed in relation to their application in the period from 2026 to 2030, with a view to potentially modifying the definitions and system boundaries of existing product benchmarks, considering as guiding principles the circular use-potential of materials and that the benchmarks should be independent of the feedstock and the type of production process, where the production processes have the same purpose. The Commission shall endeavour to adopt the implementing acts for the purpose of determining the revised benchmark values for free allocation in accordance with paragraph 2, third

possible and before the start of the period from 2026 to 2030.	subparagraph, as soon as possible and before the start of the period from 2026 to 2030. **The determined Union-wide ex-ante benchmarks shall be reviewed in relation to their application in the period from 2031 to 2035, with a view to potentially modifying the definitions and system boundaries of existing product benchmarks or creating new ones, considering as guiding principle equivalence between finished products fulfilling the same purpose. The Commission shall endeavour to adopt the implementing acts for the purpose of determining the revised benchmarks and benchmarks values for free allocation in accordance with paragraph 2, third subparagraph, as soon as possible and before the start of the period from 2031 to 2035.**
Article 10a(2)(f) (f) For the period from 2031 to 2035, the benchmark values shall be determined in the same manner as set out in points (a) and (g) of this subparagraph, on the basis of information submitted pursuant to Article 11 for the years 2026 and 2027, and on the basis of applying the annual reduction rate in respect of each year between 2008 and 2033. Information submitted by a third country for installations in its territory in accordance with an agreement concluded pursuant to Article 25 may also be taken into account.	**Article 10a(2)(f)** (f) For the period from 2031 to 2035, the **benchmarks will be reformed to better match final products and incentivize recycling practices. For benchmarks that remain unchanged, the** benchmark values shall be determined in the same manner as set out in points (a) and (g) of this subparagraph, on the basis of information submitted pursuant to Article 11 for the years 2026 and 2027, and on the basis of applying the annual reduction rate in respect of each year between 2008 and 2033. Information submitted by a third country for installations in its territory in accordance with an agreement concluded pursuant to Article 25 may also be taken into account.

Justification

Whilst the current Directive commanded to reform the existing benchmarks only, considering "as guiding principles the circular use-potential of materials", this had limited effect and left a large number of high-emission processes still incentivised.

This failure became blatant as the fallback benchmarks, which are driven by the use of zero-rated biomass, keep rewarding indiscriminately the use of heat and fuels rather than the use made of the consumed energy; in steelmaking, production that uses large contents of high-emission primary iron is rewarded more than production that uses scrap; petrochemicals are rewarded depending on the number of steamcracking stages by plants, regardless of the final products made.

Free allocation benchmarks could be reformed to resemble (and be compatible with) CBAM benchmarks and better incentivise the transition to low-emission production methods, by better matching final products[4].

[4] See Sandbag (2023), *From Process to Product: A Fix to the Allocation of Free Emission Permits to Industry*

Price stability

ENVI draft (September 2026)	Suggested change
Article 29a If the average allowance price for the ~~six~~**three** preceding calendar months is more than ~~2,~~**425% higher than**~~times~~ the average allowance price for the preceding ~~two~~**one**-year reference period, ~~75~~**25** million allowances shall be released from the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814. If the average allowance price for the three preceding months is more than 25% lower than the average allowance price for the preceding one-year reference period, 25 million allowances shall be placed in the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814.	**Article 29a** If the average allowance price for the three preceding calendar months is more than 25% higher than the average allowance price for the preceding one-year reference period, 25 million allowances shall be released from the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814. If the average allowance price for the three preceding months is more than ~~25%~~**20%** lower than the average allowance price for the preceding one-year reference period, 25 million allowances shall be placed in the market stability reserve in accordance with Article 1(7) of Decision (EU) 2015/1814.
Justification	
The proposed ENVI amendment is falsely symmetrical and creates and would lead to increased supply in the case of price stability: compounding five 25% price rises and four 25% price drops would lead to a 3.5% price drop and 25m EUA released. Real symmetry would require that price drops are applied 100/1.25 = 80%.	

Aviation

ENVI draft (Sep 2026)	Suggested change
Article 12(3)	**Article 12(3)** **(3-h) From 1 January 2031, the number of general allowances surrendered by airline operators must not exceed 100% of the number of aviation allowances surrendered by them. That proportion shall be reduced by 10% per year to reach 0% in 2040. The Commission is empowered to adopt delegated acts outlining all necessary requirements concerning the Union Registry to mark as 'aviation allowances' the allowances created pursuant to Articles 3c and 3d, and exclude from 'general allowances' the allowances created pursuant to Articles 3c and 3d.**
Justification	
Ever since the ETS has been covered intra-EU flights in 2013, the sector has failed to stay within its carbon budget, emitting more CO_2 than its allocated allowances, except in 2020-21 due to Covid-19. In 2024, aviation exceeded its carbon budget by 119%, at 62 million tonnes of CO_2.	

Aviation has so far complied with its EU ETS obligations thanks to the possibility for airlines to surrender "general allowances" (EUAs) alongside "aviation allowances" (EUAAs), to fill their deficit. In 2025, allowances issued for flights stopped being marked as different instruments, so that *general allowances* (as defined by Article 3(7) of Delegated Regulation 2019/1122, amended in 2023) are now issued for both aviation and other sectors. However, the imbalance between aviation and other sectors remains, making aviation an **increasingly large net buyer of allowances from other sectors**.

Buying allowances from other sectors weakens the incentive for airlines to reduce their emissions, as purchasing allowances can be cheaper than investing in decarbonisation options such as e-fuels. With estimates as high as €500 per tonne of CO_2 reduced[5], in comparison, EUAs cost only about €80 for 1 tonne of CO_2. Rail transport is often comparatively more expensive than air transport. In contrast, airlines create increasing demand for allowances on other sectors, raising prices.

We propose that **access by airlines to allowances from other sectors should gradually be reduced**. This would increase the scarcity of aviation allowances, making them more expensive than general allowances. In contrast, it would ease pressure and uncertainty on other sectors, as the demand from airlines can vastly vary depending on the sectors ETS coverage and emissions pathway.

