



**COUNCIL OF
THE EUROPEAN UNION**

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17215/08

**POLGEN 142
ENER 472
ENV 1010**

NOTE

from: General Secretariat of the Council
to: Delegations

Subject: Energy and climate change
– Elements of the final compromise

Delegations will find attached hereto the elements of the final compromise regarding the energy and climate change package, as agreed by the European Council at its meeting on 11 and 12 December 2008 (see 17271/08), to which paragraph 20 of the European Council conclusions refers.

ENERGY/CLIMATE CHANGE**ELEMENTS OF THE FINAL COMPROMISE**

The outcome of the intensive work carried out in recent weeks is reflected in the consolidated documents 16723/08, 16736/08, 16958/08 and 17086/08. It is completed by the following points:

(1) Industrial sectors not exposed to the risk of carbon leakage

The auctioning rate to be reached in 2020 is set at 70 %, with a view to reaching 100% in 2027, bearing in mind that the initial level in 2013 is set at 20 %.

(2) Industrial sectors exposed to the risk of carbon leakage

A sector or sub-sector is deemed to be exposed to a significant risk of carbon leakage if the sum of direct and indirect additional costs induced by the implementation of the Directive would lead to an increase in production costs exceeding 5 % of its Gross Value Added and if the total value of its exports and imports divided by the total value of its turnover and imports exceeds 10 %.

By way of derogation, a sector or sub-sector is also deemed to be exposed to a significant risk of carbon leakage if the sum of the direct and indirect additional costs induced by the implementation of the Directive would lead to an increase in production costs exceeding 30 % of its Gross Value Added or if the total value of its exports and imports divided by the total value of its turnover and imports exceeds 30 %.

The method for evaluating exposure to a significant risk of carbon leakage will be based on a level of disaggregation of the sectors or sub sectors corresponding, as a starting point, to a level 3 (NACE code-3) or, where appropriate and where the relevant data are available, to a level 4 (NACE code-4).

Installations in sectors or sub-sectors which are exposed to a significant risk of carbon leakage will be allocated 100 % of allowances free of charge at the level of the benchmark of the best technology available.

The Commission will study the consequences, for the allocation between Member States of the quantity of allowances to be auctioned, of granting additional allowances free of charge to industrial sectors exposed to a significant risk of carbon leakage. Any decision to grant these allowances will be based on a proposal by the Commission to the European Parliament and the Council, expected in June 2010 in the light of the outcome of the international negotiation. The Commission will, if necessary, propose appropriate measures, taking into account in particular possible distributional effects.

(3) Possible derogations to setting the auctioning rate at 100 % in 2013 in the electricity sector

In the context of these derogations, as defined in Article 10(c) of the Directive, the auctioning rate in 2013 will be at least 30 % and will be progressively raised to 100 % no later than 2020. A rendez-vous clause is provided for two years before the end of each derogation.

(4) Allocation of allowances¹

The total quantity of allowances between 2013 and 2020 that the Member States must auction breaks down as follows:

- 88 % of the total quantity of allowances to be auctioned will be allocated between Member States in proportions identical to the proportion of verified emissions, in the context of the Community system in 2005, of the Member State concerned;
- 10 % of the total quantity of allowances to be auctioned will be allocated between certain Member States in the interests of solidarity and growth in the Community, thus increasing the quantity of allowances that those Member States auctioned in accordance with the previous indent by the percentages specified in Annex IIA of the proposal for an ETS Directive;
- 2 % of the total quantity of the allowances to be auctioned will be allocated between the Member States which had achieved in 2005 a reduction of at least 20 % in greenhouse gas emissions compared with the reference year set by the Kyoto Protocol, broken down as follows:

Member State	Breakdown of the 2 %
Bulgaria	15 %
Czech Republic	4 %
Estonia	6 %
Hungary	5 %
Latvia	4 %
Lithuania	7 %
Poland	27 %
Romania	29 %
Slovakia	3 %

¹ See also point 2, paragraph 4.

