

**Amendments to the European Commission’s Proposal to amend:**

**DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL**

**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**

**Ambition**

**Cap/LRF**

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 27</b></p> <p>Bearing in mind that this Directive amends Directive 2003/87/EC in respect of a period of implementation that has already started on 1 January 2021, for reasons of predictability, environmental effectiveness and simplicity, the steeper linear reduction pathway of the EU ETS should be a straight line from 2021 to 2030, such as to achieve emission reductions in the EU ETS of 61 % by 2030, as the appropriate intermediate step towards Union economy-wide climate neutrality in 2050. As the increased linear reduction factor can only apply from the year following the entry into force of this Directive, a one-off reduction of the quantity of allowances should reduce the total quantity of allowances so that it is in line with <del>this level of annual reduction having been made from 2021 onwards.</del></p>	<p><b>Recital 27</b></p> <p>Bearing in mind that this Directive amends Directive 2003/87/EC in respect of a period of implementation that has already started on 1 January 2021, for reasons of predictability, environmental effectiveness and simplicity, the steeper linear reduction pathway of the EU ETS should be a straight line from 2021 to 2030, such as to achieve emission reductions in the EU ETS of 61 % by 2030, as the appropriate intermediate step towards Union economy-wide climate neutrality in 2050. As the increased linear reduction factor can only apply from the year following the entry into force of this Directive, a one-off reduction of the quantity of allowances should reduce the total quantity of allowances so that it is in line with <b><i>the average emissions of the previous three years, adjusted, from the mid-point of this period, by the linear reduction factor.</i></b></p>
<b>Justification</b>	
See justification for Article 9.	

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 9</b></p> <p>“In [the year following entry into force of this amendment], the Union-wide quantity of allowances shall <del>be decreased by [– million allowances (to be determined depending on year of entry into force)].</del> In the same year, the Union-wide quantity of allowances shall be increased by <del>79 million allowances for maritime transport.</del></p>	<p><b>Article 9</b></p> <p>In [the year following entry into force of this amendment], the Union-wide quantity of allowances shall <b><i>equal the average emissions of the previous three years, adjusted, from the mid-point of this period, by the linear reduction factor.</i></b> In the same year, the Union-wide quantity of allowances shall be increased by <b><i>a number of allowances corresponding to the emissions from maritime</i></b></p>

Starting in [the year following entry into force of this amendment], the linear factor shall be **4,2 %**. The Commission shall publish the Union-wide quantity of allowances within 3 months of [date of entry into force of the amendment to be inserted].”;

***transport activities reported in accordance with Regulation (EU) 2015/757 for 2018 and 2019 in the Union, adjusted, from year 2021, by the LRF.***

Starting in [the year following entry into force of this amendment], the linear factor shall be ***adjusted to be in line with a 2030 emission reduction target for the sectors covered by the EU ETS of 61% compared to 2005 for the same perimeter.*** The Commission shall publish the Union-wide quantity of allowances within 3 months of [date of entry into force of the amendment to be inserted].”;

**Justification**

The proposed one-off reduction of the cap (rebasings) is very small, at 78m tonnes if done in 2023 (119m if in 2024). This reduction only aligns the new trajectory with the 2020 cap, which is far above historical emissions. Consequently, the rebased cap will remain above historical emissions for another several years.

Instead, the cap should be rebased starting from the most recent emission levels (the average 3 years before entry into force), so that the decarbonisation incentive of an ETS with a net-zero 2050 target is effective immediately.

This way, for an entry into force in 2024, the rebasing amount would be calculated using the average 202123 emissions, with a new LRF starting point in 2022.

Based on Sandbag’s ‘baseline’ scenario, with emissions averaging 1299m tCO<sub>2</sub>e over 2021-23, the corresponding rebasing number would be 233m tCO<sub>2</sub>e instead of 117m (compared to the 2024 cap if no rebasing was done) proposed by the Commission. The LRF (everything else otherwise equal) would be 3.3% instead of 4.2%.

**ETS2**

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 60</b></p> <p>(66) In order to mitigate the risk of supply and demand imbalances associated with the start of emissions trading for the buildings and road transport sectors, as well as to render it more resistant to market shocks, the rule-based mechanism of the Market Stability Reserve should be applied to those new sectors. <b><del>For that reserve to be operational from the start of the system, it should be established with an initial endowment of 600 million allowances for emissions trading in the road transport and buildings sectors.</del></b> The initial lower and upper thresholds, which trigger the release or intake of allowances from the reserve, should be subject to a general review clause. Other elements such as the publication of the total number of allowances in circulation or the quantity of allowances released or placed in the reserve should follow the rules of the reserve for other sectors.</p>	<p><b>Recital 60</b></p> <p>(66) In order to mitigate the risk of supply and demand imbalances associated with the start of emissions trading for the buildings and road transport sectors, as well as to render it more resistant to market shocks, the rule-based mechanism of the Market Stability Reserve should be applied to those new sectors. The initial lower and upper thresholds, which trigger the release or intake of allowances from the reserve, should be subject to a general review clause. Other elements such as the publication of the total number of allowances in circulation or the quantity of allowances released or placed in the reserve should follow the rules of the reserve for other sectors.</p>
<b>Justification</b>	

Endowing the second MSR with 600m allowances amounts to increasing the cap. For this ETS to be effective, its cap must be enforced. If there was any issue related to the timing of EUA supply compared to demand, an article similar to Article 29a could be adapted to deal with those situations.

Original text (EC Proposal July 2021)	Amendment
<b>Article 30d(2)</b>  <del>In 2026, 600 million allowances covered by this Chapter are created as holdings in the Market Stability Reserve pursuant to Article 1a(3) of Decision (EU) 2015/1814.</del>	<b>Article 30d(2)</b> <i>(Delete)</i>
Justification	
See above justification.	

## Resilience

### Amendments to Decision (EU) 2015/1814 (MSR Decision)

Original text (EC Proposal July 2021)	Amendment
<b>Article 1 (5 and 5a)</b>  “5. In any given year, if the total number of allowances in circulation is between 833 million and 1 096 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 volume of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC and shall be placed in the reserve over a period of 12 months beginning on 1 September of that year... ...Unless otherwise decided in the first review carried out in accordance with Article 3, from 2023 allowances held in the reserve above 400 million allowances shall no longer be valid.”;	<b>Article 1 (5 and 5a)</b>  “5. <i>The upper MSR threshold above which the intake rate applies shall be 100 million allowances and the lower MSR threshold below which allowances are released from the reserve according to paragraph 6 shall be 0 allowances in the year the Decision enters into force.</i> In any given year, if the total number of allowances in circulation is between <b>the upper MSR threshold</b> and <b>132</b> 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, <b>the upper MSR threshold</b> , shall be deducted from the volume of allowances to be auctioned by the Member States under Article 10(2) of Directive 2003/87/EC and shall be placed in the reserve over a period of 12 months beginning on 1 September of that year... ...Unless otherwise decided in the first review carried out in accordance with Article 3, from 2023 allowances held in the reserve above 400 million allowances shall no longer be valid.”;
Justification	
We recommend reducing the MSR thresholds (currently 400m and 833m) down to zero and 100 million for low and high, respectively. These thresholds were set to accommodate hedging by power utilities, but this argument was not valid as hedging only involves the futures market and does not require actual permits to exist at the time of transaction. It is even less so now that the power sector has largely decarbonised and UK plants were removed from it. It should be noted that Article 29a deals with the timing of supply vs. demand, allowing EUAs to be issued “in advance” of their compliance year. If there was an imbalance between net long and net short	

positions created by “long” hedging needs, Article 29a would be a much better tool to deal with it (with a few changes), adding the missing “short” positions, than keeping surplus in the system through the MSR thresholds.

