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NOTE

From: General Secretariat of the Council
To: Permanent Representatives Committee

Subject: Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757
- Analysis of the final compromise text with a view to agreement

In view of the Coreper meeting on 8 February 2023, delegations find attached the final compromise text of the proposal for amending Directive 2003/87/EC and Decision (EU) 2015/1814 (ETS general proposal).

2021/0211(COD)

DIRECTIVE (EU) 2023/...
OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of ...

amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union and Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme



(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 192(1) thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Economic and Social Committee¹,

Having regard to the opinion of the Committee of the Regions²,

Acting in accordance with the ordinary legislative procedure³,

¹ OJ C 152, 6.4.2022, p. 175.

² OJ C 301, 5.8.2022, p. 116.

³ *Position of the European Parliament of ... (not yet published in the Official Journal) and decision of the Council of ...*

Whereas:

- (1) The Paris Agreement, adopted in December 2015 under the United Nations Framework Convention on Climate Change (UNFCCC) entered into force in November 2016 ('the Paris Agreement')⁴. Its Parties have agreed to hold the increase in the global average temperature well below 2 °C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1,5 °C above pre-industrial levels. ***This has been reinforced with the adoption of the Glasgow Climate Pact in November 2021, in which the Conference of the Parties recognises that the impacts of climate change will be much lower at the temperature increase of 1,5 °C, compared with 2 °C, and resolve to pursue efforts to limit the temperature increase to 1,5 °C.***
- (1a) ***The urgency of the need to keep the Paris Agreement goal of 1,5 °C alive has become more significant following the findings of the IPCC Sixth Assessment Report, that global warming can only be limited to 1,5 °C, if strong and sustained reductions in global greenhouse gas (GHG) emissions within this decade are immediately undertaken.***
- (2) Tackling climate and environmental-related challenges and reaching the objectives of the Paris Agreement are at the core of the Communication on "The European Green Deal", adopted by the Commission on 11 December 2019⁵.

⁴ Paris Agreement (OJ L 282, 19.10.2016, p. 4).

⁵ COM(2019)640 final.

(3) The European Green Deal combines a comprehensive set of mutually reinforcing measures and initiatives aimed at achieving climate neutrality in the EU by 2050, and sets out a new growth strategy that aims to transform the Union into a fair and prosperous society, with a modern, resource-efficient and competitive economy, where economic growth is decoupled from resource use. It also aims to protect, conserve and enhance the Union's natural capital, and protect the health and well-being of citizens from environment-related risks and impacts. ***This transition affects workers from various sectors differently.*** At the same time, ***that transition has gender equality aspects as well as a particular impact on some disadvantaged and vulnerable groups, such as older people, persons with disabilities, persons with a minority racial or ethnic background and low and lower-middle income individuals and households. It also imposes greater challenges on certain regions, in particular structurally disadvantaged and peripheral regions, as well as islands.*** It must therefore be ensured that the transition is just and inclusive, leaving no one behind.

(3a) ***On 17 December 2020, the Union submitted its nationally determined contribution (NDC) to the UNFCCC, following their approval by the Council. Directive (EU) 2003/87/EC as last amended by Directive 2018/410 is one of the instruments cited, subject to revision in light of the enhanced target, in the general description of the target in the Annex to that submission. The Council stated in its conclusions of 24 October 2022 that it stands ready, as soon as possible after the conclusions of the negotiations on the essential elements of 'Fit for 55' package, to update, as appropriate, the NDC of the EU and its Member States, in line with § 29 of the Glasgow Climate Pact to reflect how the final outcome of the essential elements of 'Fit for 55' package implements the EU headline target as agreed by the European Council in December 2020. As the EU ETS is a cornerstone of the Union's climate policy and constitutes its key tool for reducing greenhouse gas emissions in a cost-effective way, the amendments to Directive 2003/87, including with regard to the scope thereof, adopted through this Directive are part of the essential elements of the "Fit for 55" package.***

- (4) The necessity and value of **delivering on** the European Green Deal have only grown in light of the very severe effects of the COVID-19 pandemic on the health, living and working conditions and well-being of the Union’s citizens, which have shown that our society and our economy need to improve their resilience to external shocks and act early to prevent or mitigate them **in a manner that is just and results in no one being left behind, including those at risk of energy poverty**. European citizens continue to express strong views that this applies in particular to climate change⁶.
- (5) The Union committed to reduce the Union’s economy-wide net greenhouse gas emissions by at least 55 % by 2030 below 1990 levels in the updated nationally determined contribution submitted to the UNFCCC Secretariat on 17 December 2020⁷.
- (6) In Regulation (EU) 2021/1119 of the European Parliament and of the Council⁸ the Union has enshrined **in legislation** the target of economy-wide climate neutrality by 2050, **at the latest, and the aim to achieve negative emissions thereafter**. That Regulation also establishes a binding Union domestic reduction commitment of net greenhouse gas emissions (emissions after deduction of removals) of at least 55 % below 1990 levels by 2030. **That Regulation also establishes that the Commission should endeavour to align all future legislative and budgetary proposals with the objectives and targets set out in that Regulation and, in any case of non-alignment, provide the reasons as part of the impact assessment accompanying those proposals**.

⁶ Special Eurobarometer 513 on Climate Change, 2021
(https://ec.europa.eu/clima/citizens/support_en).

⁷ https://www4.unfccc.int/sites/ndcstaging/PublishedDocuments/European%20Union%20First/EU_NDC_Submission_December%202020.pdf

⁸ Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 (‘European Climate Law’) (OJ L 243, 9.7.2021, p. 1).

- (7) All sectors of the economy need to contribute to achieving those emission reductions. Therefore, the ambition of the EU Emissions Trading System (EU ETS), established by Directive 2003/87/EC of the European Parliament and of the Council⁹, ***should be adjusted to be in line with the economy-wide net greenhouse gas emissions reduction commitment for 2030, and be in line with the objective of achieving climate neutrality by 2050 at the latest, and the aim to achieve negative emissions thereafter, as laid down in Article 2(1) of Regulation (EU) 2021/1119.***
- (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 ***that installations performing an activity listed in Annex I and meeting the capacity threshold related to the same activity but not emitting any greenhouse gases are included in the scope of the EU ETS and therefore to ensure*** an equal treatment of installations in the sectors concerned. In addition, free allocation for the production of a product should ***take into account the circular use potential of materials and*** be independent of the ***feedstock or the type of*** production process, ***where the production processes have the same purpose.*** 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 ***installations using new technologies that partly or fully reduce greenhouse gas emissions*** and existing technologies. ***Notwithstanding the guiding principles, the revised benchmarks for 2026 to 2030 should continue to distinguish between primary and secondary production of steel and aluminium.*** 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, ***including green hydrogen,*** outside the refineries sector.