Unlike industrial goods, air transport is not importable, so increasing emission allowance prices for intra-EU air transport (even within an extended radius) would not unfairly favour foreign competitors offering similar services. At high allowance price levels, substitution by ground transport might happen, but such activity, which relies more on domestic infrastructure and less on fuel imports, would be more beneficial to the EU's economy.

Domestic permanent removals

ENVI draft (September 2026)	Suggested change
Article 9c	**Article 9c**
1. The Union-wide quantity of allowances referred to in Article 9 shall be increased by 250 million allowances. Those allowances shall be made available to the Commission to auction them from ~~2031~~ **2029** to 2040 to generate revenues for the purchase of an equivalent amount of domestic permanent carbon removal units generated by BioCCS, ~~and~~ DACCS **and BCR** activities under Regulation (EU) 2024/3012 of the European Parliament and of the Council*. **The share of removal units that are generated by BCR activities of those allowances shall be limited to up to 20 % of those allowances.** The Commission shall purchase those removals units prioritising a portfolio of cost-effective, high-integrity projects with payment upon delivery of the certified units.	1. The Union-wide quantity of allowances referred to in Article 9 shall be increased by 250 million allowances. Those allowances shall be made available to the Commission to auction them from ~~2029~~ **2031** to 2040 to generate revenues for the purchase of an equivalent amount of domestic permanent carbon removal units generated by BioCCS, **and** DACCS ~~and BCR~~ activities under Regulation (EU) 2024/3012 of the European Parliament and of the Council*. ~~The share of removal units that are generated by BCR activities of those allowances shall be limited to up to 20 % of those allowances.~~ The Commission shall purchase those removals units prioritising a portfolio of cost-effective, high-integrity projects with payment upon delivery of the certified units.
2. ~~An additional 10 million allowances from the Union-wide quantity of allowances referred to in Article 9 between 2031 and 2040 shall be made available to the Commission to auction them to~~	2. ***(keep deletion)***

[5] Based on prices of €800 fuel cost and 3.15 tonnes of CO2 emitted per tonne of kerosene used vs. €2500 for e-kerosene.

~~generate revenues for the purchase of those permanent carbon removals units, in the event the revenues generated from the allowances under paragraph 1 would be insufficient for the purchase of the total amount of domestic permanent carbon removals units.~~	
In the event the revenues generated from the allowances under paragraph 1 would be insufficient for the purchase of the total amount of domestic permanent carbon removal units, additional allowances from the Union-wide quantity of allowances referred to in Article 9 between [one year after the entry into force of this Directive] and 2040 shall be made available to the Commission to auction them to generate sufficient revenues for the purchase of those permanent carbon removal units. These shall be withdrawn in a uniform manner from the Member States auctioning share.	~~In the event the revenues generated from the allowances under paragraph 1 would be insufficient for the purchase of the total amount of domestic permanent carbon removal units, additional allowances from the Union-wide quantity of allowances referred to in Article 9 between [one year after the entry into force of this Directive] and 2040 shall be made available to the Commission to auction them to generate sufficient revenues for the purchase of those permanent carbon removal units.~~ These shall be withdrawn in a uniform manner from the Member States auctioning share.
4a. By 1 January 2029, the Commission shall adopt a delegated act in accordance with Article 23 to supplement this Directive by establishing additional technical criteria and enforceable long-term monitoring, reporting, verification, permanence and liability requirements, including for reversals, for the eligibility of BCR activities under this Article, based on the methodologies approved under Regulation (EU) 2024/3012	~~4a. By 1 January 2029, the Commission shall adopt a delegated act in accordance with Article 23 to supplement this Directive by establishing additional technical criteria and enforceable long-term monitoring, reporting, verification, permanence and liability requirements, including for reversals, for the eligibility of BCR activities under this Article, based on the methodologies approved under Regulation (EU) 2024/3012.~~

Justification

The climate integrity of biochar depends on the type and origin of the feedstock: the climate benefits differ significantly depending on whether waste or other biomass is used, including due to potential competing uses. Most of all, biochar raises the issue of permanence, which can no longer be ignored after uncontrolled forest fires swept through Europe this year. For these reasons, biochar should be kept out of the ETS.

By 2029, CDR MRV frameworks may not yet be sufficiently robust to ensure the integrity and comparability of reported removals.

It is important to avoid issuing more allowances when prices are already low, as this would send prices lower. Removals should therefore not be purchased "at any cost" as is proposed in the rapporteur's report. The Commission's 10 million proposed extra allowances would secure a slight premium over allowance prices. This is not justified, given other forms of support already made available for removal technologies from the Innovation Fund, Industrial Decarbonisation Bank and Article 10(3) of this Directive. Spending more allowances on the same number of removals would deprive member states and EU citizens of much needed revenues, for an environmental benefit that is less certain than that of un-emitted CO2.

ENVI draft (September 2026)	Suggested change
Article 14(1a)	**Article 14(1a)**
The acts referred to in paragraph 1 shall provide for the possibility for operators, aircraft operators and shipping companies to compensate their fossil emissions with domestic permanent carbon	***(Delete)***

removal units generated from the storage of their biogenic emissions under the scope of this Directive and certified under Regulation (EU) 2024/3012 **and DACCS activities under Regulation (EU) 2024/3012**, while avoiding the double counting of those negative emissions.	

Justification

The article proposed by the Commission dresses up CCS as "removal", which it is not. CCS is already covered by Article 12(3a), which exempts operators from surrendering emissions that are captured and stored permanently, governed Directive 2009/31/EC on the geological storage of carbon dioxide. For operators to issue removals credits would create an intermediate "crediting step" in the CCS process by qualifying CCS as removals and, given the support given to removals by this Directive, simply subsidise CCS, a technology relying on long-lasting CO2-emitting sources, over other abatement technologies.

The draft ENVI addition would allow direct offsetting by operators, creating a direct integration of removals in the EU ETS.