## Measures in the event of excessive price fluctuations

Original text (ENVI Rapporteur Draft Report)	Amendment
<p><b>Article 29a</b></p> <p>If, for more than six consecutive months, the average allowance price is more than two times the average price of allowances during the two preceding years on the European carbon market, the Commission shall release 100 million allowances covered by this Chapter from the <del>Market Stability Reserve in accordance with Article 1(7) of Decision (EU) 2015/1814</del> equally distributed within auctions during a period of six months.</p> <p>1a. If, after the period of six months referred to in paragraph 1, the condition in paragraph 1 is still met, the Commission shall immediately, and no later than seven days, convene a meeting of the Committee established by Article 9 of Decision No 280/2004/EC to assess if the price evolution referred to in paragraph 1 corresponds to changing market fundamentals.</p> <p>If the price evolution referred to in paragraph 1 does not correspond to changing market fundamentals, as a matter of urgency, one of the following measures shall be taken, taking into account the degree of price evolution:</p> <p>(a) measure which allows Member States to bring forward the auctioning of a part of the quantity to be auctioned in a subsequent calendar year;</p> <p>(b) a measure which allows Member States to auction up to <b>25 % of the remaining allowances in the</b> new entrants reserve.</p> <p>Those measures shall be adopted in accordance</p>	<p><b>Article 29a</b></p> <p>If, for more than six consecutive months, the average allowance price is more than <i>two</i> times the average price of allowances during the <i>two</i> preceding years on the European carbon market, the Commission shall <i>release 100 million allowances covered by this Chapter from the <u>New Entrants Reserve, or the number of allowances in excess 320 million allowances remaining in it, whichever is the lower,</u></i> equally distributed within auctions during a period of six months.</p> <p><b><u>1aa. If the number of allowances remaining in the New Entrants Reserve is not sufficient for the above amount to equal 100 million, Member States shall be allowed to bring forward the auctioning of allowances to be auctioned in a subsequent calendar year, up to an amount complementing it to 100 million.</u></b></p> <p><i>1a. If, after the period of six months referred to in paragraph 1, the condition in paragraph 1 is still met, the Commission shall immediately, and no later than seven days, convene a meeting of the Committee established by Article 9 of Decision No 280/2004/EC to assess if the price evolution referred to in paragraph 1 corresponds to changing market fundamentals.</i></p> <p>If the price evolution referred to in paragraph 1 does not correspond to changing market fundamentals, as a matter of urgency, one of the following measures <i>shall be taken</i>, taking into account the degree of price evolution:</p> <p>(a) measure which allows Member States to bring forward the auctioning of a part of the quantity to be auctioned <i>in a subsequent calendar year</i>;</p> <p>(b) a measure which allows Member States to auction up to <b><u>the amount remaining in the new entrants reserve in excess of 320 million.</u></b></p> <p>Those measures shall be adopted in accordance</p>

<p>with the management procedure referred to in Article 23(4).</p> <p>Any measure shall take utmost account of the reports submitted by the Commission to the European Parliament and to the Council pursuant to Article 29, as well as any other relevant information provided by Member States.</p> <p>The arrangements for the application of these provisions shall be laid down in the acts referred to in Article 10(4)."</p>	<p>with the management procedure referred to in Article 23(4).</p> <p>Any measure shall take utmost account of the reports submitted by the Commission to the European Parliament and to the Council pursuant to Article 29, as well as any other relevant information provided by Member States.</p> <p>The arrangements for the application of these provisions shall be laid down in the acts referred to in Article 10(4)."</p>
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**Justification**

It is very important for any price-control mechanism not to increase the cap. It should be noted that price volatility is not caused by the overall supply/demand balance (as we all know, a huge surplus is still there and will remain available well into the 2030s), but by the modalities and timing of allocation: due to free allocation, industry emissions are not responsive to spiking prices; at the same time, the surplus in industry accounts will only come to market (in huge numbers) in case of financial crunch. More details here.

MSR amounts were inherited from Phase 3 and even Phase 2! So is the initial 320m EUA dotation of the NER. Those amounts are therefore in excess of the cap, so releasing those amounts to the market would renounce on the ETS cap and the EU's commitments to reach 55% by 2030.

In contrast, the allocation system based on benchmarks creates a loophole whereby part of the industry's allowances (43%) are never allocated. It would be the case, for example, if production in ETS industry sectors decreased (e.g. in a high-circularity scenario). These allowances are within the cap but there is no mechanism to let them out of the NER. So it should be natural to release them, but only for those in excess of the initial 320m dotation.

**Control of supply of allowances**

<b>Original text (ETS Directive)</b>	<b>Amendment</b>
<p><b>Article 10 a (5)</b></p> <p>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.</p>	<p><b>Article 10 a (5)</b></p> <p>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. <b><i>These remaining allowances shall only be used if the previous year's emissions did not exceed the cap.</i></b> Where, nonetheless, the maximum amount is reached, free allocations shall be adjusted accordingly. Any such adjustment shall be done in a uniform manner.</p>

**Justification**

A number of mechanisms contribute to increasing the supply of allowances beyond the yearly emissions cap, including: unused allowances from previous years not removed into the MSR; allowances that are not allocated for free which are kept available for the later years (Article 10 a (5)); 320 million allowances transferred from Phase III surplus into the New Entrants Reserve; 25 million allowances carried over from Phase III can be claimed and sold by Greece. These reserves undermine the cap and their use should not allow emissions to repeatedly exceed the cap.

The above wording addresses the allowances not allocated during the earlier years of the phase, which Sandbag estimates at 263m by 2023<sup>1</sup>.

Original text (MSR Directive)	Amendment
<p><b>Article 1 (6)</b></p> <p>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.</p>	<p><b>Article 1 (6)</b></p> <p>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, <b><i>if the previous year's emissions did not exceed the cap.</i></b> Where fewer than 100 million allowances are in the reserve, all allowances in the reserve shall be released under this paragraph.</p>
Justification	
See previous justification.	

## Revenue use

### Member States

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 10 (3)</b></p>	<p><b>Article 10 (3)</b></p> <p><b><i>In paragraph 3, the following points are added:</i></b></p> <p><b><i>“(l) to promote skill formation in line with the need to adjust professional practices to circularity and the use of low-carbon materials;”;</i></b></p> <p><b><i>“(m) to support the development of a circular economy;”;</i></b></p>
Justification	
<p>The scaling up of substitution of materials with high-carbon contents for lower-carbon materials often faces the barrier of inadequate professional practices. It is necessary for the workforce to be trained to use the types of materials adapted to the transition to a low-carbon economy. No funding mechanism currently exists for such transition.</p> <p>Circularity should be one of the main pillars of a low-carbon economy, yet no funding mechanism exists for such measures.</p>	

<sup>1</sup> <https://sandbag.be/index.php/2021/09/30/impact-of-eu-ets-reform-letting-industry-loose/>



**Innovation Fund**

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 33</b></p> <p>The <del>scope of the</del> Innovation Fund referred to in Article 10a(8) of Directive 2003/87/EC should be extended to support innovation in low-carbon technologies and processes that concern the consumption of fuels in the sectors of buildings and road transport.</p> <p>In addition, the <b>Innovation</b> Fund should serve to support investments to decarbonise the maritime transport sector, including investments in sustainable alternative fuels, such as hydrogen and ammonia that are produced from renewables, as well as zero-emission propulsion technologies like wind technologies. Considering that revenues generated from penalties raised in Regulation xxxx/xxxx [FuelEU Maritime]<sup>19</sup> are allocated to the <b>Innovation</b> Fund as external assigned revenue in accordance with Article 21(5) of the Financial Regulation, the Commission should ensure that due consideration is given to support for innovative projects aimed at accelerating the development and deployment of renewable and low carbon fuels in the maritime sector, as specified in Article 21(1) of Regulation xxxx/xxxx [FuelEU Maritime]. To ensure sufficient funding is available for <b>innovation</b> within this extended scope, the <b>Innovation</b> Fund should be supplemented with 50 million allowances, stemming partly from the allowances that could otherwise be auctioned, and partly from the allowances that could otherwise be allocated for free, in accordance with the current proportion of</p>	<p><b>Recital 33</b></p> <p>The Innovation Fund referred to in Article 10a(8) of Directive 2003/87/EC should be <b>renamed ‘Carbon Neutrality Fund’ and its scope</b> extended to support <b>measures aiming to reduce large amounts of GHG emissions that are not project-based or innovative, as well as</b> innovation in low-carbon technologies and processes that concern the consumption of fuels in the sectors of buildings and road transport.</p> <p>In addition, the <b>Carbon Neutrality</b> Fund should serve to support investments to decarbonise the maritime transport sector, including investments in sustainable alternative fuels, such as hydrogen and ammonia that are produced from renewables, as well as zeroemission propulsion technologies like wind technologies. Considering that revenues generated from penalties raised in Regulation xxxx/xxxx [FuelEU Maritime]<sup>19</sup> are allocated to the <b>Carbon Neutrality</b> Fund as external assigned revenue in accordance with Article 21(5) of the Financial Regulation, the Commission should ensure that due consideration is given to support for <del>innovative</del> projects aimed at accelerating the development and deployment of renewable and low carbon fuels in the maritime sector, as specified in Article 21(1) of Regulation xxxx/xxxx [FuelEU Maritime]. To ensure sufficient funding is available for <b>measures</b> within this extended scope, the <b>Carbon Neutrality</b> Fund should be supplemented with 50 million allowances, stemming partly from the allowances that could otherwise be auctioned, and partly from the allowances that could otherwise be allocated for free, in accordance with the current proportion of funding provided from each source to the <b>Carbon Neutrality</b> Fund.</p>
<p>funding provided from each source to the <b>Innovation</b> Fund.</p>	
<p><b>Justification</b></p>	
<p>See justification for Article 10a (8).            We highly recommend caution about increasing the size of the Innovation Fund, given the absence of funding programmes dedicated to measures with high abatement potential in non-innovative areas such as education, public infrastructure or circularity, which are disadvantaged by ETS incentives focused on industrial output. An increase in size would only be justified by the adequate extension of scope.</p>	