⁹ Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a system for greenhouse gas emission allowance trading within the Union and amending Council Directive 96/61/EC (OJ L 275, 25.10.2003, p. 32).

- (8a) *Following the modification of the definitions of the products and of the processes and emissions covered for some benchmarks, it is necessary to ensure that producers do not receive double compensation for the same emissions with both free allocation and indirect costs compensation, and thus to adjust the financial measures to compensate indirect costs passed on in electricity prices accordingly.*
- (9) Council Directive 96/61/EC¹⁰ was repealed by Directive 2010/75/EU of the European Parliament and of the Council¹¹. The references to Directive 96/61/EC in Article 2 of Directive 2003/87/EC and in its Annex IV should be updated accordingly. Given the need for urgent economy-wide emission reductions, Member States should be able to act to reduce greenhouse gas emissions that are under the scope of the EU ETS through other policies than emission limits adopted pursuant to Directive 2010/75/EU.
- (10) In its Communication ‘Pathway to a Healthy Planet for All’¹², the Commission calls for steering the EU towards zero pollution by 2050, by reducing pollution across air, freshwaters, seas and soils to levels which are no longer expected to be harmful for health and natural ecosystems. Measures under Directive 2010/75/EU, as the main instrument regulating air, water and soil pollutant emissions, will often also enable emissions of greenhouse gases to be reduced. In line with Article 8 of Directive 2003/87/EC, Member States should ensure coordination between the permit requirements of Directive 2003/87/EC and those of Directive 2010/75/EU.

¹⁰ Council Directive 96/61/EC of 24 September 1996 concerning integrated pollution prevention and control (OJ L 257, 10.10.1996, p. 26).

¹¹ Directive 2010/75/EU of the European Parliament and of the Council of 24 November 2010 on industrial emissions (integrated pollution prevention and control) (OJ L 334, 17.12.2010, p. 17).

¹² Communication from the Commission to the European Parliament, the Council, the European Economic And Social Committee and the Committee of the Regions Pathway to a Healthy Planet for All, EU Action Plan: 'Towards Zero Pollution for Air, Water and Soil' (COM/2021/400 final).

- (11) Recognising that new innovative technologies will often allow reducing emissions of both greenhouse gases and pollutants, it is important to ensure synergies between policies delivering reductions of emissions of both greenhouse gases and pollutants, namely Directive 2010/75/EU, and review their effectiveness in this regard.
- (12) The definition of electricity generators was used to determine the maximum amount of free allocation to industry in the period from 2013 to 2020, but led to different treatment of cogeneration power plants compared to industrial installations. In order to incentivise the use of high efficiency cogeneration and to *level the playing field for* all installations receiving free allocation for heat production and district heating, all references to electricity generators in Directive 2003/87/EC should be deleted. In addition, Commission Delegated Regulation (EU) 2019/331¹³ specifies the eligibility of all industrial processes for free allocation. Therefore, the provisions on carbon capture and storage in Article 10a(3) of Directive 2003/87/EC have become obsolete and should be deleted.

¹³ Commission Delegated Regulation (EU) 2019/331 of 19 December 2018 determining transitional Union-wide rules for harmonised free allocation of emission allowances pursuant to Article 10a of Directive 2003/87/EC of the European Parliament and of the Council (OJ L 59, 27.2.2019, p. 8).

- (13) Greenhouse gases that are not directly released into the atmosphere should be considered emissions under the EU ETS and allowances should be surrendered for those emissions unless they are stored in a storage site in accordance with Directive 2009/31/EC of the European Parliament and of the Council¹⁴, or they are permanently chemically bound in a product so that they do not enter the atmosphere under normal use ***and any normal activity taking place after the end of the life of the product***. The Commission should be empowered to adopt ***delegated*** acts specifying the conditions where greenhouse gases are to be considered as permanently chemically bound in a product so that they do not enter the atmosphere under normal use ***and any normal activity after the end of life***, including obtaining a carbon removal certificate, where appropriate, in view of regulatory developments with regard to the certification of carbon removals. ***The normal activity after the end of life of the product should be understood broadly, covering all the activities taking place after the end of life of the product, including disposal, reuse, remanufacturing, recycling, incineration, and landfill.***

¹⁴ Directive 2009/31/EC of the European Parliament and of the Council of 23 April 2009 on the geological storage of carbon dioxide and amending Council Directive 85/337/EEC, European Parliament and Council Directives 2000/60/EC, 2001/80/EC, 2004/35/EC, 2006/12/EC, 2008/1/EC and Regulation (EC) No 1013/2006 (OJ L 140, 5.6.2009, p. 114).

- (14) International maritime transport activity, consisting of voyages between ports under the jurisdiction of two different Member States or between a port under the jurisdiction of a Member State and a port outside the jurisdiction of any Member State, has been the only means of transportation not included in the Union's past commitments to reduce greenhouse gas emissions. Emissions from fuel sold in the Union for journeys that depart in one Member State and arrive in a different Member State or a third country have grown by around 36 % since 1990. Those emissions represent close to 90 % of all Union navigation emissions as emissions from fuel sold in the Union for journeys departing and arriving in the same Member State have been reduced by 26 % since 1990. In a business-as-usual scenario, emissions from international maritime transport activities are projected to grow by around 14 % between 2015 and 2030 and 34 % between 2015 and 2050. If the climate change impact of maritime transport activities grows as projected, it would significantly undermine reductions made by other sectors to combat climate change ***and therefore to achieve the economy-wide net greenhouse gas emissions reduction target for 2030, the Union's climate-neutrality objective by 2050, at the latest, and the aim of achieving negative emissions thereafter as laid down in Article 2(1) of Regulation (EU) 2021/1119 and the goal of the Paris Agreement.***