Indirect cost compensation

COM (July 2026)	Suggested change
Article 10a(6)	**Article 10a(6)**
Member States should adopt financial measures in accordance with the second and fourth subparagraphs of this paragraph in favour of sectors or subsectors which are exposed to a genuine risk of carbon leakage due to significant indirect costs that are actually incurred from greenhouse gas emission costs passed on in electricity prices, provided that such financial measures are in accordance with State aid rules, and in particular do not cause undue distortions of competition in the internal market. The financial measures adopted should not compensate indirect costs covered by free allocation in accordance with the benchmarks established pursuant to paragraph 1 **of this Article. Where a Member State spends an amount higher than the equivalent of 25 % of the auction revenues referred to in Article 10(3) for the year in which the indirect costs were incurred, it shall set out the reasons for exceeding that amount**.	Member States should adopt financial measures in accordance with the second and fourth subparagraphs of this paragraph in favour of sectors or subsectors which are exposed to a genuine risk of carbon leakage due to significant indirect costs that are actually incurred from greenhouse gas emission costs passed on in electricity prices, provided that such financial measures are in accordance with State aid rules, and in particular do not cause undue distortions of competition in the internal market. The financial measures adopted should not compensate indirect costs covered by free allocation in accordance with the benchmarks established pursuant to paragraph 1 of this Article. Where a Member State spends an amount higher than the equivalent of 25 % of the auction revenues referred to in Article 10(3) for the year in which the indirect costs were incurred, it shall set out the reasons for exceeding that amount.
Member States shall also seek to use no more than 25 % of the revenues generated from the auctioning of allowances for the financial measures referred to in the first subparagraph. ~~**Within three months of the end of each year,**~~	Member States shall also seek to use no more than 25 % of the revenues generated from the auctioning of allowances for the financial measures referred to in the first subparagraph.

Member States that have ~~such~~ **the** financial measures **referred to in the first subparagraph** in place shall make available to the public, in an easily accessible form, the total amount of compensation provided per benefitting sector and subsector. inform the Commission as to the total amount of compensation provided per benefitting sector and subsector in their reports submitted under Regulation (EU) 2018/1999, as well as information on the implementation of the measures and their contribution to decarbonisation.	**Within three months of the end of each year,** Member States that have the financial measures referred to in the first subparagraph in place shall make available to the public, in an easily accessible form, the total amount of compensation provided per benefitting sector and subsector. inform the Commission as to the total amount of compensation provided per benefitting sector and subsector in their reports submitted under Regulation (EU) 2018/1999, as well as information on the implementation of the measures and their contribution to decarbonisation.
~~**As from 2018,**~~ in any year in which a Member State uses more than 25 % of the revenues generated from the auctioning of allowances for such purposes, it shall ~~**publish a report setting out**~~ **set out** the reasons for exceeding that amount~~**. The report**~~ **and** shall include relevant information on electricity prices for large industrial consumers benefiting from such financial measures, without prejudice to requirements regarding the protection of confidential information~~**. The report shall also**~~**, as well as** include information on whether due consideration has been given to other measures to sustainably lower indirect carbon costs in the medium to long term.	In any year in which a Member State uses more than 25 % of the revenues generated from the auctioning of allowances for such purposes, it shall ~~**set out**~~ **publish a report setting out** the reasons for exceeding that amount**. The report** ~~**and**~~ shall include relevant information on electricity prices for large industrial consumers benefiting from such financial measures, without prejudice to requirements regarding the protection of confidential information**. The report shall also**~~**, as well as**~~ include information on whether due consideration has been given to other measures to sustainably lower indirect carbon costs in the medium to long term.
The Commission shall include in the report provided for in Article 10 (5), *inter alia*, an assessment of the effects of such financial measures on the internal market and, where appropriate, recommend any measures that may be necessary pursuant to that assessment.	The Commission shall include in the report provided for in Article 10 (5), *inter alia*, an assessment of the effects of such financial measures on the internal market and, where appropriate, recommend any measures that may be necessary pursuant to that assessment.
Those measures shall be such as to ensure that there is adequate protection against the risk of carbon leakage, based on *ex-ante* benchmarks for the indirect emissions of CO 2 per unit of production. Those *ex-ante* benchmarks shall be calculated for a given sector or subsector as the product of the electricity consumption per unit of production corresponding to the most efficient available technologies and of the CO 2 emissions of the relevant European electricity production mix.	Those measures shall be such as to ensure that there is adequate protection against the risk of carbon leakage **while incentivizing the use of non-fossil electricity. To this end, support should only be granted to the non-fossil share of the electricity consumed at times when fossil electricity sets the marginal price of the installation's bidding zone. This support should be** based on *ex-ante* benchmarks for the indirect emissions of CO 2 per unit of production. Those *ex-ante* benchmarks shall be calculated for a given sector or subsector as the product of the electricity consumption per unit of production corresponding to the most efficient available technologies and of the CO 2 emissions of the relevant European electricity production mix.
Justification	

Currently, all electricity consumed by the industry sectors covered is eligible for compensation, including fossil electricity, which provides no incentive for consumers to source low-carbon electricity. Industrial installations using 24-hour grid electricity are rewarded as much as those bearing the cost of adjusting operations to intermittent renewable sources. Applying ICC compensation to the non-fossil share of electricity would better incentivise virtuous behaviours by electro-intensive industries.

Limiting the amount paid to times when fossil electricity sets the marginal price would avoid windfall profits made by firms using electricity bought from the market at times of low prices, when fossil generation is not reflected in market prices. It would also reduce costs for Member States paying out this support, as the share of low-carbon electricity soars in electricity grids, together with the frequency of such events.

Full explanations provided here[6].

A transparency issue is also addressed. The way Member States are meant to report in the Commission's version of Art 10a(6), and to whom, is not even specified.

Transparency

COM (Jul 2026)	Suggested change
Article 21(2) ~~**On the basis of the reports referred to in paragraph 1, the Commission shall publish a report on the application of this Directive within three months of receiving the reports from the Member States.**~~	**Article 21(2)** **On the basis of the reports referred to in paragraph 1, the Commission shall publish a report on the application of this Directive within three months of receiving the reports from the Member States.**
Justification	
The wording proposed by the Commission is an inacceptable regression on transparency.	