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 34</b></p> <p>Pursuant to Article 10 of Commission Regulation (EU) No 2019/112220, where aircraft operators no longer operate flights covered by the EU ETS, their</p>	<p><b>Recital 34</b></p> <p>Pursuant to Article 10 of Commission Regulation (EU) No 2019/112220, where aircraft operators no longer operate flights covered by the EU ETS, their</p>

accounts are set to excluded status, and processes may no longer be initiated from those accounts. To preserve the environmental integrity of the system, allowances which are not issued to aircraft operators due to their closure should be used to cover any shortfall in surrenders by those operators, and any leftover allowances should be used to accelerate action to tackle climate change by being placed in the **Innovation** Fund.

accounts are set to excluded status, and processes may no longer be initiated from those accounts. To preserve the environmental integrity of the system, allowances which are not issued to aircraft operators due to their closure should be used to cover any shortfall in surrenders by those operators, and any leftover allowances should be used to accelerate action to tackle climate change by being placed in the **Carbon Neutrality** Fund.

Justification

See the justification for Article 10a(8).

Original text (EC Proposal July 2021)

Amendment

**Recital 35**

Carbon Contracts for Difference (CCDs) are an important element to trigger emission reductions in in industry, offering the opportunity to guarantee investors in **innovative** climate-friendly technologies a price that rewards CO2 emission reductions above those induced by the current price levels in the EU ETS. The range of The measures that the **Innovation** Fund can support should be extended to provide support to projects through price-competitive tendering, such as should CCDs. The Commission should be acts on the adopt delegated acts on the precise type of support.

Carbon Contracts for Difference (CCDs) are an important element to trigger emission reductions industry, offering the opportunity to guarantee in climate-friendly technologies a price that rewards CO2 emission reductions above those induced by the current price levels in the EU ETS. range of measures that the **Carbon Neutrality** Fund can support should be extended to provide support to projects through price-competitive tendering, such as CCDs. The Commission empowered to be empowered to adopt delegated rules for this precise rules for this type of support.

Justification

See the justification for Article 10a(8).

Original text (EC Proposal July 2021)

Amendment

**Recital 54**

Innovation and development of new low-carbon technologies in the sectors of buildings and road transport are crucial for ensuring the cost-efficient contribution of these sectors to the expected emission reductions. Therefore, 150 million allowances from emissions trading in the buildings and road transport sectors should also be made available to the Innovation Fund to stimulate the cost-efficient emission reductions.

**Recital 54**

Innovation and development of new low-carbon technologies **and measures** in the sectors of buildings and road transport are crucial for ensuring the cost-efficient contribution of these sectors to the expected emission reductions. Therefore, 150 million allowances from emissions trading in the buildings and road transport sectors should also be made available to the **Innovation Carbon Neutrality** Fund to stimulate the cost-efficient emission reductions.

Justification

See the justification for Article 10a(8).

Original text (EC Proposal July 2021)

Amendment

**Article 10a (8):**

“8. 365 million allowances from the quantity which could otherwise be allocated for free pursuant to this Article, and 85 million allowances from the quantity which could otherwise be auctioned

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“8. 365 million allowances from the quantity which could otherwise be allocated for free pursuant to this Article, and 85 million allowances from the quantity which could otherwise be auctioned



pursuant to Article 10, as well as the allowances resulting from the reduction of free allocation referred to in Article 10a(1a), shall be made available to a Fund with the objective of supporting innovation in low-carbon technologies and processes, and contribute to zero pollution objectives (the 'Innovation Fund').

Allowances that are not issued to aircraft operators due to the closure of aircraft operators and which are not necessary to cover any shortfall in surrenders by those operators, shall also be used for innovation support as referred to in the first subparagraph...

...The **Innovation** Fund shall cover the sectors listed in Annex I and Annex III, including environmentally safe carbon capture and utilisation ("CCU") that contributes substantially to mitigating climate change, as well as products substituting carbon intensive ones produced in sectors listed in Annex I, and to help stimulate the construction and operation of projects aimed at the environmentally safe capture and geological storage ("CCS") of CO<sub>2</sub>, as well as of innovative renewable energy and energy storage technologies; in geographically balanced locations.

The **Innovation** Fund may also support breakthrough innovative technologies and infrastructure to decarbonise the maritime sector and for the production of low- and zero-carbon fuels in aviation, rail and road transport. Special attention shall be given to projects in sectors covered by the [CBAM regulation] to support innovation in low carbon technologies, CCU, CCS, renewable energy and energy storage, in a way that contributes to mitigating climate change. Projects in the territory of all Member States, including small-scale projects, shall be eligible. Technologies receiving support shall be **innovative** and not **yet** commercially viable at a similar scale without support but shall represent **breakthrough** solutions or be sufficiently mature for application at pre-commercial scale...

... Projects shall be selected on the basis of objective and transparent criteria, taking into account, where relevant, the extent to which projects contribute to achieving **emission reductions well below the benchmarks referred to in paragraph 2...**

...taken into account under paragraph 7.";

pursuant to Article 10, as well as the allowances resulting from the reduction of free allocation referred to in Article 10a(1a), shall be made available to a Fund with the objective of supporting **emissions avoidance, including through** innovation in low-carbon technologies and processes, and contribute to zero pollution objectives (the 'Innovation Fund', **which shall be renamed 'Carbon Neutrality Fund'**).

Allowances that are not issued to aircraft operators due to the closure of aircraft operators and which are not necessary to cover any shortfall in surrenders by those operators, shall also be used for innovation support as referred to in the first subparagraph...

...The **Carbon Neutrality** Fund shall cover the sectors listed in Annex I and Annex III, including **large scale emission reduction projects using mature technologies, public and private initiatives supporting circularity, EU-wide programmes for emission reduction,** environmentally safe carbon capture and utilisation ("CCU") that contributes substantially to mitigating climate change, as well as products substituting carbon intensive ones produced in sectors listed in Annex I, and to help stimulate the construction and operation of projects aimed at the environmentally safe capture and geological storage ("CCS") of CO<sub>2</sub>, as well as of innovative renewable energy and energy storage technologies; in geographically balanced locations.

The **Carbon Neutrality** Fund may also support break-through innovative technologies and infrastructure to decarbonise the maritime sector and for the production of low- and zero-carbon fuels in aviation, rail and road transport. Special attention shall be given to projects in sectors covered by the [CBAM regulation] to support **circularity measures, professional training to use lowcarbon products,** innovation in low carbon technologies, CCU, CCS, renewable energy and energy storage, in a way that contributes to mitigating climate change. Projects **and measures** in the territory of all Member States, including smallscale projects, shall be eligible. Technologies receiving support shall be **of deep decarbonisation** and not commercially viable at a similar scale without support but shall represent solutions or be sufficiently mature for application at pre-commercial scale...

...Projects **and measures** shall be selected on the basis of objective and transparent criteria, taking into account, where relevant, the extent to which projects contribute to achieving **the Union's carbon neutrality objective...**

...taken into account under paragraph 7.";

## Justification

The Innovation Fund is one of the main sources of climate funding, yet it's restricted to innovative technologies, which suggests the Commission's belief that the main obstacle to decarbonisation is a lack of innovation.