(5) Correction of the linear trajectory for Member States authorised to increase their emissions (Effort Sharing Decision)

Member States permitted to increase their greenhouse gas emissions over the period 2005-2020 will not be subject to the obligation to limit emissions quantities in 2013 to the average annual volume of emissions in the period 2008-2010.

The volume of those Member States' emissions in 2013 will, however, be no greater than it would have been that year had they increased in a linear manner from 2009.

(6) Funding for innovative carbon capture and storage technologies and renewable energy sources

The volume of emissions allowances available for such funding is 300 million in the framework of a fair geographical distribution of the demonstration projects.

No project shall receive support via this mechanism that exceeds 15% of the total number of allowances available for this purpose.

(7) Clean development mechanism and joint implementation (Effort Sharing Decision)

The maximum quantity of credits authorised per Member State is set at 3 % of verified 2005 emissions.

However, Member States with an emissions reduction target or target of an increase of at most 5 % under the Effort Sharing Decision will be able to use additional credits amounting to 1 % of their verified 2005 emissions for projects in least developed countries and small island developing states, subject to compliance with one of the following three conditions:

- an overall cost higher than or equal to 0,70 % of GDP according to the Commission's impact assessment;

- an increase of at least 0,1% of GDP between the adoption target actually adopted for the Member State concerned and the cost-effective scenario;
- more than 50 % of the total emissions covered by the Effort Sharing Decision accounted for by transport-related emissions;
- a renewable energies target in excess of 30 %.

The Member States concerned are: Austria, Finland, Denmark, Italy, Spain, Belgium, Luxembourg, Portugal, Ireland, Slovenia, Cyprus and Sweden.

(8) Voluntary pre-allocation of part of auctioning revenues

The European Council adopted the following declaration:

"The European Council underlines the vital importance of achieving the strategic objective of limiting the global average temperature increase to not more than 2°C above pre-industrial levels. It stresses the need for decisive and immediate action, in order for the challenges of climate change to be tackled effectively. International collective action will be critical in driving an effective, efficient and equitable response on the scale required to face climate change challenges.

In this context, agreement on the energy-climate package is a major contribution to safeguard the future of our planet, strengthening the European leading role in the fight against climate change. The EU climate and energy package will contribute to EU efforts to provide finance for actions to mitigate and adapt to climate change, in particular through the carbon market in the context of a wider international agreement.

The European Council recalls that Member States will determine, in accordance with their respective constitutional and budgetary requirements, the use of revenues generated from the auctioning of allowances in the EU emissions trading system. It takes note of their willingness to use at least half of this amount for actions to reduce greenhouse gas emissions, mitigate and adapt to climate change, for measures to avoid deforestation, to develop renewable energies, energy efficiency as well as other technologies contributing to the transition to a safe and sustainable low-carbon economy, including through capacity building, technology transfers, research and development.

In the context of an international agreement on climate change in Copenhagen in 2009, and for those who wish so, part of this amount will be used to enable and finance actions to mitigate and adapt to climate change in developing countries that will have ratified this agreement, in particular in least developed countries. Further steps are to be taken at the Spring 2009 European Council in this regard."

(9) Commission report on the feasibility of an option related to auctioning

The Commission will submit by mid-2009 a report on the feasibility for a Member State to opt to allocate less than the maximum percentage set out in Article 10a, paragraph 7 (first sub-paragraph) and paragraph 8 of the ETS Directive, while respecting the basic principles of that Directive.

(10) Other issues

– basis for calculating the allocation of emission rights

The allocation of emission rights per Member State will be based on the higher of the following values: 2005 or the average over the period 2005-2007.

– permission to exceed the carry-forward rate in the event of extreme meteorological conditions (Effort Sharing Decision)

Member States may exceed their annual emissions ceilings by a maximum of 5 %.