MSR

ENVI draft (Sep 2026)	Suggested change
Article 1(5), 1st subparagraph In any given year, if the total number of allowances in circulation is between 833 million and ~~**1096**~~**947** million, a number of allowances equal to the difference between the total number of allowances in circulation, as set out in the most recent publication as referred to in paragraph 4 of this Article, and 833 million shall be deducted from the quantity of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC and shall	**Article 1(5), 1st subparagraph** In any given year, if the total number of allowances in circulation is between ~~**833**~~**650** million and ~~**947**~~**739** million, a number of allowances equal to the difference between the total number of allowances in circulation, as set out in the most recent publication as referred to in paragraph 4 of this Article, and ~~**833**~~**650** million shall be deducted from the quantity of allowances to be auctioned by the Member States under Article 10(2) of Directive

[6] Sandbag (2025), *State Aid for Indirect Carbon Costs: Reform before extending!*

be placed in the reserve over a period of 12 months beginning on 1 September of that year. If the total number of allowances in circulation is above ~~1096~~**947** million allowances, the number of allowances to be deducted from the quantity of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC and to be placed in the reserve over a period of 12 months beginning on 1 September of that year shall be equal to 12 % of the total number of allowances in circulation. ~~**By way of derogation from the second sentence of this subparagraph, until 31 December 2030, the percentage referred to in that sentence shall be doubled.**~~ **From 2029, the thresholds of 833 and 947 million under this paragraph shall decrease annually by 4%, rounded to the nearest million, as specified in Annex I.**	2003/87/EC and shall be placed in the reserve over a period of 12 months beginning on 1 September of that year. If the total number of allowances in circulation is above ~~947~~**739** million allowances, the number of allowances to be deducted from the quantity of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC and to be placed in the reserve over a period of 12 months beginning on 1 September of that year shall be equal to 12 % of the total number of allowances in circulation. From 2029, the thresholds of ~~833~~**650** and ~~947~~**739** million under this paragraph shall decrease annually by ~~4%~~**8%**, rounded to the nearest million, as specified in Annex I.
Article 1(6)	**Article 1(6)**
~~**6. In any year, if the total number of allowances in circulation is less than 400 million, 100 million allowances shall be released from the reserve and added to the volume of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC. Where fewer than 100 million allowances are in the reserve, all allowances in the reserve shall be released under this paragraph.**~~	
6. In any year, if the total number of allowances in circulation is between 300 million and 400 million, a number of allowances equal to the difference between 400 million and the total number of allowances in circulation shall be released from the reserve. If the total number of allowances in circulation is less than 300 million, an amount of 100 million allowances shall be released from the reserve.	6. In any year, if the total number of allowances in circulation is between 300 million and 400 million, a number of allowances equal to the difference between 400 million and the total number of allowances in circulation shall be released from the reserve. If the total number of allowances in circulation is less than 300 million, an amount of 100 million allowances shall be released from the reserve.
From 2029, the thresholds of 400 million and of 300 million and the amount of 100 million allowances to be released from the reserve, set out in the previous subparagraph, shall decrease annually by 4 %, rounded to the nearest million, as specified in Annex I.	From 2029, the thresholds of 400 million and of 300 million and the amount of 100 million allowances to be released from the reserve, set out in the previous subparagraph, shall decrease annually by ~~4 %~~**8%**, rounded to the nearest million, as specified in Annex I.
Where fewer allowances are in the reserve than must be released in accordance with this paragraph, the release shall be equal to the allowances that remain in the reserve.	Where fewer allowances are in the reserve than must be released in accordance with this paragraph, the release shall be equal to the allowances that remain in the reserve.
The amount of allowances released from the reserve under this paragraph shall be added to the volume of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC.	The amount of allowances released from the reserve under this paragraph shall be added to the volume of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC.

Justification
The correction of threshold compensates the effect of the change in TNAC calculation. The TNAC change is a welcome simplification, but it has the effect of raising the effective threshold and allowing too much surplus in the system. The reduction rate of the thresholds should also be increased, as the LRF applied to reduce the cap annually is calculated over the cap's much higher 2010 level, which will be between 9-16% of its annual value over 2031-40. It is important not to let the surplus/emission ratio rise too high, in order to keep the incentive to reduce emissions by 85%.

EP position (Sep 2026)	Suggested change
Article 1(5a) Unless otherwise decided in the first review carried out in accordance with Article 3, from 2023 **until 31 January 2027** allowances held in the reserve above 400 million allowances shall no longer be valid. **From 1 February 2027, allowances held in the reserve above 650 million allowances shall no longer be valid.**	**Article 1(5a)** Unless otherwise decided in the first review carried out in accordance with Article 3, from 2023 until 31 January 2027 allowances held in the reserve above 400 million allowances shall no longer be valid. From 1 February 2027, allowances held in the reserve above 650 million allowances shall no longer be valid. **From 1 January 2031, the invalidation threshold of 650 million under this paragraph shall be adjusted annually by [8%][an amount proportionally equal to the decrease of the cap], rounded to the nearest million.**
Justification	
Invalidation is the most important feature that saved the EU ETS in 2018. Before that date, even after the MSR was set up, EUA prices were still only €9. Without invalidation, the surplus can return back into the market. The threshold should make sure that the surplus / emissions ratio does not grow, which is why it should decrease in line with the LRF, which itself represent annual reduction rates of 9-16%.	

Technical note: Impacts on the market balance

In this note, we analyse how the proposed changes will impact the supply and demand balance of the emission allowance market. The measures with significant impact are (1) raising the cap, (2) issuing up to 260 million allowances to purchase carbon removals, and (3) changing the rules governing the Market Stability Reserve (MSR).

This note is based on a small number of selected combinations of design options, whereas the full scope of combinations can be explored on our updated EU ETS Simulator. Supply and demand numbers are given based on the emissions scenarios described by the impact assessment published by the European Commission in 2024 as part of the EU Climate Law:

- Emission scenario S1: 75% reduction in EU-wide emissions by 2040[7] (ETS sectors: -81%[8])
- Emission scenario S2: 85% reduction in EU-wide emissions by 2040 (ETS sectors: -89%)
- Emission scenario S3: 95% reduction in EU-wide emissions by 2040 (ETS sectors: -93%)

The Impact Assessment provides emission breakdowns between power, industry, aviation, and shipping sectors. We translated these into forecasts for the sectors covered by the EU ETS, using short-term production forecasts from major business associations and drawing linear trajectories from short-term values to 2040 in the relevant sectors.