However, there are many technologies (or, simply put, "measures") with vast abatement potential that are ready, not particularly innovative but simply not economical, in need for support to be deployed. It is the case of the substitution of concrete with timber, or the reuse of steel products, in the construction sector. Those measures, which would require public funding (not least in education, e.g. to train builders to new materials), are not eligible for funding from the Innovation Fund by lack of innovation content, or to any other funding instrument.

In the same way as feed-in tariffs to (un-innovative) renewable energies helped decarbonising the power sector in the 2010s, support to the deployment of uneconomical, high-potential abatement measures should help decarbonising our economy. This would be more effective than a risky gamble on innovation, which the failed NER300 subsidy programme already demonstrated in that same decade. Feed-in tariffs are an example of programme run by individual Member States in an uncoordinated fashion (some MS have no tariffs at all), whereas coordination at EU level would sometimes be preferable. Similar programmes could be more efficiently applied to many types of subsidies, if coordinated and financed at EU level, including to support circularity, carbon-free mobility etc. Another example of lack of coordination is hydrogen, for which some MS plan large-scale transport infrastructure while others plan production near consumption sites.

Using free allocation benchmarks as reference to assess environmental performance is too weak a comparison:

- Those benchmarks were initially based on the 10% best installations, but some of them are just arbitrary (e.g. the heat benchmark is just based on natural gas heating),
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- They are backward looking, only being based on a reference observed in 2007-08. Projects are selected by comparing their GHG emissions with this out-of-touch reference, which e.g. for hydrogen production represent 6.84 tCO<sub>2</sub> per tonne of hydrogen produced, even though the 10% most efficient "grey hydrogen" plants in Europe only emit 4.09 tCO<sub>2</sub>.
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Instead of aiming at a level only below the free allocation benchmarks, Innovation Fund activities should therefore aim at carbon neutrality.

We urge to refocus the Innovation Fund on environmental impact rather than innovation, and recommend caution about increasing its already large size unless it also supports:

- Projects with large-scale abatement potential regardless of their innovation content
- measures not based on individual projects, to support circularity. These could include support to the retraining of workforce to using low-carbon types of materials.
- Programmes of support at EU level which could improve sector-based coordination in emission reductions.

This change of focus justifies our proposal to rename **the Innovation Fund as 'Carbon Neutrality Fund'**.

## Modernisation Fund

Original text (EC Proposal July 2021)	Amendment
<b>Recital 38</b>  The scope of the Modernisation Fund should be aligned with the most recent climate objectives of the Union by requiring that investments are consistent with the objectives of the European	<b>Recital 38</b>  The scope of the Modernisation Fund should be aligned with the most recent climate objectives of the Union by requiring that investments are consistent with the objectives of the European

<p>Green Deal and Regulation (EU) 2021/1119, and eliminating the support to any investments related to fossil fuels. In addition, the percentage of the Modernisation Fund that needs to be devoted to priority investments should be increased to <b>80%</b>; energy efficiency should be targeted as a priority area at the demand side; and support of households to address energy poverty, including in rural and remote areas, should be included within the scope of the priority investments.</p>	<p>Green Deal and Regulation (EU) 2021/1119, and eliminating the support to any investments related to fossil fuels. In addition, the percentage of the Modernisation Fund that needs to be devoted to priority investments should be increased to <b>100%</b>; energy efficiency should be targeted as a priority area at the demand side; and support of households to address energy poverty, including in rural and remote areas, should be included within the scope of the priority investments.</p>
<b>Justification</b>	
<p>The share of allocation to a series of priority investments should be raised to 100%, to ensure that the list of priority investments is fully adhered to by the eligible Member States and to channel all the available funding to the most pressing climate needs.</p>	

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 10 is amended as follows:</b>  <b>(a) in paragraph 1, the third subparagraph is replaced by the following:</b></p> <p>“2 % of the total quantity of allowances between 2021 and 2030 shall be auctioned to establish a fund to improve energy efficiency and modernise the energy systems of certain Member States (‘the beneficiary Member States’) as set out in Article 10d (‘the Modernisation Fund’). The beneficiary Member States for this amount of allowances shall be the Member States with a GDP per capita at market prices below 60 % of the Union average in 2013. The funds corresponding to this quantity of allowances shall be distributed in accordance with Part A of Annex IIb.</p> <p><del>In addition, 2,5 % of the total quantity of allowances between [year following the entry into force of the Directive] and 2030 shall be auctioned for the Modernisation Fund. The beneficiary Member States for this amount of allowances shall be the Member States with a GDP per capita at market prices below 65 % of the Union average during the period 2016 to 2018. The funds corresponding to this quantity of allowances shall be distributed in accordance with Part B of Annex IIb.”</del></p>	<p><b>Article 10 is amended as follows:</b>  <b>(a) in paragraph 1, the third subparagraph is replaced by the following:</b></p> <p>“2 % of the total quantity of allowances between 2021 and 2030 shall be auctioned to establish a fund to improve energy efficiency and modernise the energy systems of certain Member States (‘the beneficiary Member States’) as set out in Article 10d (‘the Modernisation Fund’). The beneficiary Member States for this amount of allowances shall be the Member States with a GDP per capita at market prices below 60 % of the Union average in 2013. The funds corresponding to this quantity of allowances shall be distributed in accordance with Part A of Annex IIb.</p>
<b>Justification</b>	
<p>We are concerned that the problem with energy transition in CEE countries is not the lack of funding, but the lack of capacity to deal with the funds already granted. To foster a strategic and efficient absorption of the available financing from the Modernisation Fund, the Commission should provide more technical assistance to the potential beneficiaries as for developing high-quality projects, notably to municipalities and other local and regional authorities, which lack the necessary administrative and practical competences.</p>	

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 10d</b> is amended as follows:</p> <p>paragraph 2 is replaced by the following:</p>	<p><b>Article 10d</b> is amended as follows:</p> <p>paragraph 2 is replaced by the following:</p>

"2. ~~At least 80%~~ of the financial resources from the Modernisation Fund shall be used to support investments in the following:  
(a) the generation and use of electricity from renewable sources;...

"2. **100%** of the financial resources from the Modernisation Fund shall be used to support investments in the following:  
(a) the generation and use of electricity from renewable sources;...

#### Justification

The share of allocation to a series of priority investments should be raised to 100%, to ensure that the list of priority investments is fully adhered to by the eligible Member States and to channel all the available funding to the most pressing climate needs. This would strengthen the accountability and transparency of using the funds, as spending would be fully reported and monitored. In particular, Sandbag's research highlighted the need to develop heating and cooling from renewable sources, e.g. in Romania<sup>2</sup>.

## Incentives

### Original text (EC Proposal July 2021)

### Amendment

#### Recital 8

The EU ETS should incentivise production from installations that partly or fully reduce greenhouse gas emissions. Therefore, the description of some categories of activities in Annex I to Directive 2003/87/EC should be amended to ensure an equal treatment of installations in the sectors concerned. In addition, free allocation for the production of a product should be independent of the nature of the production process. It is therefore necessary to modify the definition of the products and of the processes and emissions covered for some benchmarks to ensure a level playing field for new and existing technologies. It is also necessary to decouple the update of the benchmark values for refineries and for hydrogen to reflect the increasing importance of production of hydrogen outside the refineries sector.

#### Recital 8

The EU ETS should incentivise measures that partly or fully reduce greenhouse gas emissions, **whether those reductions are due to less emissionintensive production or to reduced consumption**. Therefore, the description of some categories of activities in Annex I to Directive 2003/87/EC should be amended to ensure an equal treatment of installations **abatement measures** in the sectors concerned. In addition, free allocation for the production of a product should be **avoided where possible, and in any case** independent of the nature of the production process. It is therefore necessary to modify the definition of the products and of the processes and emissions covered for some benchmarks to ensure a level playing field for new and existing technologies, **products and circular economy measures**. It is also necessary to decouple the update of the benchmark values for refineries and for hydrogen to reflect the increasing importance of production of hydrogen outside the refineries sector.