- (15) In 2013, the Commission adopted a strategy for progressively integrating maritime emissions into the Union's policy for reducing greenhouse gas emissions. As a first step in this approach, the Union established a system to monitor, report and verify emissions from maritime transport in Regulation (EU) 2015/757 of the European Parliament and of the Council¹⁵, to be followed by the laying down of reduction targets for the maritime sector and the application of a market based measure. In line with the commitment of the co-legislators expressed in Directive (EU) 2018/410 of the European Parliament and of the Council¹⁶, action by the International Maritime Organization (IMO) or the Union should start from 2023, including preparatory work on adoption and implementation of a measure ensuring that the sector duly contributes to the efforts needed to achieve the objectives agreed under the Paris Agreement and due consideration being given by all stakeholders.
- (16) Pursuant to Directive (EU) 2018/410, the Commission should report to the European Parliament and to the Council on the progress achieved in the IMO towards an ambitious emission reduction objective, and on accompanying measures to ensure that the maritime transport sector duly contributes to the efforts needed to achieve the objectives agreed under the Paris Agreement. Efforts to limit global maritime emissions through the IMO are under way and should be encouraged, ***including the rapid implementation of the IMO Initial Strategy on Reduction of Greenhouse Gas Emissions from Ships, adopted in 2018, which also refers to possible market-based measures to incentivise greenhouse gas emission reductions from international shipping.*** However, while ***there recently has been progress in the IMO, this has so far not been*** sufficient to achieve the objectives of the Paris Agreement. ***Given the international character of shipping, it is important that the Member States and the Union within their respective competences work with third countries to step up diplomatic efforts to strengthen global measures and make progress on the development of a global market-based measure at the IMO level.***

¹⁵ Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport, and amending Directive 2009/16/EC (OJ L 123, 19.5.2015, p. 55).

¹⁶ Directive (EU) 2018/410 of the European Parliament and of the Council of 14 March 2018 amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments, and Decision (EU) 2015/1814 (OJ L 76, 19.3.2018, p. 3).

(17) ***CO₂ emissions from the maritime sector account for around three to four percent of Union emissions.*** In the European Green Deal, the Commission stated its intention to take additional measures to address greenhouse gas emissions from the maritime transport sector through a basket of measures to enable the Union to reach its emissions reduction targets. In this context, Directive 2003/87/EC should be amended to include the maritime transport sector in the EU ETS in order to ensure this sector contributes ***its fair share*** to the increased climate objectives of the Union as well as to the objectives of the Paris Agreement, which requires developed countries to take the lead by undertaking economy-wide emission reduction targets, while developing countries are encouraged to move over time towards economy-wide emission reduction or limitation targets¹⁷. Considering that emissions from international aviation outside Europe should be capped from January 2021 by global market-based action while there is no action in place that caps or prices maritime transport emissions, it is appropriate that the EU ETS covers a share of the emissions from voyages between a port under the jurisdiction of a Member State and port under the jurisdiction of a third country, with the third country being able to decide on appropriate action in respect of the other share of emissions. The extension of the EU ETS to the maritime transport sector should thus include half of the emissions from ships performing voyages arriving at a port under the jurisdiction of a Member State from a port outside the jurisdiction of a Member State, half of the emissions from ships performing voyages departing from a port under the jurisdiction of a Member State and arriving at a port outside the jurisdiction of a Member State, emissions from ships performing voyages arriving at a port under the jurisdiction of a Member State from a port under the jurisdiction of a Member State, and emissions ***within*** a port under the jurisdiction of a Member State. This approach has been noted as a practical way to solve the issue of Common but Differentiated Responsibilities and Capabilities, which has been a longstanding challenge in the UNFCCC context. The coverage of a share of the emissions from both incoming and outgoing voyages between the Union and third countries ensures the effectiveness of the EU ETS, notably by increasing the environmental impact of the measure compared to a geographical scope limited to voyages within the EU, while limiting the risk of evasive port calls and the risk of delocalisation of transshipment activities outside the Union. To ensure a smooth inclusion of the sector in the EU ETS, the

¹⁷ Paris Agreement, Article 4(4).

surrendering of allowances by shipping companies should be gradually increased with respect to verified emissions reported for the period **2024** to **2025**. To protect the environmental integrity of the system, to the extent that fewer allowances are surrendered in respect of verified emissions for maritime transport during those years, once the difference between verified emissions and allowances surrendered has been established each year, a corresponding ■ number of allowances should be cancelled. As from 2026, shipping companies should surrender the number of allowances corresponding to all of their verified emissions. *While the climate impact of maritime transport is mainly due to carbon dioxide emissions, non-CO₂ emissions represent a significant share of shipping emissions. According to the Fourth IMO Greenhouse Gas Study¹⁸, methane emissions increased significantly over the period 2012-2018. Methane and nitrous oxide emissions will likely grow over time, notably with the development of vessels powered by liquefied natural gases or other energy sources. The inclusion of methane and nitrous oxide emissions would be beneficial for environmental integrity and incentivising good practices. These emissions should first be included in Regulation (EU) 2015/757 as from 2024 and they should be included in the EU ETS as from 2026.*

¹⁸ *International Maritime Organization, Fourth IMO Greenhouse Gas Study 2020, p. 110.*

- (17a)** *The extension of the scope of Directive 2003/87/EC to maritime transport will lead to changes in the cost of shipping. All parts of the Union will be affected by this as the goods transported to and from ports within the Union by maritime transport have their origin or destination in the different Member States, including in landlocked Member States. The allocation of allowances to be auctioned by the Member States should therefore, in principle, not change as a consequence of the inclusion of maritime activities and include all Member States. However, Member States will be affected to different extents. Notably Member States with a high reliance on shipping will be most exposed to the effect of the extension. Member States with a large maritime sector compared to their relative size will be more affected by the extension of the EU ETS to maritime transport. It is therefore appropriate to provide additional time-limited assistance to those Member States in the form of additional allowances to support decarbonisation of maritime activities and for the administrative costs incurred. The assistance should be gradually introduced in parallel with the introduction of surrender obligations and thus with the increased effect on those Member States. Within the context of the review of Directive 2003/87/EC, the Commission should consider the relevance of this additional assistance in light, notably, of the development in the shipping companies under the responsibility of different Member States.*
- (17b)** *The EU ETS should contribute significantly to reducing greenhouse gas emissions from maritime activities and to increasing efficiency. The use of EU ETS revenues pursuant to Article 10(3) of the Directive should include, inter alia, the promotion of climate friendly transport and public transport in all sectors.*
- (17c)** *Renewing fleets of ice-class ships and developing innovative technology that reduces the emissions of such ships will take time and require financial support. Currently, the design enabling ice-class ships to sail in ice conditions, leads to such ships consuming more fuel and emitting more than ships of similar size designed for sailing only in open water. Therefore, a flag-neutral method should be implemented under this Directive allowing for a reduction of allowances to be surrendered by shipping companies on the basis of their ships' ice class until 31 December 2030.*