Having updated Sandbag's ETS Simulator with the latest (preliminary) emissions data, we found that the EU ETS ended 2025 with a total surplus of 2,190 million EUAs, which was brought down to **1,902m surplus allowances**, after 270m allowances from the MSR were invalidated on 1 January 2026. This is **1.7 times the level of emissions** covered by the scheme in 2025, estimated at 1,139m tCO_2.

The surplus breaks down as follows:

- 874m allowances in circulation;[9]
- 486m in the New Entrants Reserve;
- 117m unallocated allowances carried over from previous years;
- 25m in the Greece fund; and
- 400m in the MSR.

We calculated **excess EUAs** as the sum of allowances in circulation and the **New Entrants Reserve (NER)**, as it is likely that unallocated NER amounts will eventually reach the market, for example through the Investment Booster proposed by the European Commission. We therefore assumed that all amounts

[7] Compared to 1990 level
[8] Compared to 2005 level
[9] This is less than the TNAC published yearly, which included net aviation demand before 2024.

locked in the NER will gradually be "in circulation"[10]. The total surplus amount includes excess EUAs as well as allowances locked up in other reserves, i.e. only the MSR in 2040.

Regarding the MSR, our calculations also incorporate the revised invalidation threshold of 700 million allowances, as agreed by the trilogue on 20 October.

Year	Total surplus (m EUA)	Emissions (m tCO2e)	Surplus / Emissions
2026	1,902	1,139	**1.7 x**
2040	680	177 (S3 – 95%)	**3.8 x**
2040	-94	274 (S2 – 85%)	**-0.3 x**

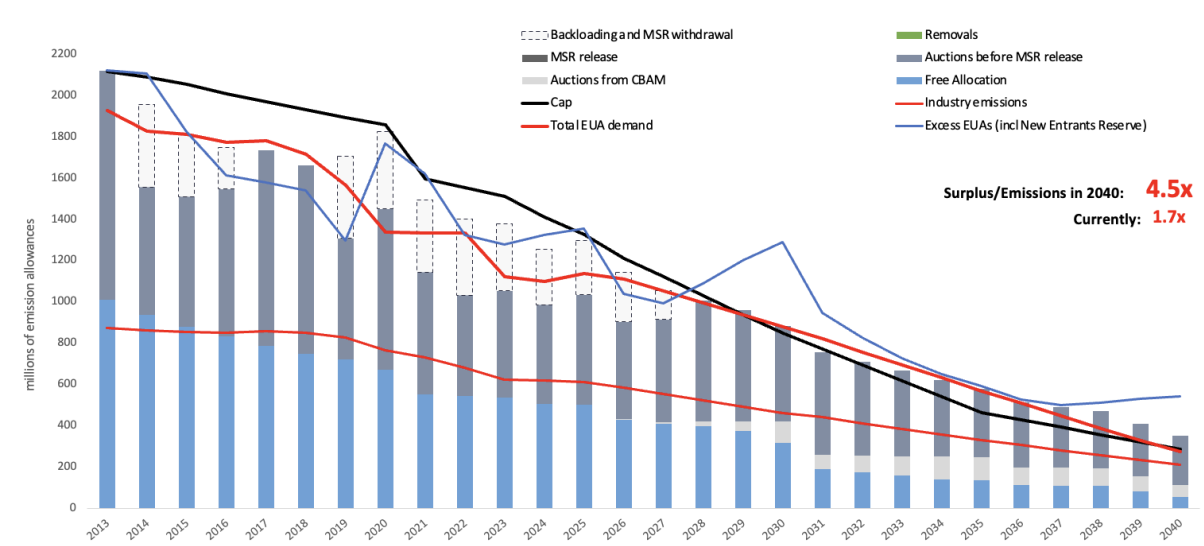
Sandbag's ETS Simulator was updated to include the main design features proposed by the Commission, except for extensions (e.g. to international flights and waste incinerators), the net effect of which should be small as they add both demand and supply to the market.

Cap as proposed by the Commission

The cap proposed by the Commission follows a trajectory with a lower linear reduction factor (LRF), from 4.4% (in the current directive) to 3.7% in 2031-2035 and to 1.7% in 2036-2040.

The Commission justified this new cap by the need to take into account the EU's target of 85% domestic emissions reduction, after its 90% target was amended in November 2025 to include 5% from international credits. We have therefore tested this proposed cap against the emissions scenario S2, in which EU-wide emissions are reduced by 85% (compared to 1990 levels) by 2040, and EU ETS emissions are reduced by 89% (compared to 2005 levels).

We found that the Commission's proposed cap would change the market's balance from a deficit of 363m allowances to a surplus of **1,244m** allowances (including 700 million in the MSR), which is **4.5 times the emissions expected that year** (274m tCO2 in scenario S2).



	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	0.82	0.63
Surplus / Em	2x	2x	2.1x	2.1x	2.3x	2.4x	2.7x	3.1x	3.7x	4.5x

In 2040			
Cap	Emissions	MSR	Excess EUA
-87%	-87%	700m	544m

[10] This is a slightly different approach from the one used in our recent brief *Let's not Invalidate Climate Policy*, which only assumed 400 million EUAs being released from the NER, causing more allowances to be released from the NER.