#### Justification

The ETS should not only ensure there is fair competition between different technologies producing the same product types, but also between products fulfilling the same function and avoid competitive distortion between ways of achieving emission reductions, whether from improved processes or from reduced production thanks to circularity measures.

Therefore, in order to accelerate the industrial transformation that results in greater greenhouse gas reductions, the EU ETS needs to reform its current free allocation approach to make it less dependent on production processes, and rather make provision to incentivise resource efficiency and recycling of materials, by linking its approach to products (as per article 10a of the ETS Directive, which recognises the need to provide "incentives for reductions in greenhouse gas emissions and energy efficient techniques, by

<sup>2</sup> <https://sandbag.be/index.php/2021/03/25/harnessing-eu-funds-for-romania-energy-transition/>

taking account of the most efficient techniques, **substitutes...**). To date, the EU ETS has continually failed to incentivise circular economy efforts that reduce consumption.

### Conditionality of Free Allocation

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 29</b></p> <p>Further incentives to reduce greenhouse gas emissions by using cost-efficient techniques should be provided. To that end, the free allocation of emission allowances to stationary installations from 2026 onwards should be conditional on <del>investments in techniques to increase energy efficiency and reduce emissions. Ensuring that this is focused on larger energy users would result in a substantial reduction in burden for businesses with lower energy use, which may be owned by small and medium sized enterprises or micro-enterprises. [Reference to be confirmed with the revised EED].</del> The relevant delegated acts should be adjusted accordingly.</p>	<p><b>Recital 29</b></p> <p>Further incentives to reduce greenhouse gas emissions by using cost-efficient techniques should be provided. To that end, the free allocation of emission allowances to stationary installations from 2026 onwards should be conditional on: <b>1) a material risk of carbon leakage for those installations; 2) the lack of identified options for substitution between the products made by those installations and alternative product types or circularity measures; 3) the inadequacy of other measures than free allocation, such as product requirements or a CBAM to address the risk of carbon leakage.</b> The relevant delegated acts should be adjusted accordingly.</p>
<b>Justification</b>	
See the justification for Article 10a.	

Original text (EC Proposal July 2021)	Amendment
	<p><b>New recital XX (after current Recital 30 "The Carbon Border Adjustment Mechanism...")</b></p> <p><b><i>The EU's increased emission reduction ambitions, the introduction of the CBAM, and rapid evolutions of economic and technological factors in the EU and worldwide require the carbon leakage list to be updated before 2030. These updates should be made periodically in order to better consider actual market conditions and emission levels, in accordance with the Directive methodology that states that "the determination of sectors and subsectors deemed at risk of carbon leakage [is] based on data for the three most recent calendar years available." These updates should allow for the possibility not only to add sectors and subsectors to the carbon leakage list, but also to remove those that no longer fulfil the criteria set in the Directive.</i></b></p> <p><b><i>In its 2020 Special Report on the ETS, the European Court of Auditors regretted that the European Commission did not include passthrough rates in the methodology used to</i></b></p>

*assess carbon leakage risk. While there is no agreement on a single formula that would accurately measure the cost pass-through ability for all sectors, this ability can nevertheless be measured through a qualitative assessment. Such qualitative assessments should be possible to request not only at the initiative of sectors and subsectors, but also at the initiative of other interested parties, if they can provide evidence suggesting that a sector or subsector is incorrectly deemed at risk of carbon leakage.*

#### Justification

By adopting in 2019 a carbon leakage list for the 2021-2030 period, the European Commission broke with the previous practice of more regular updates. Such a long period does not allow either to assess carbon leakage risk based on recent data ("*the three most recent calendar years available*" as per the methodology set in the directive). Setting aside changes brought by the CBAM, a carbon leakage list that covers over 90% of the ETS emissions, with no possibility of revision before 2030, will hinder the decarbonisation efforts needed to achieve the EU's increased climate ambitions. While there is no agreement on a single method that would better capture the ability of all sectors to pass through carbon costs further down their respective value chains, qualitative assessments as those already carried out by the Commission to add to the carbon leakage list sectors and subsectors that do not meet the carbon leakage indicator criterion may also reveal that sectors and subsectors meeting this criterion are nevertheless not exposed to a high carbon leakage risk due to factors not taken into account by the current methodology (direction of trade, distance).

#### Original text (EC Proposal July 2021)

Article 10a is amended as follows:

(a) paragraph 1 is amended as follows:

"(i) the following two subparagraphs are inserted after the second subparagraph:

~~"In the case of installations covered by the obligation to conduct an energy audit under Article 8(4) of Directive 2012/27/EU of the European Parliament and of the Council(\*) [Article reference to be updated with the revised Directive], free allocation shall only be granted fully if the recommendations of the audit report are implemented, to the extent that the pay-back time for the relevant investments does not exceed five years and that the costs of those investments are proportionate. Otherwise, the amount of free allocation shall be reduced by 25%. The amount of free allocation shall not be reduced if an operator demonstrates that it has implemented other measures which lead to greenhouse gas emission reductions equivalent to those recommended by the audit report. The measures referred to in the first subparagraph shall be adjusted accordingly.~~ No free allocation shall be given to installations in sectors or subsectors to the extent they are covered by other measures to address the risk of carbon leakage as established by Regulation (EU) .../.. [reference to

#### Amendment

Article 10a is amended as follows:

(a) paragraph 1 is amended as follows:

"(i) the following two subparagraphs are inserted after the second subparagraph:

**"free allocation shall only be granted fully on condition of 1) an ongoing risk of carbon leakage for those installations, pursuant to Article 10b; 2) the lack of identified options of substitution between the products made by those installations and alternative product types or circularity measures; 3) the inadequacy of other measures than free allocation, such as product requirements or a CBAM, to address the risk of carbon leakage. Sectors and subsectors that meet these three criteria shall be allocated allowances free of charge, for a period of three years that can be renewed following reexamination, and at 100 % of the quantity determined pursuant to this Article.**

Otherwise, the amount of free allocation shall be reduced by 100%.

No free allocation shall be given to installations in sectors or subsectors to the extent they are covered by other measures to address the risk of carbon leakage as established **by, inter alia**, Regulation (EU) .../.. [reference to CBAM](\*\*) **or product requirements, or to the extent that alternative**

CBAM](\*\*). The measures referred to in the first subparagraph shall be adjusted accordingly.

**products or circularity measures might be disadvantaged relatively to the installations receiving free allowances.** The measures referred to in the first subparagraph shall be adjusted accordingly.

#### Justification

In a [recent article](#), Sandbag exposed why free allocation was a major obstacle to innovation, industrial decarbonisation and a well-functioning carbon market. It should therefore be avoided wherever possible and only used as last resort under strict conditions.

The Commission's proposed approach of conditioning free allocation to investment is missing the point that carbon leakage is not related to the behaviour of individual plants or companies.

Many industrial plants have not managed to significantly reduce their emissions since joining the EU ETS in 2005, having reached the maximum level of efficiency for the type of process or product manufactured. The most effective resource allocation might not be investment into those plants, but rather the most affordable low-carbon solutions might come from substitute products, circularity or very different types of plants. The proposal to subject free allocation to investment or efficiency audit is therefore of limited value.

As a carbon leakage protection measure, free allocation should therefore not be used as a carrot-and-stick. For those plants that are *actually* at risk (the list of which should be re-assessed), the possibility to be covered by a CBAM would make FA the wrong protection against carbon leakage. Further, the existence of substitute products, and demand-side or circularity measures, would also make free allocation inappropriate to incentivise emission reductions.

#### **Condition 1: carbon leakage risk**

Carbon leakage risk should be reassessed as per Article 10b.

#### **Condition 2: lack of identified substitute products or circularity measures**

The damage caused by keeping free allocation for specific goods is related to the price elasticity of those goods:

- Some goods have a low elasticity, which means that a price increase in those goods would not trigger any significant change in consumption patterns, because the goods are essential and have no substitutes. For those, the damage of keeping free allocation is more limited. An example is fuels for passenger vehicles, for which the carbon price would not incentivise alternative transport.
- Some goods have a lower elasticity, which means that an increase in price would trigger changes in consumption patterns, such as substitutions with other goods, recycling or demand reduction. For those, free allocation would obstruct all these changes and be a major obstacle to decarbonisation and should be abolished. An example is clinker, for which a multitude of substitute products exist (clinker-free cements, timber products...) at affordable costs, and circularity and demand reduction options also exist.