- (17d)** *Islands with no road or rail link with the mainland are more dependent on maritime transport than the other regions and depend on maritime links for their connectivity. In order to assist islands with a smaller population to remain connected following the inclusion of maritime activities in the scope of Directive 2003/87/EC it is appropriate to provide for the possibility to provide for a temporary derogation from the surrender obligations under that Directive for certain maritime transport activities with islands with a population lower than 200 000 inhabitants.*
- (17e)** *It should be possible for Member States to request that transnational public service contract or a transnational public service obligation between two Member States should be temporarily exempted from certain obligations under Directive 2003/87/EC. The possibility should be limited to connections between a Member State without a land-border with another Member State and the geographically closest Member State, such as the maritime connection between Cyprus and Greece, which has been absent for over two decades. This temporary derogation contributes to the compelling need to provide a service of general interest and ensure connectivity as well as economic, social and territorial cohesion.*
- (17f)** *Taking into account the special characteristics and permanent constraints of the outermost regions of the Union as recognised in Article 349 of the Treaty, and given their heavy dependence on maritime transport, special consideration should be given to preserving their accessibility and efficient connectivity by maritime transport. Therefore, a temporary derogation from certain obligations pursuant to Directive 2003/87/EC should be provided for emissions from maritime transport activities between a port located in an outermost region of a Member State and a port located in the same Member State, including ports located in the same outermost region and in another outermost region of the same Member State.*

- (18) The provisions of Directive 2003/87/EC as regards maritime transport activities should be kept under review in light of future international developments and efforts undertaken to achieve the objectives of the Paris Agreement, including the second global stocktake in 2028, and subsequent global stocktakes every five years thereafter, intended to inform successive nationally determined contributions, ***and in the event of the adoption by the IMO of a global market-based measure to reduce greenhouse gas emissions from maritime transport. To this end, the Commission should present a report to the European Parliament and to the Council within 18 months of the adoption of such a measure and before it becomes operational. The Commission should in that report examine that global market-based measure as regards its ambition in light of the objectives of the Paris Agreement, its overall environmental integrity, including compared to the provisions of this Directive covering maritime transport, and any issue related to the coherence of the EU ETS and that measure, in particular taking into account the level of participation in that global market-based measure, its enforceability, transparency, penalties for non-compliance, the processes for public input, monitoring, reporting and verification of emissions, registries and accountability. Where appropriate, the report should be accompanied by a legislative proposal to amend this Directive in a manner that is consistent with the Union 2030 climate target and the climate-neutrality objective as set out in Regulation (EU) 2021/1119 and with the aim of preserving the environmental integrity and effectiveness of Union climate action, to ensure coherence between the implementation of a global market-based measure adopted by the IMO, while avoiding any significant double burden, and thereby recalling the Union's competence to regulate its share of emissions from international shipping voyages, in line with the obligations of the Paris Agreement.***

- (18a) *With the increased costs of shipping which the extension of Directive 2003/87/EC to maritime shipping activities entails, there is in the absence of a global measure a risk of circumvention. Evasive port calls to ports outside of the Union and relocation of transshipment activities to ports outside of the Union will not only diminish the environmental benefits of internalising the cost of emissions from maritime activities but may lead to additional emissions due to the extra distance travelled to evade application of Directive 2003/87/EC. It is therefore appropriate to exclude from the concept of port of call certain stops at non-Union ports. That exclusion should be targeted to ports in the Union's vicinity where the risk of evasion is the largest. A limit of 300 nautical miles from a port under the jurisdiction of a Member State constitutes a proportionate response to evasive behaviour, balancing the additional burden and the risk of evasion. Moreover, the exclusion from the concept of port of call should only target stops by containerships at certain non-Union ports, where the transshipment of containers accounts for most container traffic. For such shipments, the risk of evasion, in the absence of mitigating measures, also consists in a shift of port hub to ports outside the Union, aggravating the effects of the evasion. To ensure the proportionality and equal treatment of the measure, account should be taken to measures in third countries that have an effect equivalent to Directive 2003/87/EC.*
- (19) The Commission should review the functioning of Directive 2003/87/EC in relation to maritime transport activities in the light of experience of its application, including *detecting evasive behaviour in order to prevent them at an early stage*, and should then propose measures to ensure its effectiveness. *Such measure could include increased surrender requirements for voyages where the evasion risk is higher, such as to and from a port that is located in the Union's vicinity, in a third country that has not adopted measures similar to Directive 2003/87/EC.*

- (19a) *Shipping emissions from vessels below 5 000 gross tonnage represent less than 15 % of shipping emissions, taking into account the scope of application of this Directive, but are emitted by a large number of ships. The inclusion of these vessels from the start of the inclusion of maritime transport in the EU ETS is too early for reasons of administrative practicability, but their inclusion in the future would improve the effectiveness of the ETS and potentially reduce evasive behaviour with the use of vessels below the 5 000 gross tonnage threshold. Therefore, no later than 31 December 2026, the Commission should present a report to the European Parliament and to the Council in which it should examine the feasibility and economic, environmental and social impacts of the inclusion in this Directive of emissions from ships below 5 000 gross tonnage, including offshore ships.*
- (20) The person or organisation responsible for the compliance with the EU ETS should be the shipping company, defined as the **ship owner** or any other organisation or person, such as the manager or the bareboat charterer, that has assumed the responsibility for the operation of the ship from the **ship owner** and that, on assuming such responsibility, has agreed to take over all the duties and responsibilities imposed by the International Management Code for the Safe Operation of Ships and for Pollution Prevention. This definition is based on the definition of ‘company’ in Article 3, point (d) of Regulation (EU) 2015/757, and in line with the global data collection system established in 2016 by the IMO.

(20a) *The emissions from a ship depend inter alia on the vessel energy efficiency measures taken by the ship-owner and the fuel, the cargo carried, the route and the speed of the ship which may be under the control of a different entity than the ship-owner. The responsibilities for purchasing fuel or taking operational decisions that affect the greenhouse gas emissions of the ship may be assumed by an entity other than the shipping company under a contractual arrangement. At the point of contract negotiation, mainly the latter aspects would not be known and thus the ultimate emissions from the ship covered by Directive 2003/87/EC would be uncertain. However, without a pass-through of carbon costs to the entity operating the ship, the incentives to implement operational measures for fuel efficiency would be limited. In line with the polluter pays principle and to encourage the adoption of efficiency measures and the uptake of cleaner fuels, the shipping company should therefore be entitled, under national law, to claim reimbursement for the costs arising from the surrender of allowances from the entity that is directly responsible for the decisions affecting the greenhouse gas emissions of the ship. While such a mechanism of reimbursement could be subject to a contractual arrangement, Member States should, to reduce administrative costs, not be obliged to ensure or control the existence of such contracts but should instead provide, in national law, a statutory entitlement for the shipping company to be reimbursed and the corresponding access to justice to enforce that entitlement. For the same reasons, this entitlement, including any possible conflict relating to the reimbursement between the shipping company and the entity operating the ship, should not affect the obligations of the shipping company vis-à-vis the administering authority nor the enforcement measures that might be necessary against such a company to ensure the full compliance with Directive 2003/87/EC. At the same time, as the purpose served by the provision concerning the entitlement to reimbursement is closely connected with the Union, in particular in relation to the compliance with obligations under this Directive by a shipping company vis-a-vis a given Member State, it is important that this entitlement is observed throughout the Union, in all contractual relations that allow another entity than the ship owner to determine the cargo carried and/or the route and the speed of the ship, in a manner that safeguards undistorted competition in the internal market, which can include provisions preventing parties to such contractual agreements from circumventing the entitlement to reimbursement by a choice of law clause.*