Figure 3: Cap as proposed by Commission in scenario S2

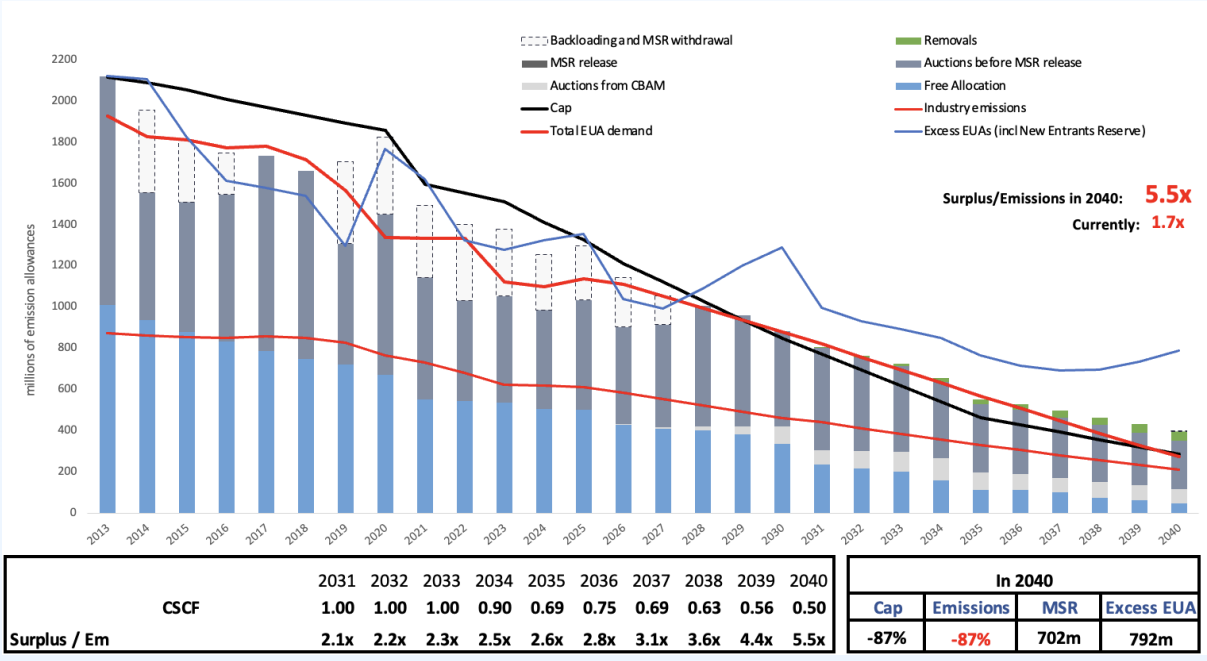
The table below summarises the effect of the modified cap. In scenario S2, it increases the surplus by 1,099 million EUAs compared to the current cap.

Year	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO_2e)	Surplus / Emissions
2040	1,244	**1,338**	274 (S2 – 85%)	**4.5 x**

Allowances for the purchase of domestic removals

According to the newly proposed Article 9c, the total number of allowances would be increased by 260 million, made available from 2031 to 2040 to generate revenues for the purchase of "an *equivalent amount* [of 250 million] domestic permanent carbon removal units generated by BioCCS and DACCS activities" (emphasis added). It should be noted that the Commission is therefore ready to pay no more than 1.04 EUA per removal unit.

Under scenario S2, assuming the allowances are sold in equal amount each year between 2031 and 2040, this policy design would lead to a **surplus of 1,492m allowances**, equivalent to **5.5 times the emissions expected in 2040**. This would cause a price drop so steep that the emissions reduction goal set for S2 could only be achieved through other policies than the ETS alone.



	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	0.90	0.69	0.75	0.69	0.63	0.56	0.50
Surplus / Em	2.1x	2.2x	2.3x	2.5x	2.6x	2.8x	3.1x	3.6x	4.4x	5.5x

In 2040			
Cap	Emissions	MSR	Excess EUA
-87%	-87%	702m	792m

Figure 4: With 260m allowances sold for the purchase of BioCCS and DACCS activities, in scenario S2

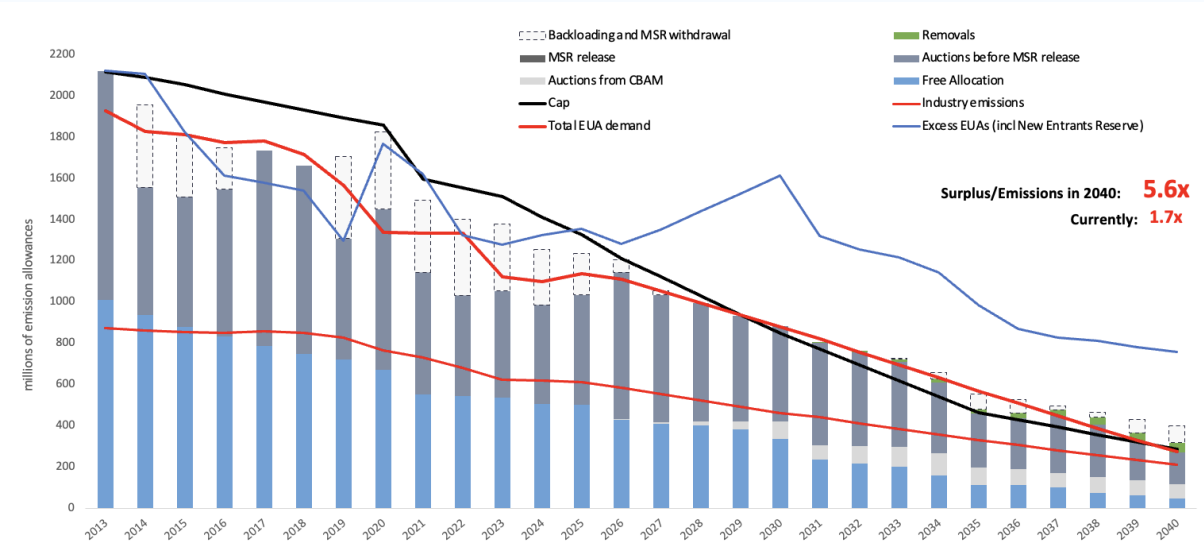
The table below summarises the effect of the 260 million EUA sales for removals combined with the higher cap, with the difference it creates.

Year	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO2e)	Surplus / Emissions
2040	**1,492**	**+249**	274 (S2 – 85%)	**5.5 x**

With modified MSR withdrawal / release rules

The Commission's proposal includes a new calculation of the Total Number of Allowances in Circulation, which effectively increases the MSR thresholds, triggering withdrawal and release from the MSR at higher levels of excess EUAs. On the other hand, the nominal values of these thresholds are reduced by 4% per year, which has the reverse effect, especially in later years.

When combined with the above design features, this measure results in a surplus of 1,610 million allowances (including 789 million in the MSR)[11], equal to 5.6 times the emissions in 2040. This single measure creates a net addition of +116 million allowances. It should be noted that, in this configuration, 239 million more allowances are invalidated compared to the configuration of the previous section.