#### **Condition 3: unsuitability of alternatives to free allocation (incl. CBAM)**

Rather than free allocation, other kinds of carbon leakage protections should be prioritised, ensuring free allocation is kept as very last recourse. Other protections may include a CBAM but also product requirements.

For example, hydrogen production could easily be protected against carbon leakage by means of a product requirement, so that any new domestic production (and imports) is compliant with a certified standard. Regulations such as FuelEU or REDII could ensure that existing plants quickly switch from 'grey' to 'green' production (with some free allocation in the meantime, except for the fertilisers sector as it joins the CBAM).



**Original text (ETS Directive)****Amendment****Article 10b**

1. Sectors and subsectors in relation to which the product resulting from multiplying their intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the European Economic Area (annual turnover plus total imports from third countries), by their emission intensity, measured in kgCO<sub>2</sub>, divided by their gross value added (in euros), exceeds 0,2, shall be **deemed** to be at risk of carbon leakage. ~~Such sectors and subsectors shall be allocated allowances free of charge for the period until 2030 at 100 % of the quantity determined pursuant to Article 10a.~~

2. Sectors and subsectors in relation to which the product resulting from multiplying their intensity of trade with third countries by their emission intensity exceeds 0,15 may be included in the group referred to in paragraph 1, using data for the ~~years from 2014 to 2016~~, on the basis of a qualitative assessment and of the following criteria:

- ~~(a)~~ the extent to which it is possible for individual installations in the sector or subsector concerned to reduce emission levels or electricity consumption;
- ~~(b)~~ current and projected market characteristics, including, where relevant, any common reference price;
- ~~(c)~~ profit margins as a potential indicator of longrun investment or relocation decisions, taking into account changes in costs of production relating to emission reductions.

~~4. Other sectors and subsectors are considered to be able to pass on more of the costs of allowances in product prices, and shall be allocated allowances free of charge at 30 % of the quantity determined pursuant to Article 10a. Unless otherwise decided in the review pursuant to Article 30, free allocations to other sectors and subsectors, except district heating, shall decrease by equal amounts after 2026 so as to reach a level of no free allocation in 2030.~~

~~5.~~ The Commission is empowered to adopt, ~~by~~

**Article 10b**

(a) paragraph 1 is amended as follows:

1. **Using data for the three most recent calendar years available**, sectors and subsectors in relation to which the product resulting from multiplying their intensity of trade with third countries, defined as the ratio between the total value of exports to third countries plus the value of imports from third countries and the total market size for the European Economic Area (annual turnover plus total imports from third countries), by their emission intensity, measured in kgCO<sub>2</sub>, divided by their gross value added (in euros), exceeds 0,2, shall be **presumed** to be at risk of carbon leakage.

(b) paragraph 2 is amended as follows:

2. Sectors and subsectors in relation to which the product resulting from multiplying their intensity of trade with third countries by their emission intensity exceeds 0,15 may be included in the group referred to in paragraph 1, using data for the **three most recent calendar years available** on the basis of a qualitative assessment and of the following criteria:

- (a) the ability of sectors and subsectors to pass through costs;**
- (b)** the extent to which it is possible for individual installations in the sector or subsector concerned to reduce emission levels or electricity consumption;
- (c)** current and projected market characteristics, including, where relevant, any common reference price;
- (d)** profit margins as a potential indicator of long-run investment or relocation decisions, taking into account changes in costs of production relating to emission reductions.

~~c) paragraph 4 is deleted and replaced by the following;~~

**4. Interested parties may apply to the Commission for a qualitative assessment of all sectors and subsectors presumed at risk of carbon leakage under the tests laid down in this Article if they consider that such a qualitative assessment may conclude to a limited risk of carbon leakage or an important ability to pass through costs. These applications shall be supported by substantial evidence.**

d) paragraph 5 is amended as follows:

<p><del>31 December 2019</del>, delegated acts in accordance</p>	<p>5. The Commission is empowered to adopt delegated acts in accordance with Article 23 to</p>
<p>with Article 23 to supplement this Directive concerning the determination of sectors and subsectors deemed at risk of carbon leakage, as referred to in paragraphs 1, 2 and 3 of this Article, for activities at a 4-digit level (NACE-4 code) as far as paragraph 1 of this Article is concerned, based on data for the three most recent calendar years available.</p>	<p>supplement this Directive concerning the determination of sectors and subsectors deemed at risk of carbon leakage, as referred to in paragraphs 1, 2 and 3 of this Article, for activities at a 4-digit level (NACE-4 code) as far as paragraph 1 of this Article is concerned, based on data for the three most recent calendar years available.</p> <p><i>f) the following paragraph 6 is inserted:</i>  <b>6. The list of sectors and subsectors presumed at risk of carbon leakage should be revised at least every three years and may be modified following the results of quantitative assessments mentioned in paragraph 5 of this Article to add or remove sectors and subsectors that, based on the most recent data, become qualified or are no longer qualified to be on the carbon leakage list</b></p>
<p><b>Justification</b></p>	
<p>We propose to limit the validity of the carbon leakage list to three years in order to base the assessment of carbon leakage risk on recent and actual data. Since the ability to pass through costs is a major determinant of carbon leakage risk but it is not easily measurable through a single formula for all sectors. Therefore, we propose to explicitly add it to the list of criteria taken into account for qualitative assessments, to make it possible to carry out qualitative assessments even in relation to sectors and subsectors presumed at risk of carbon leakage under the generic carbon leakage indicator. Further, the scope of persons authorised to apply to the Commission for such an assessment should be broadened beyond the concerned sectors and subsectors themselves, in order to make the carbon leakage list reversible and possibly remove from it sectors and subsectors that no longer fulfil the conditions.</p>	

**Reform of the Benchmarks**

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 10a – paragraph 1 – subparagraph 5</b></p> <p>(ii) the following sentence is added at the end of the third subparagraph:            “In order to provide further incentives for reducing greenhouse gas emissions and improving energy efficiency, the determined Union-wide ex-ante benchmarks shall be reviewed <del>before the period from 2026 to 2030</del> in view of <del>potentially</del> modifying the definitions and system boundaries of existing product benchmarks.”</p>	<p><b>Article 10a – paragraph 1 – subparagraph 5</b></p> <p>(ii) the following sentence is added at the end of the third subparagraph:            “In order to provide further incentives for reducing greenhouse gas emissions and improving energy efficiency, the determined Union-wide ex-ante benchmarks shall be reviewed <b>within 6 months from the entry into force of the Directive</b> in view of modifying the definitions and system boundaries of existing product benchmarks <b>taking into account the full potential of product substitution, and the circular use of materials.</b>”</p>
<p><b>Justification</b></p>	
<p>The benchmarks must be reviewed sooner than is proposed (before the period from 2026 to 2030) as there could be several aspects to review once it is in force and leaving it any later will risk loopholes making their way into the system, thus weakening the effectiveness of this measure. Further, the review must account for other available measures, such as assessing if the product could be substituted, and the circular use of materials to increase resource efficiency.</p>	