- (21) In order to reduce the administrative burden on shipping companies, one Member State should be responsible for each shipping company. The Commission should publish an initial list of shipping companies that performed a maritime activity falling within the scope of the EU ETS, which specifies the administering authority in respect of each shipping company. The list should be updated **regularly and** at least every two years to reattribute shipping companies to another administering authority as relevant. For shipping companies registered in a Member State, the administering authority should be that Member State. For shipping companies registered in a third country, the administering authority should be the Member State in which the shipping company had the greatest estimated number of port calls from voyages falling within the scope of Directive 2003/87/EC in the last **four** monitoring years. For shipping companies registered in a third country and which did not perform any voyage falling within the scope of Directive 2003/87/EC in the last **four** monitoring years, the administering authority should be the Member State ■ where **a ship of** the shipping company **arrived or** started its first voyage falling within the scope of that Directive. The Commission should publish and update on a biennial basis a list of shipping companies falling within the scope of Directive 2003/87/EC, **as relevant**, specifying the administering authority for each shipping company. In order to ensure equal treatment of shipping companies, Member States should follow harmonised rules for the administration of shipping companies for which they have responsibility, in accordance with detailed rules to be established by the Commission.
- (22) Member States should ensure that the shipping companies that they administer comply with the requirements of Directive 2003/87/EC. In the event that a shipping company fails to comply with those requirements and any enforcement measures taken by the administering authority have failed to ensure compliance, Member States should act in solidarity. As a last resort measure, Member States should be able to refuse entry to the ships under the responsibility of the shipping company concerned, except for the Member State whose flag the ship is flying, which should be able to detain that ship.

- (23) Shipping companies should monitor and report their aggregated emissions data from maritime transport activities at company level in accordance with the rules laid down in Regulation (EU) 2015/757. The reports on aggregated emissions data at company level should be verified in accordance with the rules laid down in that Regulation. When performing the verifications at company level, the verifier should not verify the emissions report at ship level and the report referred to in Article 11(2) of that Regulation, as those reports at ship level would have been already verified.
- (24) Based on experience from similar tasks related to environmental protection, the European Maritime Safety Agency (EMSA) or another relevant organisation should, as appropriate and in accordance with its mandate, assist the Commission and the administering authorities in respect of the implementation of Directive 2003/87/EC. Owing to its experience with the implementation of Regulation (EU) 2015/757 and its IT tools, EMSA **should** assist the administering authorities notably as regards the monitoring, reporting and verification of emissions generated by maritime activities under the scope of this Directive by facilitating the exchange of information or developing guidelines and criteria. ***The Commission, assisted by the European Maritime Safety Agency, should endeavour to develop appropriate monitoring tools, as well as guidance to facilitate and coordinate verification and enforcement activities related to the application of this Directive to maritime transport. As far as practicable, such tools should be made available to the Member State and the verifiers in order to better ensure robust enforcement of this Directive.***
- (24a) ***In parallel to the adoption of this Directive, Regulation (EU) 2015/757 is being amended to provide for monitoring, reporting and verification rules that are necessary for an extension of the EU ETS to maritime transport activities and to provide for the monitoring, reporting and verification of emissions of additional greenhouse gases and ship types.***

- (25) Regulation (EU) 2017/2392 of the European Parliament and of the Council¹⁹ amended Article 12(3) of Directive 2003/87/EC to allow all operators to use all allowances that are issued. The requirement for greenhouse gas emissions permits to contain an obligation to surrender allowances, pursuant to Article 6(2), point (e), of that Directive, should be aligned accordingly.
- (26) Achieving the Union's emissions reduction target for 2030 will require a reduction in the emissions of the sectors covered by the EU ETS of **62 %** compared to 2005. The Union-wide quantity of allowances of the EU ETS needs to be reduced to create the necessary long-term carbon price signal and drive for this degree of decarbonisation. ***The total quantity of allowances should be reduced in 2024 and 2026 to bring it more in line with the actual emissions. Moreover, the linear reduction factor should be increased in 2024 and in 2028, also taking into account the inclusion of emissions from maritime transport. The steeper cap trajectory resulting from these changes will lead to significantly greater levels of cumulative emission reductions up to 2030 than would have occurred pursuant to Directive (EU) 2018/410 of the European Parliament and of the Council. The figures relating to the maritime inclusion should be derived from the emissions from maritime transport activities that are addressed in Article 3g of Directive 2003/87/EC and reported in accordance with Regulation (EU) 2015/757 for 2018 and 2019 in the Union and the EEA-EFTA States, adjusted, from 2021 until 2024, by the linear reduction factor for the year 2024. The linear reduction factor will be applied in 2024 to the increase of the Union-wide quantity of allowances in that year.***

¹⁹ Regulation (EU) 2017/2392 of the European Parliament and of the Council of 13 December 2017 amending Directive 2003/87/EC to continue current limitations of scope for aviation activities and to prepare to implement a global market-based measure from 2021 (OJ L 350, 29.12.2017, p. 7).