However, in 2013 and in 2014, a Member State may ask the Commission for an increased carry-forward rate if it experiences extreme meteorological conditions leading to substantially increased greenhouse gas emissions. The Commission will decide whether or not to grant this derogation on the basis of information provided by the Member State concerned.

– use of specific credits from project types (ETS Directive)

Article 11a, paragraph 8, of the ETS Directive should read as follows:

"From 1 January 2013, measures may be applied to restrict the use of specific credits from project types.

These measures shall also set the date from which the use of credits under paragraphs 1 to 4 shall be in accordance with these measures. That date shall be, at the earliest, six months following the adoption of the measures or, at the latest, three years from their adoption.

Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 23(2). The Commission shall consider submitting to the Committee a draft of such measures to be taken where a Member State requests it."

– closure of Ignalina

Under the Treaty concerning the accession of Lithuania to the European Union, the Ignalina plant is to be closed at the end of 2009. If it turns out that the closure of Ignalina leads to a very substantially increased emissions, Lithuania may benefit from additional emission rights under the new entrants' reserve. Those additional rights will amount to the difference between (a) emissions verified in the period 2013-2015 and (b) the sum of the free allowances allocated to Lithuania's electricity-producing installations and 3/8 (three eighths) of the auctioning rights during that period. Any excess in the allocations over verified emissions in 2008-2012 will be deducted from those additional rights.

The Commission will also make the following statement: "The Commission will monitor the situation, particularly in the light of the state of interconnection in the Baltic energy market and will report by the end of 2015".

Latvia, owing to the significant level of electricity imported from Lithuania, will also be able to benefit from additional rights in due proportion.

– energy security

In its impact assessment of the negotiations on an international climate change agreement, the Commission will take account of the impact of carbon leakage on Member States' energy security, in particular where the electricity connections with the rest of the European Union are insufficient and where there are electricity connections with third countries. The Commission may take appropriate measures in this regard.

ANNEX II – Carbon leakage – Article 10a (ETS Directive)

7. Subject to Article 10b, the amount of allowances allocated free of charge under paragraphs 3 to 6 of this Article in 2013 shall be 80 % of the quantity determined in accordance with the measures referred to in paragraph 1 and thereafter the free allocation shall decrease each year [by equal amounts] resulting in 30 % free allocation in 2020.
8. In 2013 and in each subsequent year up to 2020, installations in sectors or sub-sectors which are exposed to a significant risk of carbon leakage shall be allocated, pursuant to Article 10a (1), allowances free of charge **100 %** of the quantity determined in accordance with paragraphs 2 to 6.

The allocation of allowances referred to in the first subparagraph shall apply, subject to the measures foreseen in Article 10b.

9. At the latest by 31 December 2009 and every 5 years thereafter the Commission shall determine, after discussion in the European Council, the sectors or sub-sectors referred to in paragraph 8 on the basis of the criteria referred to in paragraphs 9a, 9b, 9c and 9d.

Every year the Commission may, at its own initiative or on request of a Member State, add to the list referred to in paragraph 8 a sector or subsector if it can be demonstrated, in an analytical report, that this sector or subsector qualifies for the criteria below, following a change that has a substantial impact on the sector's activities.

For the purpose of implementing this article, the Commission shall consult the Member States, the sectors or sub-sectors concerned and other relevant stakeholders.

Those measures, designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 23(3).

- 9a. In order to determine the sectors or sub-sectors referred to in paragraph 8, the Commission shall assess, at a Community level, the extent to which it is possible for the sector or sub-sector concerned, at the relevant level of disaggregation, to pass on the direct cost of the required allowances and indirect costs from higher electricity prices resulting from the implementation of the present directive into product prices without significant loss of market share to less carbon efficient installations outside the Community. These assessments will be based on an average carbon price according to the Commission's impact assessment and trade, production and value added data from the three most recent years for each sector or sub-sector, if available.
- 9b. A sector or sub-sector is deemed to be exposed to a significant risk of carbon leakage if:
- (a) the extent to which the sum of direct and indirect additional costs induced by the implementation of this directive would lead to a substantial increase of production cost, calculated as a proportion of the Gross Value Added, of at least **5 %**; and
 - (b) the non-EU Trade intensity defined as the ratio between total of value of exports to non EU + value of imports from non-EU and the total market size for the Community (annual turnover plus total imports) is above **10 %**.