## CBAM

Original text (EC Proposal July 2021)	Amendment
<p><b>Recital 30</b></p> <p>The Carbon Border Adjustment Mechanism (CBAM), established under Regulation (EU) [.../..] of the European Parliament and of the Council<sup>18</sup>, is an alternative to free allocation to address the risk of carbon leakage. To the extent that sectors and subsectors are covered by that measure, they should not receive free allocation. <del>However, a transitional phasing-out of free allowances is needed to allow producers, importers and traders to adjust to the new regime.</del> The reduction of free allocation should be implemented by applying a factor to free allocation for CBAM sectors, while the CBAM is phased in. <del>This percentage (CBAM factor) should be equal to 100 % during the transitional period between the entry into force of [CBAM Regulation] and 2025, 90 % in 2026 and should be reduced by 10 percentage points each year to reach 0 % and thereby eliminate free allocation by the tenth year.</del> The relevant delegated acts on free allocation should be adjusted accordingly for the sectors and subsectors covered by the CBAM. <del>The free allocation no longer provided to the CBAM sectors based on this calculation (CBAM demand) must be auctioned and the revenues will accrue to the Innovation Fund, so as to support innovation in low carbon technologies, carbon capture and utilisation ('CCU'), carbon capture and geological storage ('CCS'), renewable energy and energy storage, in a way that contributes to mitigating climate change.</del> Special attention should be given to projects in CBAM sectors. To respect the proportion of the free allocation available for the non-CBAM sectors, the final amount to deduct from the free allocation and to be auctioned should be calculated based on the proportion that the CBAM demand represents in respect of the free allocation needs of all sectors receiving free allocation.</p>	<p><b>Recital 30</b></p> <p>The Carbon Border Adjustment Mechanism (CBAM), established under Regulation (EU) [.../..] of the European Parliament and of the Council, is an alternative to free allocation to address the risk of carbon leakage. To the extent that sectors and subsectors are covered by that measure, they should not receive free allocation.</p> <p>The reduction of free allocation should be implemented by applying a factor to free allocation for CBAM sectors, while the CBAM is phased in. <b><i>The CBAM factor shall be equal to 100% in 2023, 90 % in 2024, 80 % in 2025, 60 % in 2026, 40 % in 2027, and reach 0 % by the end of 2028.</i></b></p> <p>The relevant delegated acts on free allocation should be adjusted accordingly for the sectors and subsectors covered by the CBAM. <b><i>50 % of the allowances resulting from the reduction of free allocation shall be made available to the Carbon Neutrality Fund (formerly the Innovation Fund). The other 50 % shall be auctioned by Member States.</i></b></p> <p>Special attention should be given to projects in CBAM sectors. To respect the proportion of the free allocation available for the non-CBAM sectors, the final amount to deduct from the free allocation and to be auctioned should be calculated based on the proportion that the CBAM demand represents in respect of the free allocation needs of all sectors receiving free allocation.</p>
<b>Justification</b>	
See the justification for Article 10a paragraph 1, and Article 10a(8).	

Original text (EC Proposal July 2021)	Amendment
<p><b>Article 10a</b></p> <p>(b) the following paragraph 1a is inserted: "1a. No free allocation shall be given in relation to the production of products listed in Annex I of Regulation [CBAM] as from the date of application of the Carbon Border Adjustment Mechanism.</p>	<p><b>Article 10a</b></p> <p>(b) the following paragraph 1a is inserted: "1a. No free allocation shall be given in relation to the production of products listed in Annex I of Regulation [CBAM] as from the date of application of the Carbon Border Adjustment Mechanism.</p>

By way of derogation from the previous subparagraph, for the first years of operation of Regulation [CBAM], the production of these products shall benefit from free allocation in reduced amounts. A factor reducing the free allocation for the production of these products shall be applied (CBAM factor). The CBAM factor ~~shall be equal to 100 % for the period during the entry into force of [CBAM regulation] and the end of 2025, 90 % in 2026 and shall be reduced by 10 percentage points each year to reach 0 % by the tenth year.~~ The reduction of free allocation shall be calculated annually as the average share of the demand for free allocation for the production of products listed in Annex I of Regulation [CBAM] compared to the calculated total free allocation demand for all installations, for the relevant period referred to in Article 11, paragraph 1. The CBAM factor shall be applied.

Allowances resulting from the reduction of free allocation shall be made available to support **innovation** in accordance with Article 10a(8).

By way of derogation from the previous subparagraph, for the first years of operation of Regulation [CBAM], the production of these products shall benefit from free allocation in reduced amounts. A factor reducing the free allocation for the production of these products shall be applied (CBAM factor). The CBAM factor **shall be determined for each sector covered by the CBAM depending on the sector's transition readiness, exposure to carbon leakage and relative carbon-intensity of international competitors. There will therefore be a CBAM factor unique to each sector. The CBAM factor shall be equal to 100% during the year of entry to force of the CBAM regulation and shall be reduced linearly each year to reach 0% by or prior to 2028.** The reduction of free allocation shall be calculated annually as the average share of the demand for free allocation for the production of products listed in Annex I of Regulation [CBAM] compared to the calculated total free allocation demand for all installations, for the relevant period referred to in Article 11, paragraph 1. The CBAM factor shall be applied.

**50% of the** allowances resulting from the reduction of free allocation shall be made available to support **deep decarbonisation** in accordance with Article 10a(8).

#### Justification

To be perfectly clear, we shall repeat the European Commission's statement that the CBAM should be "an alternative to the measures that address the risk of carbon leakage in the EU's Emissions Trading System"<sup>3</sup>, such as free allocation.

The implementation schedule of a CBAM for a particular sector should depend on three factors: 1) actual risk of carbon leakage (a function of exposure to international trade and carbon costs); 2) the carbon content of products manufactured by international competitors, and 3) the readiness of EU manufacturers to transition to lower carbon production.

As free allocation is phased out, the ability of a CBAM to protect EU installations against competition impacts depends on the cost difference between the phased-out free allowances for EU plants and the CBAM fee paid by importers of similar products: competition impacts will only be negative if imported products have significantly lower carbon content than EU-made products because they will pay less CBAM than EU plants pay for their carbon.

For products with little or no risk of such imports, competition impacts will either be small or even positive, so the CBAM can be implemented immediately. For sectors with low carbon competitors that can quickly transition to lower carbon production, implementation can be fast although not immediate. Only the sectors with high risk of carbon leakage, low carbon competitors, and low readiness may require a higher implementation time.

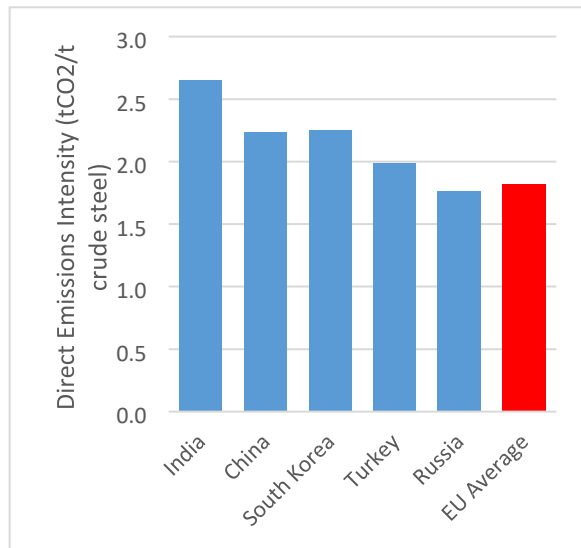
For **flat steel products**, typically made via the primary production route (Blast furnaces), the EU's average direct emissions intensity is lower than the majority of its largest steel trade partners. As such, the EU is unlikely to lose a significant share of trade in the steel sector and EU producers should be able to pass through most of the additional costs due to the EU ETS.

<sup>3</sup> [Communication on the European Green Deal](#), European Commission, December 2019

It should be noted that some countries produce flat steel products from slightly less emitting direct reduced iron (DRI) but none has the capacity to massively penetrate the EU market.

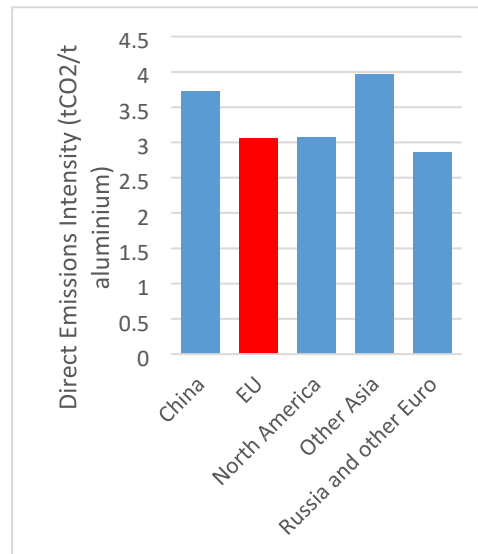
In the Aluminium sector, the EU, again has a competitive emissions intensity, with only Russia having a slightly lower direct emissions intensity. Data used is from the International Aluminium Institute Life Cycle Inventory Summary by Region and Unit Process.