- (28) Achieving the increased climate ambition will require substantial public *and private* resources in the EU as well as *in Member States* to be dedicated to the climate transition. To complement and reinforce the substantial climate-related spending in the EU budget, all auction revenues *or the equivalent financial value* that are not attributed to the Union budget *in the form of own resources* should be used for climate-related purposes, *with the exception of the revenues used for the compensation of indirect carbon costs. The list of climate-related purposes in Article 10(3) of Directive 2003/87/EC should be expanded to cover additional purposes with a positive environmental impact.* This includes the use for financial support to address social aspects in lower- and middle-income households by reducing distortive taxes *and targeted reductions of duties and charges for renewable electricity. Member States should report annually on the use of auctioning revenues in accordance with Article 19 of Regulation (EU) 2018/1999 of the European Parliament and of the Council, specifying, as appropriate, if revenues are used to implement their integrated national energy and climate plans and their territorial just transition plans.*
- (28a) *Member States' auctioning revenue will increase as a result of the inclusion of the maritime sector under the EU ETS. Therefore, Member States are encouraged to increase the use of EU ETS revenues pursuant to Article 10(3) of Directive 2003/87/EC to contribute to the protection, restoration and better management of marine-based ecosystems, in particular marine protected areas.*
- (28b) *Significant financial resources are needed to implement the goals of the Paris Agreement in developing countries and the Glasgow Climate Pact urges developed country Parties to urgently and significantly scale up their provision of climate finance. The Council conclusions on the Preparations for the 27th Conference of the Parties (COP 27) of the UNFCCC recall that the EU and its Member States are the largest contributor to international public climate finance and have more than doubled their contribution to climate finance to support developing countries since 2013. It also renews the strong commitment made by the EU and its Member States to continue scaling up their international climate finance towards the developed countries' goal of mobilising at least USD 100 billion per year as soon as possible and through to 2025 from a wide variety of sources, expecting the goal to be met in 2023.*

- (28c) *To address distributional and social effects of the transition in low-income Member States, an additional amount of 2,5 % of the Union-wide quantity of allowances from 2024 to 2030 should be used to fund the energy transition of the Member States with a gross domestic product (GDP) per capita below 75 % of the Union average in 2016-2018, through the Modernisation Fund referred to in Article 10d of Directive 2003/87/EC.*
- (28d) *The beneficiary Member States should be able to use the resources allocated to the Modernisation Fund to finance investments involving the adjacent EU border regions when this is relevant to the energy transition of beneficiary Member States.*
- (29) 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 investments in techniques to increase energy efficiency and reduce emissions, **in particular for large energy users. The Commission should ensure that the application of the conditionality does not jeopardise a level playing field, environmental integrity and equal treatment between installations across the Union. The Commission should therefore without prejudice to the rules applicable under Directive 2012/27/EU of the European Parliament and of the Council²⁰, adopt delegated acts supplementing this Directive to address any issue identified in particular on the above mentioned principles and provide for administratively simple rules for the application of the conditionality. These rules should be part of the general rules for free allocation, using the established procedure for national implementing measures, and provide timelines, criteria for the recognition of implemented energy efficiency measures as well as for alternative measures reducing GHG emissions. In addition, incentives to reduce greenhouse gas emissions should be further reinforced for installations with high greenhouse gas emission intensities. To that end, from 2026 onwards, the free allocation of emission allowances to the 20 % stationary installations with the highest emission intensities under a given product benchmark should also be conditional on the set-up and implementation of climate neutrality plans.**

²⁰ *Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC (OJ L 315, 14.11.2012, p. 1).*

(30) The Carbon Border Adjustment Mechanism (CBAM), established under Regulation (EU) 20.../nn of the European Parliament and of the Council²¹ [**CBAM Regulation**], is **set to replace the mechanisms established under Directive 2003/87/EC** to **prevent** the risk of carbon leakage. To the extent that sectors and subsectors are covered by that measure, they should not receive free allocation. However, a transitional phasing-out of free allowances is needed to allow producers, importers and traders to adjust to the new regime. The reduction of free allocation should be implemented by applying a factor to free allocation for CBAM sectors, while the CBAM is phased in. **The CBAM factor** should be equal to 100 % **for the** period between the entry into force of **that Regulation** and **the end of 2025, and subject to the application of provisions referred to in Article 36(3), point (b), of that Regulation, should be equal to 97,5 % in 2026, 95 % in 2027, 90 % in 2028, 77,5 % in 2029, 51,5 % in 2030, 39 % in 2031, 26,5 % in 2032 and 14 % in 2033. From 2034, no CBAM factor should apply.** The relevant delegated acts on free allocation should be adjusted accordingly for the sectors and subsectors covered by the CBAM. The free allocation no longer provided to the CBAM sectors based on this calculation (CBAM demand) **will be added** 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. **In this context**, 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 **be deducted** from the free allocation and **made available under the Innovation Fund** 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.

²¹ [please insert full OJ reference]

- (30a) *In order to mitigate potential carbon leakage risks related to goods subject to CBAM and produced in the Union for export to third countries which do not apply the EU ETS or a similar carbon pricing mechanism, an assessment should be carried out before the end of the transitional period under Regulation (EU) 20.../nn [CBAM Regulation]. Where the report concludes that there is such a carbon leakage risk, the Commission should, where appropriate, present a legislative proposal to address that carbon leakage risk in a manner that is compliant with WTO rules. Moreover, Member States should be allowed to use auction revenues to address any residual risk of carbon leakage in CBAM sectors and in accordance with State aid rules. Where allowances due to a reduction of free allocation in application of the conditionality rules are not fully used to exempt the installations with the lowest greenhouse gas emission intensity from the cross-sectoral correction, 50 % of these residual allowances should be added to the Innovation Fund, while the other 50 % should be auctioned on behalf of Member States, which they should be able to use to address any residual risk of carbon leakage in CBAM sectors.*
- (31) In order to better reflect technological progress ■ while ensuring emission reduction incentives and properly rewarding innovation, *the minimum adjustment of the benchmark values should be increased from 0,2 % to 0,3 % per year, and the maximum adjustment ■ should be increased from 1,6 % to 2,5 % per year.* For the period from 2026 to 2030, the benchmark values should thus be adjusted within a range of 6 % to 50 % compared to the value applicable in the period from 2013 to 2020. *In order to provide predictability to installations, the Commission should adopt the implementing acts determining the revised benchmark values for free allocation as soon as possible before the start of the period from 2026 to 2030.*
- (31a) *To incentivise new breakthrough technologies in the steel industry and to avoid a significantly disproportionate reduction of the benchmark value and in light of the particular situation of the steel industry such as the high emission intensity and the international and Union market structure, it is necessary to exclude from the calculation of the hot metal benchmark value for the period 2026-2030 installations that were operational during the reference period 2021-2022 and that would otherwise be included in that calculation due to the review of its definition.*

