

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 (Text with EEA relevance)

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

(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 Committee⁽¹⁾,

Having regard to the opinion of the Committee of the Regions⁽²⁾,

Acting in accordance with the ordinary legislative procedure⁽³⁾,

Whereas:

- (1) Directive 2003/87/EC of the European Parliament and of the Council⁽⁴⁾ established a system for greenhouse gas emission allowance trading within the Union, in order to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner.
- (2) The European Council of October 2014 made a commitment to reduce the overall greenhouse gas emissions of the Union by at least 40 % below 1990 levels by 2030. All sectors of the economy should contribute to achieving those emission reductions and the target is to be delivered in the most cost-effective manner through the European Union emission trading system ('EU ETS'), amounting to a reduction of 43 % below 2005 levels by 2030. This was confirmed in the intended nationally determined reduction commitment of the Union and its Member States submitted to the Secretariat of the United Nations Framework Convention on Climate Change (UNFCCC) on 6 March 2015.
- (3) The Paris Agreement, adopted on 12 December 2015 under the UNFCCC ('the Paris Agreement') entered into force on 4 November 2016. 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. The Parties have also agreed to periodically take stock of the implementation of the Paris Agreement to assess the collective progress towards achieving the purpose of the Paris Agreement and its long-term goals.

- (4) In line with the commitment of the co-legislators expressed in Directive 2009/29/EC of the European Parliament and of the Council⁽⁵⁾ and Decision No 406/2009/EC of the European Parliament and of the Council⁽⁶⁾, all sectors of the economy should contribute to the reduction of greenhouse gas emissions. Under the Paris Agreement, the Union and its Member States have undertaken an economy-wide reduction target. Efforts to limit international maritime emissions through the International Maritime Organisation (IMO) are under way and should be encouraged. The IMO has set up a process to adopt in 2018 an initial emission reduction strategy to reduce greenhouse gas emissions from international shipping. The adoption of an ambitious emission reduction objective as part of this initial strategy has become a matter of urgency and is important for ensuring that international shipping contributes its fair share to the efforts needed to achieve the objective of well below 2 °C agreed under the Paris Agreement. The Commission should keep this under regular review, and should report at least once a year 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 sector duly contributes to the efforts needed to achieve the objectives agreed under the Paris Agreement. Action from the IMO or the Union should start from 2023, including preparatory work on adoption and implementation and due consideration being given by all stakeholders.
- (5) The European Council of October 2014 confirmed in its conclusions that a well-functioning, reformed EU ETS with an instrument to stabilise the market will be the main European instrument to achieve the reduction target of at least 40 %, with an annual reduction factor of 2,2 % from 2021 onwards. The European Council also confirmed that free allocation will not expire and that existing measures will continue after 2020 to prevent the risk of carbon leakage due to climate policy, as long as no comparable efforts are undertaken in other major economies, without the share of allowances to be auctioned being reduced. The auction share should be expressed as a percentage figure in Directive 2003/87/EC to enhance planning certainty as regards investment decisions, to increase transparency and to render the overall system simpler and more easily understandable.
- (6) It is a key Union priority to establish a resilient Energy Union to provide secure, sustainable, competitive and affordable energy to its citizens and industries. Achieving this requires the continuation of ambitious climate action with the EU ETS as the cornerstone of the Union's climate policy, and also requires progress on the other aspects of the Energy Union. Implementing the ambition decided in the Union's 2030 climate and energy policy framework contributes to delivering a meaningful carbon price and continuing to stimulate cost-efficient greenhouse gas emission reductions.
- (7) Article 191(2) of the Treaty on the Functioning of the European Union (TFEU) requires that Union policy be based on the principle that the polluter should pay and, on this basis, Directive 2003/87/EC provides for a transition to full auctioning over time.

Avoiding carbon leakage justifies temporarily postponing full auctioning, and targeted free allocation of allowances to industry is justified in order to address genuine risks of increases in greenhouse gas emissions in third countries where industry is not subject to comparable carbon constraints, as long as comparable climate policy measures are not undertaken by other major economies.