Notwithstanding the provisions of the first subparagraph, a sector or sub-sector is also deemed to be exposed to a significant risk of carbon leakage:

- if the sum of direct and indirect additional costs induced by the implementation of this directive would lead to a particularly high increase of production cost, calculated as a proportion of the Gross Value Added, of at least **30 %**; or
- if the non-EU Trade intensity defined as the ratio between total of value of exports to non EU + value of imports from non-EU and the total market size for the Community (annual turnover plus total imports) is above **30 %**.

- 9c. The list of sectors or subsectors which are exposed to a significant risk of carbon leakage may be supplemented after completion of a qualitative assessment, taking into account, when the relevant data are available, the following criteria:
- the extent to which it is possible for individual installations in the sector and/or subsector concerned to reduce emission levels or electricity consumption, including, as appropriate, the increase in cost of production that the related investment may entail, for instance on the basis of the most efficient techniques;
 - market characteristics (current and projected), including when trade exposure or direct and indirect cost increase rates are close to one of the thresholds mentioned in paragraph 9b, second subparagraph;
 - profit margins as potential indicator of long-run investment and/or relocation decisions.
- 9d. The list of sectors or subsectors exposed to a significant risk of carbon leakage shall be determined after taking into account, where the relevant data are available, the extent to which third countries, representing a decisive share of world production of products in sectors deemed to be at risk of carbon leakage, firmly commit to reducing greenhouse gas emissions in the relevant sectors and within the same time frame to an extent comparable to that of the EU and the extent to which carbon efficiency of installations located in these countries is comparable to that of the EU.
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**ANNEXE III – Proposed review clause– redistributive impact – carbon leakage –
Article 10(2) (ETS Directive)**

Add the following paragraph:

The Commission will assess at the latest by 31 March 2011 whether the decisions made on the proportion of allowances received free of charge by sectors or sub-sectors according to Article 10b, including the effect of the setting of ex-ante benchmarks according to Article 10a(1a), is likely to significantly affect the quantity of allowances to be auctioned by Member States according to Article 10(2b) compared to a scenario with full auctioning for all sectors in 2020. It shall, if appropriate, submit adequate proposals to the European Parliament and the Council, taking into account its possible distributional effects.

ANNEXE IV – Derogations in the energy sector – Article 10c (ETS Directive)

Article 10c: Option for transitional free allocation for modernisation of electricity generation

1. As an exception to Article 10a, paragraphs (1) to (4), Member States may give a transitional free allocation to installations operating by 31 December 2008 or to installations for which the investment process was physically initiated by the same date for electricity production if one of the following conditions is met:
 - the national electricity network was not, in 2007, directly or indirectly connected to the network interconnected system operated by the Union for the Coordination of the transmission of electricity (UCTE);
 - or where the national electricity network was, in 2007, only directly or indirectly connected to the network operated by Union for the Coordination of the transmission of electricity (UCTE) through a single line with a capacity of less than 400 MW;
 - or where, in 2006, more than 30 % of electricity was produced from a single fossil fuel, and, where in 2006 the gross domestic product per capita at market prices did not exceed 50 % of the average gross domestic product per capita of the EU.

The Member State concerned shall submit to the Commission a national plan that provides for investments in retrofitting and upgrading of the infrastructure and clean technologies and for the diversification of their energy mix and sources of supply for an amount to the extent possible equivalent to the market value of the free allocation with respect to the intended investments, while taking into account the need to limit as far as possible directly linked price rises. It shall submit to the Commission, every year, a report on investments made in upgrading infrastructure and clean technologies. Investment undertaken from the entry into force of this Directive may be counted for this purpose.