- (31b) *To reward best performers and innovation, installations whose greenhouse gas emission levels are below the average of the 10 % most efficient installations under a given benchmark should be excluded from the application of the cross-sectoral correction factor. Allowances that are not allocated due to a reduction of free allocation in application of the conditionality rules should be used to cover the deficit in the reduction of free allocation resulting from excluding best performers from the application of the cross-sectoral correction factor.*
- (31c) *In order to speed up the decarbonisation of the economy while strengthening EU industrial competitiveness, an additional 20 million allowances from the quantity which could otherwise be allocated for free and an additional 5 million allowances from the quantity which could otherwise be auctioned should be made available to the Innovation Fund. When reviewing the timing and sequencing of the auctioning of the Innovation Fund established in Commission Regulation (EU) No 1031/2010 in view of the changes introduced by this Directive, the Commission should consider making available larger amounts of resources in the first years of implementation of the revised Directive 2003/87/EC to boost the decarbonisation of relevant sectors.*
- (32) A comprehensive approach to innovation is essential for achieving the objectives of *Regulation (EU) 2021/1119*. At EU level, the necessary research and innovation efforts are supported, among others, through Horizon Europe which include significant funding and new instruments for the sectors coming under the ETS. *Consequently, the Commission should seek synergies with Horizon Europe and, where relevant, with other Union funding programmes.*
- (32a) *The Innovation Fund should support innovative techniques, processes and technologies, including the scaling up of such techniques, processes and technologies, with a view to their broad roll-out across the EU. Breakthrough innovation should be prioritized in the selection of projects supported through grants.*

- (33) The scope of the Innovation Fund referred to in Article 10a(8) of Directive 2003/87/EC should be extended to support innovation in **zero- and** low-carbon technologies and processes that concern the consumption of fuels in the sectors of buildings and road transport, **including collective forms of transport such as public transport and coach services**. In addition, the Innovation Fund should serve to support investments to decarbonise the maritime transport sector, including investments in **energy efficiency of ships, ports, short-sea shipping, in electrification of the sector, in** sustainable alternative fuels, such as hydrogen and ammonia that are produced from renewables, as well as zero-emission propulsion technologies like wind technologies, **and innovations in regard to ice-class ships. Special attention should be** given to innovative projects **contributing to decarbonize the maritime sector and reduce all of its climate impacts, including black carbon emissions. In that respect, the Commission should foresee dedicated topics in Innovation Fund calls for proposals. The calls should take biodiversity protection, noise and water pollution issues into account. As far as maritime transport is concerned, projects with clear EU added value should be eligible.**
- (34) Pursuant to Article 10 of Commission Regulation (EU) No 2019/1122²², where aircraft operators no longer operate flights covered by the EU ETS, their 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.

²² [Commission Delegated Regulation \(EU\) 2019/1122 of 12 March 2019 supplementing Directive 2003/87/EC of the European Parliament and of the Council as regards the functioning of the Union Registry \(OJ L 177, 2.7.2019, p. 3\).](#)

- (34a)** *Technical assistance from the Commission focused on Member States from which few or no projects have been submitted so far would contribute to achieving a high number of project applications for funding by the Innovation Fund across all Member States. This assistance should among others support activities aimed at improving the quality of proposals for projects located in the Member States mentioned, for example through sharing information, lessons learned and best practice and at boosting the activities of National Contact Points. Other measures serving the same aim would be raising awareness of funding options and increasing the capacity of those Member States to identify and support potential project applicants. Project partnerships across Member States and matchmaking between potential applicants, in particular for large-scale projects, should also be promoted.*
- (34b)** *In order to improve the role of Member States in the governance of the Innovation Fund and increase transparency, the Commission should report to the Climate Change Committee on the implementation of the Innovation Fund, providing an analysis of the expected impact of awarded projects by sector and by Member State. The Commission should also provide the report to the Council and the European Parliament and make it public. Subject to the agreement of applicants, following the closure of a call for proposals, the Commission should inform Member States of the applications for funding of projects in their respective territories and should provide them with detailed information of those applications in order to facilitate the Member States' coordination of the support to projects. In addition, the Commission should inform the Member States about the list of pre-selected projects prior to the award of the support. Member States should ensure that the national transposition provisions do not hamper innovations and are technologically neutral, while the Commission should provide technical assistance, in particular to Member States with low effective participation, in order to improve the effective geographical participation in the Innovation Fund and increase the overall quality of submitted projects. The Commission should also ensure comprehensive monitoring and reporting, including information on progress towards effective, quality-based geographical coverage across the Union and appropriate follow up.*

- (34c) *In order to align with the comprehensive nature of the European Green Deal, the selection process of projects supported through grants should give priority to projects addressing multiple environmental impacts. In order to support the replication and the faster market penetration of the supported technologies or solutions, projects funded by the Innovation Fund should share knowledge with other relevant projects as well as with Union-based researchers having a legitimate interest.*
- (35) *Contracts for Difference (CDs), Carbon Contracts for Difference (CCDs) and fixed premium contracts are important elements to trigger emission reductions in industry by up-scaling new technologies, offering the opportunity to guarantee investors in innovative climate-friendly technologies a price that rewards CO₂ emission reductions above those induced by the prevailing carbon price level in the EU ETS. The range of measures that the Innovation Fund can support should be extended to provide support to projects through price-competitive bidding, leading to the award of CDs, CCDs or fixed premium contracts. Competitive bidding would be an important mechanism for supporting the development of decarbonisation technologies and optimising the use of available resources. It would also offer certainty to investors in these technologies. In view of minimising any contingent liability for the Union budget, risk mitigation should be ensured in the design of CDs and CCDs and appropriate coverage by a budgetary commitment should be provided with full coverage at least for the first two rounds with appropriations resulting from the proceeds of auctioning of allowances allocated pursuant to Article 10a(8) of Directive 2003/87/EC. No such risks exist for fixed premium contracts, because the legal commitment will be covered by a matching budgetary commitment. In addition, the Commission should conduct, after concluding the first two rounds of CDs and CCDs, and each time it is necessary afterwards, a qualitative and quantitative assessment of the financial risks arising from their implementation. By a delegated act based on the results of that assessment, the Commission should be allowed to decide to use an appropriate provisioning rate rather than full coverage for further rounds of CDs or CCDs. Such an approach should take into account any elements that may reduce the financial risks for the Union budget, in addition to the allowances available in the Innovation Fund, such as possible sharing of liability with Member States, on a voluntary basis, or a possible re-insurance mechanism*

from the private sector. It is therefore necessary to allow for derogations from parts of Title X of Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council²³. The provisioning rate for the first two rounds of bidding should be 100 %. However, derogating from Article 210(1), 211(1), 211(2) and 218(1) of that Regulation, a minimum provisioning rate of 50 % as well as a maximum share of revenue from the Innovation Fund to be used for provisioning of 30 % should be set in this Directive for later rounds and the Commission should be able to specify the provisioning rate necessary on the basis of the experience from the first two calls and the amount of revenue to be used for provisioning. The total financial liability borne by the Union budget should thus not exceed 60 % of the proceeds from auctioning for the Innovation Fund. Moreover, as provisioning will come, in general, from the Innovation Fund, derogations should be made from rules in Article 212 to 214 of that Regulation relating to the common provisioning fund established by Article 212 of that Regulation. The novel nature of CDs and CCDs might also necessitate derogations from Articles 209(2)(d) and (h) of that Regulation, given that they do not rely on leverage/multipliers nor depend entirely on an ex ante assessment, from Article 219(3), due to the link to Article 209(2)(d), and from Article 219(6) thereof as implementing partners will not have credit/equity exposures under a guarantee. The use of any derogation from that Regulation should be limited to what is necessary. The Commission should be empowered to amend the maximum share of revenue from the Innovation Fund to be used for provisioning by no more than a total of 20 percentage points above what is provided for in this Directive.