- (8) The auctioning of allowances remains the general rule, with free allocation as the exception. The Commission's Impact Assessment specifies that the share of allowances to be auctioned is 57 % over the period from 2013 to 2020. In principle, that share should remain 57 %. It is made up of allowances auctioned on behalf of Member States, including allowances set aside for new entrants but not allocated, allowances for modernising electricity generation in some Member States and allowances which are to be auctioned at a later point in time because of their placement in the market stability reserve established by Decision (EU) 2015/1814 of the European Parliament and of the Council⁽⁷⁾. That share should include 75 million allowances used to support innovation. In the event that demand for free allowances triggers the need to apply a uniform cross-sectoral correction factor before 2030, the share of allowances to be auctioned over the ten year period beginning on 1 January 2021 should be reduced by up to 3 % of the total quantity of allowances. For the purposes of solidarity, growth and interconnections, 10 % of the allowances to be auctioned by the Member States should be distributed among those Member States whose gross domestic product (GDP) per capita at market prices did not exceed 90 % of the Union average in 2013, and the rest of the allowances should be distributed among all Member States on the basis of verified emissions. The derogation for certain Member States with an average level of income per capita more than 20 % higher than the Union average in relation to that distribution in the period from 2013 to 2020 should expire.
- (9) Recognising the interaction between climate policies at Union and national level, Member States should have the possibility of cancelling allowances from their auction volume in the event of closures of electricity-generation capacity in their territory. To ensure predictability for operators and market participants with regard to the amount of auction allowances available, the possibility of cancelling allowances in such cases should be limited to an amount corresponding to the average verified emissions of the installation concerned over a period of five years preceding the closure.
- (10) To preserve the environmental benefit of emission reductions in the Union while actions by third countries do not provide comparable incentives to industry to reduce emissions, transitional free allocation should continue to installations in sectors and subsectors at genuine risk of carbon leakage. Experience gathered during the operation of the EU ETS has confirmed that sectors and subsectors are at risk of carbon leakage to varying degrees, and that free allocation has prevented carbon leakage. While some sectors and subsectors can be deemed to be at a higher risk of carbon leakage, others are able to pass on a considerable share of the costs of allowances to cover their emissions in product prices without losing market share, and only bear the remaining part of the costs so that they are at a low risk of carbon leakage. The Commission should determine and differentiate the relevant sectors based on their trade intensity and their emissions intensity to better identify sectors at genuine risk of carbon leakage.

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While the assessment of sectors and subsectors should take place at a 4-digit level (NACE-4 code), specific circumstances should also be anticipated in which it may be appropriate to have the possibility of requesting an assessment at a 6-digit or an 8-digit level (Prodcom). Such possibility should exist where sectors and subsectors have previously been considered to be exposed to carbon leakage at a 6-digit or an 8-digit level (Prodcom), given that certain NACE codes, in particular those ending with .99, encompass heterogeneous activities ‘not elsewhere classified’ (‘n.e.c.’). Where a sector or subsector is subject to the refineries benchmark and another product benchmark, this circumstance should be taken into account so that, where relevant, a qualitative analysis of the risk of carbon leakage can be done to ensure a level playing field for products produced both in refineries and in chemical plants. Where, based on the criteria of trade intensity and emissions intensity, a threshold determined by taking into account the respective possibility for sectors and subsectors concerned to pass on costs in product prices is exceeded, the sector or subsector should be deemed at risk of carbon leakage. Other sectors and subsectors should be considered to be at low risk or no risk of carbon leakage. Taking into account the possibilities for sectors and subsectors outside of electricity generation to pass on costs through product prices should also reduce windfall profits. Unless otherwise decided in a review pursuant to Article 30 of Directive 2003/87/EC, free allocations to sectors and subsectors considered to be at low risk or no risk of carbon leakage, except district heating, should decrease by equal amounts after 2026 so as to reach a level of no free allocation in 2030.