### Steel from blast furnace



Source: <https://www.globalefficiencyintel.com/ussteel-industry-benchmarking-energy-co2-intensities>

### Aluminium

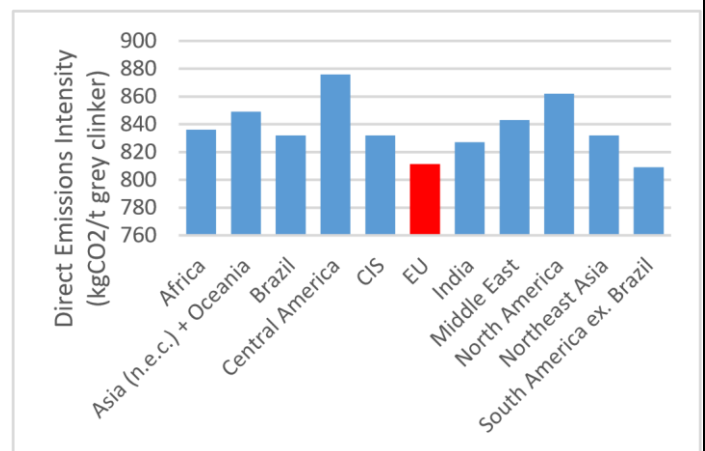


Source: International Aluminium Institute Life Cycle Inventory Summary by Region and Unit Process

### Cement

It is a similar situation in the cement sector, where on average the EU has the second lowest emissions intensity for producing grey clinker, the main polluting component of cement. This is based on 2019 data from the Global Cement and Concrete Association.

Source: Global Cement and Concrete Association



[https://gccassociation.org/gnr/geo/GNRIndicator\\_59cAG-geo.html](https://gccassociation.org/gnr/geo/GNRIndicator_59cAG-geo.html)

Important assumptions for the data in these graphs are that all the country or region values are average values. So, whilst the EU as a whole has one of the lowest emissions intensities, specific countries within the EU have higher emissions intensities which will be less competitive.

## Scope

### Hydrogen

Original text (EC Proposal July 2021)	Amendment
<p><b>Annex 1</b></p> <p><b>(v) The twenty-fourth row is replaced by the following</b></p> <p>Production of hydrogen (H<sub>2</sub>) and synthesis gas with a production capacity exceeding 25 tonnes per day</p>	<p><b>Annex 1</b></p> <p><b>(v) The twenty-fourth row is replaced by the following</b></p> <p>Production of hydrogen (H<sub>2</sub>) and synthesis gas <b>by reforming or partial oxidation</b> with a production capacity exceeding 25 tonnes per day.</p>

#### Justification

This wording reverts to the current state of row 24.

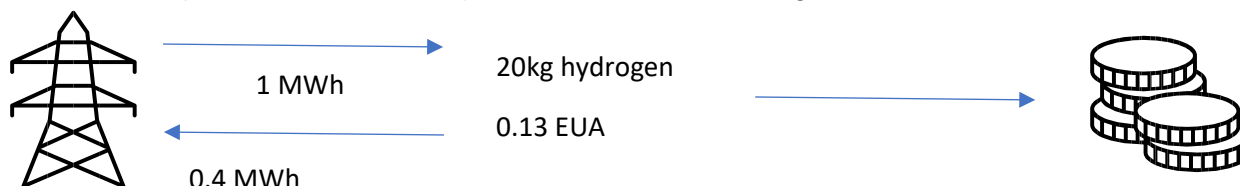
The Commission's proposal opens the door to granting free allowances to all types of hydrogen production facilities, and although it would improve the competitiveness of low-carbon hydrogen, it is not an appropriate means to protect against carbon leakage, as shown below.

Instead, a combination of product requirement for green/low carbon hydrogen, constraints (e.g. FuelEU, REDII) for the refining sector, and CBAM for fertilisers would fulfil that role more effectively while driving decarbonisation.

The problem with extending the ETS to more hydrogen production plants stems from the fact that hydrogen is usually an energy vector rather than an actual product, and this would create at least three problems.

#### Energy-to-waste projects

Firstly, there are uses of hydrogen for which issuing free emission allowances would be damaging for the climate. With the proposed design, projects could be subsidised for wasting electricity. For example, a project converting grid electricity into hydrogen then back into electricity (through a CCGT plant) could earn 0.22 EUA (worth about 20 euros) for each MWh lost through conversions.



This subsidy would compound with state-aid compensation for indirect carbon costs (due to the heavy use of electricity), which the project would likely qualify for.

#### Losing control of EUA supply

Secondly, the inclusion of new hydrogen manufacturing facilities (with potentially little or no environmental benefits) in the EU ETS means that the free EUAs they will receive will be sourced from the New Entrant Reserve instead of from the 43% share of standard free EUAs, i.e. on top of the cap. Such “reserves” undermine the cap and make it possible to emit more than what should be allowed to reach the -55% emission reduction target.

Our research suggests that the increased renewable hydrogen production needed by the Hydrogen Strategy could increase free allocation by 84m EUAs over 2026-2030. This does not account for “blue” or other types of hydrogen, which would increase the supply further.

## The threshold problem

Another problem is the capacity threshold. According to the proposal, only facilities with capacity to produce 25 tonnes of hydrogen per day would be eligible to free allocation. For electrolyzers running on intermittent renewable electricity, this would only concern facilities of 100MW electrolyzing capacity or more, none of which are in operation or under construction.

Lowering the threshold would not address the problem that smaller facilities are at a disadvantage compared to bigger ones. Also, the lower the threshold, the more facilities will fall under the ETS, with all the **bureaucracy** it creates.

## Waste Incinerators

Original text (EC Proposal July 2021)	Amendment
	<b>Recital 13a (new)</b>  <i>(13 c) The inclusion of municipal waste incineration installations would encourage recycling, reuse and repair of products, while also contributing to economy-wide decarbonisation. Accordingly, municipal waste incineration installations should be included within the scope of Directive 2003/87/EC from 1 January 2024.</i>
<b>Justification</b>	
See justification for Article 3h.	

Original text (EC Proposal July 2021)	Amendment
<b>Article 3h(1a) Article 3h(1a)</b>  The provisions of this Chapter shall apply to greenhouse gas emissions permits and to the allocation and issue of allowances in the respect of activities listed in Annex I other than aviation and maritime transport activities."; Activities.";	provisions of this Chapter shall apply to greenhouse gas emissions permits and allocation and issue of allowances in respect of activities listed in Annex I other than aviation and maritime transport  <i>From 1 January 2024, the provisions of this Chapter shall apply to greenhouse gas emissions permits and the allocation and issue of allowances in respect of municipal waste incineration installations.</i>
<b>Justification</b>	
Incinerators are the main source of emissions for products made from fossil fuels such as plastic products. Data <sup>4</sup> indicate that on average the production of one tonne of plastic emits 2.5tCO <sub>2</sub> and results in an embedded carbon content of another 2.7tCO <sub>2</sub> , released at incineration.  Covering incinerators under the EU ETS would put a price on those latter emissions and therefore internalise most of the externalities linked to the emissions from plastic products. This would make both EU-made and imported plastic products more costly and less competitive and would incentivise substitutions with products of lower carbon content.	

<sup>4</sup> Material Economics (2018). The circular economy – A powerful force for climate mitigation.



The inclusion of municipal waste incineration installations should be covered by the EU-ETS as soon as possible. Simultaneously, the Commission should put in place the necessary legislation to avoid and address the risk of diverted waste streams towards landfills and waste exports to third countries.

Original text (EC Proposal July 2021)	Amendment
	<p><b>Article 9 (3a) (New)</b></p> <p><i>From 1 January 2024, the Union-wide quantity of allowances shall be increased as a result of the inclusion of municipal waste incineration installations in the EU ETS. The Commission shall adopt implementing acts setting out the amount of the increase in the Union-wide quantity of allowances to take into account the inclusion of municipal waste incineration installations in the EU ETS. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 22a(2).</i></p>
<b>Justification</b>	
<p>The inclusion of incinerators would cover most emissions from plastic products, of which the ETS only covers a small part. Putting a price on emissions from incineration would increase the cost of both EU-made and imported plastic products, making the ETS fraction of them relatively small. This would make it easier to abolish free allocation for such products.</p>	

Original text (EC Proposal July 2021)	Amendment
<p><b>Annex 1</b></p>	<p><b>Annex 1</b></p> <p><b>(ia) The first row is replaced by the following:</b></p> <p>Combustion of fuels in installations with a total rated thermal input exceeding 20 MW <del>(except in installations for the incineration of hazardous or municipal waste).</del></p>
<b>Justification</b>	
<p>As per justifications for Article 3h (1a) and Article 9 (3a).</p>	