(35a) The Innovation Fund is subject to the general regime of conditionality for the protection of the Union budget established by Regulation (EU, Euratom) 2020/2092.

²³ *Regulation (EU, Euratom) 2018/1046 of the European Parliament and of the Council of 18 July 2018 on the financial rules applicable to the general budget of the Union, amending Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014, and Decision No 541/2014/EU and repealing Regulation (EU, Euratom) No 966/2012 (OJ L 193, 30.7.2018, p. 1).*

- (36) Where an installation's activity is temporarily suspended, free allocation is adjusted to the activity levels which are mandatorily reported annually. In addition, competent authorities can suspend the issuance of emission allowances to installations that have suspended operations as long as there is no evidence that they will resume operations. Therefore, operators should no longer be required to demonstrate to the competent authority that their installation will resume production within a specified and reasonable time in case of a temporary suspension of the activities.
- (37) Corrections of free allocation granted to stationary installations pursuant to Article 11(2) of Directive 2003/87/EC can require granting additional free allowances or transferring back surplus allowances. The allowances set aside for new entrants under Article 10a(7) of Directive 2003/87/EC should be used for those purposes.
- (37a) *Since 2013, electricity producers have been obliged to purchase all the allowances they need to generate electricity. Nevertheless, in accordance with Article 10c of Directive 2003/87/EC, some Member States have the option to provide transitional free allocation for the modernisation of the energy sector for the period 2021 to 2030. Three Member States have chosen to use this option. Given the need for rapid decarbonisation, especially in the energy sector, the Member States concerned should only be able to provide this transitional free allocation for investments carried out until 31 December 2024. They should be able to add any remaining allowances for the period 2021 to 2030 that are not used for such investments, in the proportion they determine, to the total quantity of allowances that the Member State concerned receives for auctioning, or use them to support investments within the framework of the Modernisation Fund. With the exception of the deadline for notification thereof, allowances transferred to the Modernisation Fund should be subject to the same rules concerning investments that are applicable to the allowances already transferred pursuant to Article 10d(4) of Directive 2003/87/EC. To ensure predictability and transparency with regard to the volumes of allowances either available for auctioning or for the transitional free allocation, and with regard to the assets managed by the Modernisation Fund, Member States should inform the Commission of the respective amounts of remaining allowances to be used for each purpose by 15 May 2024.***

- (38) 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 Green Deal and Regulation (EU) 2021/1119, and eliminating the support to any investments related to *energy-generation based on fossil fuels, except as regards the support for such investments with revenue from allowances voluntarily transferred to the Modernisation Fund in accordance with Article 10d(4) of the ETS Directive. In addition, limited support for such investments should continue to be possible with revenue from the allocations referred to in the third subparagraph of Article 10(1) of the ETS Directive under certain conditions, in particular where the activity qualifies as environmentally sustainable under Regulation (EU) 2020/852 and as regards the allowances auctioned until 2027. For the latter category of allowances the downstream uses of non-solid fossil fuels should, in addition, not be supported with revenue from allowances auctioned after 2028. Furthermore*, the percentage of the Modernisation Fund that needs to be devoted to priority investments should be increased to 80 % *for the Modernisation Fund allowances transferred in accordance with Article 10d(4) of the ETS Directive and referred to in the third subparagraph of Article 10(1) thereof, and to 90 % for the additional amount of 2,5 % from the Union-wide quantity of allowances. Energy efficiency including in industry, transport, buildings, agriculture and waste; heating and cooling from renewable sources; as well as support of households to address energy poverty, including in rural and remote areas, should be included within the scope of the priority investments. In order to increase transparency and better assess the impact of the Modernisation Fund, the Investment Committee should report annually to the Climate Change Committee on experience with the evaluation of investments, notably in terms of emission reductions and abatement costs.*
- (38a) *Directive (EU) 2018/410 introduced provisions relating to the cancellation by Member States of allowances from their auction volume in respect of closures of electricity-generation capacity in their territory. In view of the increased climate ambition of the Union and the resulting accelerated decarbonisation of the electricity sector, this cancellation has become increasingly relevant. Therefore, the Commission should assess whether the use by Member States of cancellation can be facilitated by amending the relevant delegated acts adopted pursuant to Article 10(4).*

- (38b) *Adjustments to free allocation introduced in Directive 2018/410 and operationalized in Commission Implementing Regulation (EU) 2019/1842 improved the efficiency and incentives provided by free allocation, but increased the administrative work and made the historical date of issuance of free allocation of 28 February not operational. In order to better take into account the adjustments to free allocation, it is relevant to make adjustments to the compliance cycle. The deadline for competent authorities to grant free allocation should therefore be postponed from 28 February to 30 June and the deadline for operators to surrender allowances should be postponed from 30 April to 30 September.*
- (39) Commission Implementing Regulation (EU) 2018/2066²⁴ lays down rules on the monitoring of emissions from biomass which are consistent with the rules on the use of biomass laid down in the Union legislation on renewable energy. As the legislation becomes more elaborate on the sustainability criteria for biomass with the latest rules established in Directive (EU) 2018/2001 of the European Parliament and of the Council²⁵, the conferral of implementing powers in Article 14(1) of Directive 2003/87/EC should be explicitly extended to the adoption of the necessary adjustments for the application in the EU ETS of sustainability criteria for biomass, including biofuels, bioliquids and biomass fuels. In addition, the Commission should be empowered to adopt implementing acts to specify how to account for the storage of emissions from mixes of zero-rated biomass and biomass that is not from zero-rated sources.

²⁴ Commission Implementing Regulation (EU) 2018/2066 of 19 December 2018 on the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council and amending Commission Regulation (EU) No 601/2012 (OJ L 334, 31.12.2018, p. 1).

²⁵ Directive (EU) 2018/2001 of the European Parliament and of the Council of 11 December 2018 on the promotion of the use of energy from renewable sources (OJ L 328, 21.12.2018, p. 82).