- (11) The benchmark values for free allocation applicable from 2013 onwards should be reviewed in order to avoid windfall profits and to reflect technological progress in the sectors concerned in the period between 2007-2008 and each later period for which free allocations are determined in accordance with Article 11(1) of Directive 2003/87/EC. In order to reflect technological progress in the sectors concerned and adjust the benchmark values to the relevant period of allocation, provision should be made for the benchmark values for free allocations to installations, determined on the basis of data from the years 2007 and 2008, to be updated in line with observed improvement. For reasons of predictability, this should be done through applying a factor that represents the best assessment of progress across sectors, which should then take into account robust, objective and verified data from installations, considering the average performance of the 10 % most efficient installations, so that benchmark values reflect the actual rate of improvement. Where the data shows an annual reduction of less than 0,2 % or more than 1,6 % of the 2007-2008 value over the relevant period, the related benchmark value should be adjusted with rates other than the actual rates of improvement to preserve emission reduction incentives and properly reward innovation. For the period from 2021 to 2025, those benchmark values should be adjusted in respect of each year between 2008 and the middle of the period from 2021 to 2025 with either 0,2 % or 1,6 %, leading to an improvement of 3 % or 24 % respectively compared to the value applicable in the period from 2013 to 2020. For the period from 2026 to 2030, those benchmark values should be adjusted in the same way, leading to an improvement of 4 % or 32 % respectively compared to the value applicable in the period from 2013 to 2020. To ensure a level playing field for the production of aromatics, hydrogen and syngas in refineries and chemical plants, the benchmark values

for aromatics, hydrogen and syngas should continue to be aligned to the refineries benchmarks.

- (12) The level of free allocation for installations should be better aligned with their actual production levels. To that end, allocations should be periodically adjusted in a symmetrical manner to take account of relevant increases and decreases in production. Data used in this context should be complete, consistent, independently verified and should present the same high level of accuracy and quality as the data used to determine the free allocation. In order to prevent manipulation or abuse of the system for adjustments to allocations and to avoid any undue administrative burden, considering the deadline that applies to the notification of changes in production, and bearing in mind the need to ensure that the changes to the allocations are carried out in an effective, non-discriminatory and uniform manner, the relevant threshold should be set at 15 % and be assessed on the basis of a rolling average of two years. The Commission should be able to consider further measures to be put in place, such as the use of absolute thresholds regarding the changes to allocations, or with respect to the deadline that applies to the notification of changes in production.
- (13) It would be desirable that Member States partially compensate, in accordance with State aid rules, certain installations in sectors or subsectors which have been determined to be exposed to a significant risk of carbon leakage because of costs related to greenhouse gas emissions passed on in electricity prices, including *inter alia* for the consumption of electricity by the installations themselves produced through the combustion of waste gases. By seeking to use no more than 25 % of the revenues generated from the auctioning of allowances for indirect cost compensation, Member States are likely both to facilitate the achievement of the objectives of the EU ETS and to preserve the integrity of the internal market and of conditions of competition. To enhance the transparency in relation to the extent to which such compensation is provided, Member States should regularly report to the public on the measures they have in place and on the beneficiaries of the compensation, while ensuring that the confidential nature of certain information and related data protection concerns are duly taken into account. Where a Member State uses a significant amount of its auction revenues for compensating indirect costs, there is an increased interest in making public the reasons for this choice. When reviewing its State aid guidelines on compensation for indirect emission costs, the Commission should consider *inter alia* the usefulness of upper limits on the compensation granted by Member States. The review of Directive 2003/87/EC should consider the extent to which those financial measures have been effective in avoiding significant risks of carbon leakage due to indirect costs, and consider the possibility of further harmonisation of the measures, including a harmonised mechanism. Public sector climate finance will continue to play an important role in mobilising resources after 2020.

Therefore, auction revenues should also be used for financing climate actions in vulnerable third countries, in particular Least Developed Countries, including adaptation to the impacts of climate change, *inter alia* through the UNFCCC Green Climate Fund. The amount of climate finance to be mobilised will also depend on the ambition and quality of the Nationally Determined Contributions, subsequent