	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	0.90	0.69	0.75	0.69	0.63	0.56	0.50
Surplus / Em	2.4x	2.5x	2.6x	2.8x	3x	3.2x	3.5x	4x	4.7x	5.6x

In 2040			
Cap	Emissions	MSR	Excess EUA
-87%	-87%	782m	760m

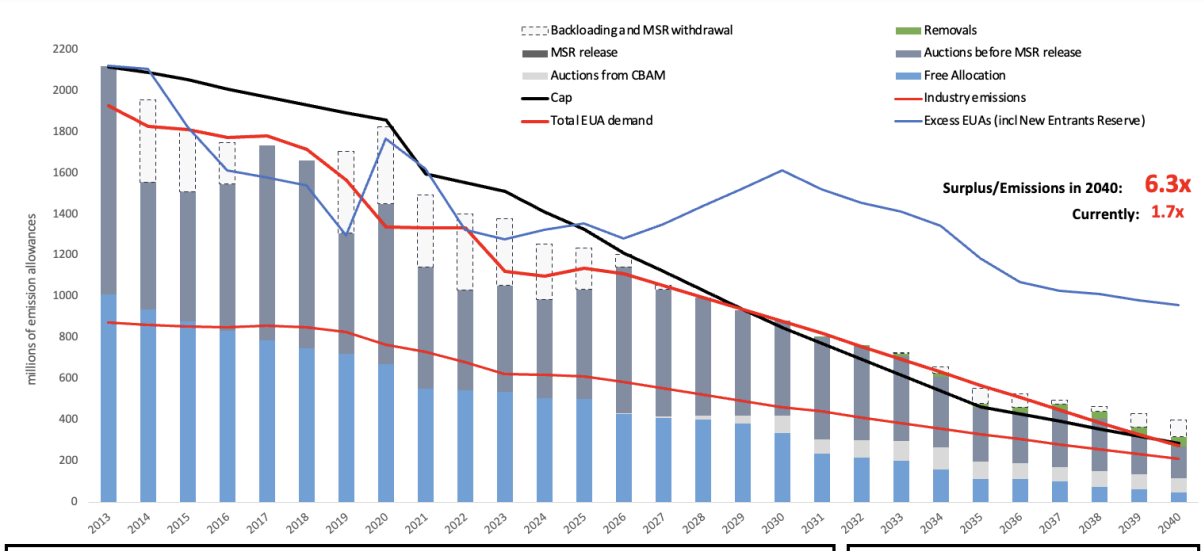
Figure 5: With proposed MSR rules for withdrawal and release, in scenario S2

Year	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO2e)	Surplus / Emissions
2040	1,542	**+49**	274 (S2 – 85%)	**5.6 x**

Ending the transfer of 200m allowances from the NER to the MSR

We also assessed the impact of ending the transfer of 200 million allowances from the New Entrants Reserve (NER) to the MSR. Compared with the previous configuration, this change results in a surplus of 1,737 million allowances in 2040, an increase of 127 million allowances. This represents 6.3 times the emissions expected in 2040 under scenario S2 (274m tCO_2).

[11] The amount at the end of each year can exceed 400 million, as the invalidation only occurs on 1 January of the following year.



	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	0.90	0.69	0.75	0.69	0.63	0.56	0.50
Surplus / Em	2.4x	2.5x	2.6x	2.8x	3x	3.3x	3.7x	4.2x	5.1x	6.3x

In 2040			
Cap	Emissions	MSR	Excess EUA
-87%	-87%	776m	960m

Figure 6. With no transfer from NER to MSR, in scenario S2

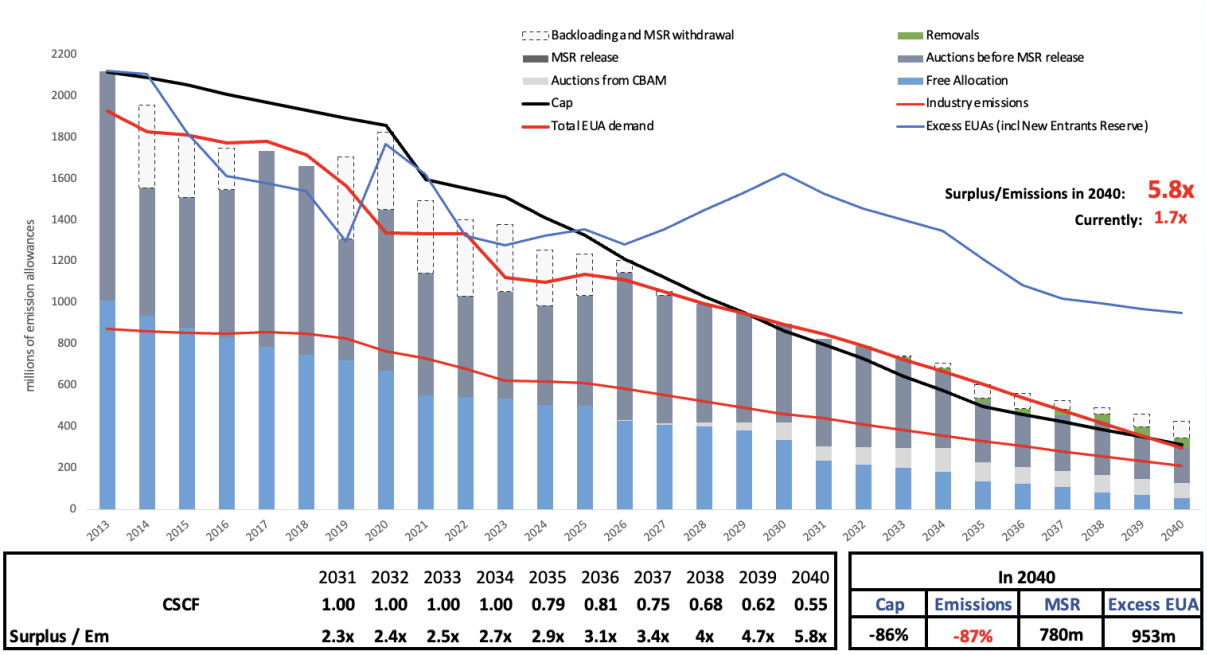
Year	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO2e)	Surplus / Emissions
2040	1,737	**+195**	274 (S2 – 85%)	**6.3 x**

With Extensions

The Commission's proposal includes extension to the actual scope:

- Shipping: extending the scope of the maritime ETS to specific categories of small vessels (with a gross tonnage below 5 000 but not below 400) from 203.
- Waste: extending the ETS to municipal waste incineration from 2031.
- Aviation: extending the scope of the aviation ETS to cover all flights departing from an airport situated in the EEA and landing in aerodromes in third countries located no more than 5,000 kilometres from the aerodrome of Frankfurt, from 2029 to 2032.

