Emissions trading: Questions & Answers on temporary free allocation of emission allowances for power plants beyond 2012

In which Member States is temporary free allocation for power plants allowed, and why?

When the revised Directive[1] governing the EU Emission Trading System (EU ETS) was adopted in 2009, it was decided to introduce a harmonised EU-wide approach to the allocation of greenhouse gas emission allowances to installations covered by the system.

In particular it was agreed that, from the start of the third phase of the EU ETS (2013-2020), allowances should no longer be granted for free to power plants, which would instead have to buy all their allowances through auctions (or on the secondary market).

However, to help modernise their electricity sector, 10 new Member States[2] were given the option of gaining temporary exemptions from the 'full auctioning' rule and continuing to allocate a limited number of emission allowances to power plants for free until 2019. This option was introduced[3] as part of the overall compromise on the so-called 'climate and energy package' of legislation reached by the Council and European Parliament.

The main motivation of the Member States which asked for this provision has been a desire to prevent too sharp increases in electricity prices for households. Another reason was to help the power sector in these countries cope more easily with the costs of making the transition to less carbon-intensive electricity generation.

With the exception of Latvia and Malta, in September 2011 all eligible Member States submitted applications for clearance to allocate a limited number of allowances to power plants for free beyond this year in order to finance investments in the energy system.

What is the state of play in terms of approving applications for temporary free allocation for power plants?

The Commission has already approved the applications from Cyprus, Estonia and Lithuania (see MEMO/12/350), from Bulgaria, the Czech Republic and Romania (see MEMO/12/530) and from Poland (see MEMO/12/561). Today, the Commission approved the application from Hungary. In its decisions, the Commission does not raise objections to the applications, but in the case of Poland some specific modifications were needed.

Why has the Commission issued Decisions approving applications when, under the legislation, a Decision is required only if it decides to reject an application?

The EU ETS Directive indeed foresees that applications are considered tacitly approved if the Commission does not reject them. However, the Commission has decided to issue Decisions even in cases where it raises no objections, for two main reasons:

1. The Commission wants to provide legal certainty to the Member States and the power generators concerned on the quantity and terms of the transitional free allocation;

2. Given that the allowances allocated for free will be deducted from the auctioning rights of the Member States concerned, the Commission wants to provide clarity to the market on the quantity and expected timing of the free allocation to power generators.

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[1] *Directive 2009/29/EC*

[2] *Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania*

[3] *Art 10c of the revised directive*

Are the quantities of free allowances laid down in the Commission Decisions final or are changes still possible?

The quantities of free allowances approved by the decisions represent the maximum amount that can be handed out. Member States could decide to reduce them provided this is done in a non-discriminatory, objective and transparent manner.

Member States must ensure that at least the equivalent value of the free allowances is invested in modernising their electricity generation through investments set out in a national plan included in their applications.

Bulgaria, Cyprus, Czech Republic, Estonia and Lithuania envisage handing out the allowances only upon evidence that the investments have been undertaken. If the investments cannot be undertaken as foreseen in the national plans, the allowances will be auctioned on the relevant phase 3 auction platform at the latest in the third year after the investment was to have taken place.

In Romania, allowances will be issued to the operators ex-ante, i.e. before the investments have been undertaken, and corrective measures will be applied if the investments are not carried out.

Poland will issue allowances upon evidence that the investments have been undertaken. Any allowances not issued will be auctioned at the end of the trading period.

Hungary will issue the allowances only in 2013 to the operators who will be required to transfer the financial value of the allowances to the designated fund. The funds collected will then be used to finance the investments upon evidence that they have been undertaken.

On the basis of the annual reports to be submitted by the Member States, the Commission will check that the relevant monitoring and enforcement provisions are properly applied in all cases.

How did the Commission assess these applications?

The Commission examined the eligibility of the Member States; the eligibility of the power plants that are due to receive free allowances, including the allocation rules applied; the eligibility of investments identified in the national plan; and the monitoring and enforcement provisions set out in the applications.

What if an application does not fulfil the requirements laid down in the Directive?

If the Commission concludes that an application or any aspect thereof does not comply with the relevant legal provisions, it will reject the application as a whole or the non-compliant parts of it. The Directive requires the Commission to do so within six months of receiving the relevant information.

In its Decisions, the Commission states that it considers the allocation of allowances free of charge to involve state aid. What implications does this have for the current Decisions?

This implies that Member States are required to notify applications also under State aid procedures. Decisions pursuant to Article 10(c) of the ETS Directive are without prejudice to Member States' State aid notification obligations pursuant to Article 108 of the Treaty. The Commission will have to assess whether the allocation of allowances and the corresponding investments in the National Plan of these Member States are in line with EU State aid rules as set out in the Commission Guidelines on the application of State aid rules to the ETS[4]. The Commission has already adopted the corresponding state aid decisions for Cyprus and Estonia.

[4] http://ec.europa.eu/competition/sectors/energy/environment_en.html