2. Transitional free allocations shall be deducted from the quantity of allowances that the respective Member State would otherwise auction pursuant to Article 10(2). In 2013, the total transitional free allocation shall not exceed **70 %** of the annual average verified emissions in 2005-2007 from such generators for the amount corresponding to gross final national consumption pursuant to verified emissions in 2005-2007 of the Member State concerned and shall gradually decrease thereafter, resulting in no free allocation in **2020**. For those Member States which did not participate in the Community scheme in 2005, the relevant emissions shall be calculated using their verified Community scheme emissions under the Community scheme in 2007.

The Member State concerned may determine that the allowances allocated pursuant to this article may only be used by the operator of the installation concerned for surrendering allowances pursuant to Article 12(3) with respect to emissions of the same installation during the year for which the allowances are allocated.

3. Allocations to operators shall be based on the allocation under the verified emissions in 2005-2007 or an ex ante efficiency benchmark based on the weighted average of emission levels of most greenhouse gas efficient electricity production covered by the Community system for installations using different fuels. The weights may reflect the fuel-specific shares in electricity production in the Member State concerned. The Commission shall, in accordance with the procedure in Article [23(2)], provide guidance to ensure that the allocation methodology avoids undue distortions of competition and minimises negative impacts on the incentives to reduce emissions.
4. Any Member State using this Article shall require benefiting electricity generators and network operators to report every 12 months on the implementation of their investments referred to in the national plan, and shall report on this to the Commission and make those reports public.

5. Any Member State that intends to allocate allowances on the basis of the present article shall, by 30 September 2011, submit to the Commission an application containing the proposed allocation methodology and individual allocations. An application shall contain:
 - (a) evidence that the Member State falls under at least one of the categories in paragraph 1;
 - (b) list the installations covered by the application and the amount of allowances to be allocated to each installation in accordance with paragraph 3 and the Commission guidance;
 - (c) the national plan referred to in paragraph 1, second indent;
 - (d) monitoring and enforcement provisions with respect to the intended investments pursuant to the national plan;
 - (e) information showing that the allocations do not create undue distortions of competition.
6. The Commission shall assess the application taking into account the elements set out in paragraph 5 and may reject the application within 6 months of receiving the relevant information."
7. 2 years before the end of the period during which a Member State may give transitional free allocation to installations operating by 31 December 2008 for electricity production, the Commission shall assess the progress made in the implementation of the national action plan. If the Commission estimates, on request of the concerned Member State, that there is a need for a possible extension of that period, it may submit to the European Parliament and the Council appropriate proposals, including the conditions that would have to be met in the case of an extension of that period.

ANNEX V – ETS Directive

Commission Declaration ad Article 10(3)

3a. Between 2013 and 2016, Member States may also use revenues generated from the auctioning of allowances to support the construction of highly efficient power plants, including new energy power plants that are CCS-ready. For new installations exceeding the degree of efficiency of a power plant according to Annex 1 to the Commission Decision of 21 December 2006 (2007/74/EC)¹ the Member States may support up to 15% of the total costs of the investment for a new installation that is CCS-ready.

¹ Commission Decision of 21 December 2006 establishing harmonised efficiency reference values for separate production of electricity and heat in application of Directive 2004/8/EC of the European Parliament and of the Council (*notified under document number C(2006) 6817*).

ANNEX VI – Renewables Directive

Declaration by the Commission on the occasion of the adoption of the Renewables Directive

"The Commission acknowledges that some Member States already in 2005 have achieved a high share of renewable energy at national level. When establishing the reports referred to in Article 20 para. 6(d), 7 and 8, the Commission will, as part of its assessment of the best cost-benefit basis, take due account of marginal costs of increasing the share of renewable energies and will include, as appropriate, adequate solutions also for such Member States in any proposal put forward in accordance with the above mentioned Article of the Directive."