When combined with the above design features, this measure results in a surplus of 1,733 million allowances (including 630 million in the MSR), equal to 5.8 times the emissions in 2040. This single measure creates a net addition of -4 million allowances.



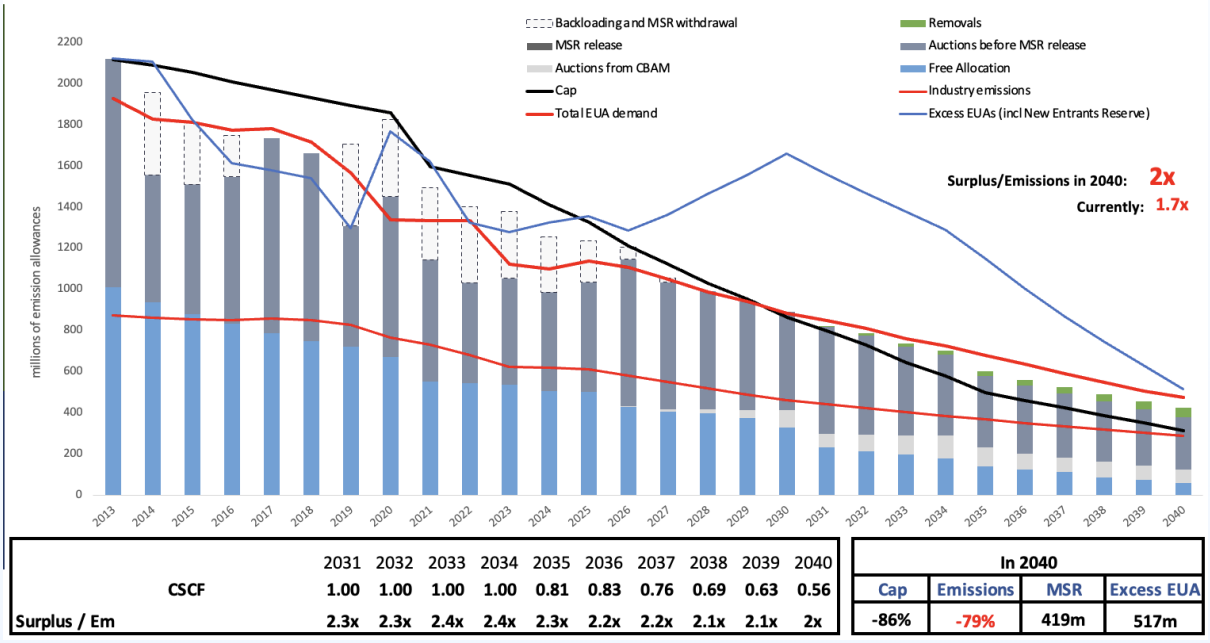
	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	1.00	0.79	0.81	0.75	0.68	0.62	0.55
Surplus / Em	2.3x	2.4x	2.5x	2.7x	2.9x	3.1x	3.4x	4x	4.7x	5.8x

In 2040			
Cap	Emissions	MSR	Excess EUA
-86%	-87%	780m	953m

Figure 7. With extensions, in scenario S2

Year	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO2e)	Surplus / Emissions
2040	1,733	**-4**	301 (S2 – 85%)	**5.8 x**

We also tested this configuration against the emissions scenario S1, where EU-wide emissions are only reduced by 75%. It would result in a surplus of 935 million allowances in 2040 (including 419m in the MSR), compared to emissions of 443 million tCO_2. This would bring the surplus **to 2.0 times the emissions that year**, already larger than the current 1.7 ratio, which is exactly the same ratio as today. It is therefore likely that market forces, through the carbon price, would drive emissions to the S1 scenario (-75% EU wide) rather than S2 (-85%).



	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040
CSCF	1.00	1.00	1.00	1.00	0.81	0.83	0.76	0.69	0.63	0.56
Surplus / Em	2.3x	2.3x	2.4x	2.4x	2.3x	2.2x	2.2x	2.1x	2.1x	2x

In 2040			
Cap	Emissions	MSR	Excess EUA
-86%	-79%	419m	517m

Figure 8: Combined design options proposed by the Commission, in scenario S1 (-75% EU wide emissions)

Year	Total surplus by 2040 (m EUA)	**Total difference due to Commission proposal**	Emissions (m tCO_2e)	Surplus / Emissions
2040	1,733	1,827	301 (S2 – 85%)	**5.8 x**
2040	935	1,029	477 (S1 – 75%)	**2.0 x**

Summary table

The combined design features proposed by the Commission amount to a **net increase of 1,827m allowances** over the period to 2040. They increase the surplus/emissions ratio from 1.7x today to 5.8x in 2040 if emissions follow the desired -85% reduction target. The ratio would be brought back to 1.7x in 2040 if emissions only follow a less ambitious -75% emissions reduction pathway.

Feature	Total surplus by 2040 (m EUA)	**Difference (brought by this feature only)**	Emissions (m tCO_2e)	Surplus / Emissions
Cap	1,244	**1,338**	274 (S2 – 85%)	**4.5 x**
Removals	1,492	**+249**	274 (S2 – 85%)	**5.5 x**
MSR rules	1,542	**+49**	274 (S2 – 85%)	**5.6 x**
Ending transfer NER-> MSR	1,737	**+195**	274 (S2 – 85%)	**6.3 x**
Extensions	1,733	**-4**	301 (S2 – 85%)	**5.8 x**
Total – S2	1,733	**1,827**	301 (S2 – 85%)	**5.8%**
Total – S1	935	**1,029**	477 (S1 – 75%)	**2.0 x**