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EUROPEAN COMMISSION

Brussels, 11.12.2009

COMMISSION DECISION

of 11.12.2009

concerning the national allocation plan for the allocation of greenhouse gas emission allowances notified by Estonia in accordance with Directive 2003/87/EC of the European Parliament and of the Council

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(Only the Estonian text is authentic)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC¹, and in particular Article 9(3) thereof,

Whereas:

- (1) The national allocation plan of Estonia for the period 2008 to 2012, developed under Article 9(1) of Directive 2003/87/EC, was notified to the Commission by letter dated 7 July 2006 and registered by the Commission on 12 July 2006. Estonia submitted additional information in order to complete the notified plan by letter dated 7 November 2006, registered on 9 November 2006, in reply to questions from the Commission, and by letter of 6 February 2007, registered on 15 February 2007 (the national allocation plan as amended and completed will be referred to hereinafter as "the national allocation plan").
- (2) On 4 May 2007, the Commission took the Decision C(2007)1978 final rejecting the national allocation plan. Estonia has amended its national allocation plan in conformity with Decision C(2007)1978 final. Among others, it reduced the total quantity of allowances intended to be allocated. Estonia implemented the amended national allocation plan according to Article 11(2) of Directive 2003/87/EC. Pursuant to Commission Regulation (EC) No 2216/2004 of 21 December 2004 for a standardised and secured system of registries pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council², the Estonian national allocation plan table has been entered into the Community independent transaction log and the allowances were issued to individual installations for 2008 and 2009.
- (3) In parallel, Estonia brought an action for annulment against Decision C(2007)1978 (Case T-263/07). On 23 September 2007, the Court of First Instance (First Chamber) rendered a judgment annulling that decision. In contacts between Commission and Estonian officials, the common understanding of the judgement has been that, independent of whether an appeal is lodged, a new decision should be taken by the Commission within three months of the judgement. Estonian officials indicated that an

¹ OJ L 275, 25.10.2003, p. 32, as amended by Directive 2004/101/EC(OJ L 338, 13.11.2004, p. 18).

² OJ L 386, 29.12.2004, p.1.

amended national allocation plan would not be submitted beforehand. Accordingly, the Commission has reassessed the national allocation plan that was the subject of Decision C(2007) 1978.

- (4) The Climate Change Committee established under Article 9 of Decision No 280/2004/EC of the European Parliament and of the Council of 11 February 2004 concerning a mechanism for monitoring Community greenhouse gas emissions and for implementing the Kyoto Protocol³ considered on 22 September 2006 the national allocation plan and called on the Commission to assess all national allocation plans on a consistent, coherent and robust basis. In this context, the Climate Change Committee underlined the importance of using the 2005 verified emissions figures as a significant element for the assessment of second period national allocation plans. The Climate Change Committee also, inter alia, stressed the crucial importance of transparent and credible baseline data and projected emissions and urged the Commission to take into account the importance of preserving the integrity of the internal market and to avoid undue distortions of competition. Inter alia, the Climate Change Committee noted with concern that the proposed cap amounts to almost twice as much as 2005 verified emissions. It urged the Commission to compare the proposed allocation to Estonia's projections and measures for the non-trading and trading sectors, including in particular assumptions made (on growth rates and carbon intensity trends), and compare Estonia's allocation to recent historic and projected emissions and to examine the justification for deviations from recent historic and projected emissions for the trading sector. The Climate Change Committee also called on the Commission to scrutinise Estonia's allocation to the electricity sector, including assumptions made on growth rates and export trends, in the light of corresponding allocations and projections made by Estonia, Latvia and other countries bordering the Baltic Sea. In addition, the Climate Change Committee urged the Commission to scrutinise the plan with a view to avoiding the double counting of growth in output and emissions. Moreover, the Committee urged the Commission to scrutinise the accommodation of early action. This decision takes account of and is consistent with the views of the Climate Change Committee.
- (5) The national allocation plan contravenes criteria 1, 2 and 3 of Annex III to Directive 2003/87/EC because the total quantity of allowances intended to be allocated is more than would be consistent with assessments of actual and projected progress made pursuant to Decision No 280/2004/EC and more than would be consistent with the potential, including the technological potential, of activities covered by the Community scheme to reduce emissions. Criteria 2 and 3 provide for a methodology comparing Estonia's proposed figures using the most representative emissions figures, taking into account economic growth and carbon intensity improvements. Pursuant to criterion 1, the total quantity of allowances to be allocated shall not be more than what is likely to be needed for the strict application of the criteria of Annex III to Directive 2003/87/EC.
- (6) With respect to criterion 2, the actual verified greenhouse gas emissions of the sectors covered by the Community scheme in Estonia in 2005 are reported as being 12.621824 million tonnes CO₂ equivalent, compared to an allocation in the Community scheme for that year of 16.747054 million tonnes, more than 4.1 million tonnes higher than actual emissions. In 2006, the actual verified greenhouse gas emissions of the sectors covered by the Community scheme in Estonia are reported as being 12.104433 million

³ OJ L 49, 19.2.2004, p. 1.

tonnes, compared to an allocation in the Community scheme for that year of 18.199834 million tonnes, more than 6 million tonnes higher than actual emissions. In 2007, the actual verified greenhouse gas emissions of the sectors covered by the Community scheme in Estonia in 2007 are reported as being 15.329934 million tonnes, compared to an allocation in the Community scheme for that year of 21.343525 million tonnes, more than 6 million tonnes higher than actual emissions. These emission figures are reliable and accurate emissions figures for the Commission to compare with Estonia's proposed figures for the assessment under criteria 2 and 3 because they have been reported by individual installations in Estonia falling under the Community scheme and have been independently verified pursuant to Article 15 of Directive 2003/87/EC. The comparison shows that from 2005 to 2007 the allocations have exceeded actual emissions by more than 16 million tonnes (some 40%).

- (7) The Commission notes that Estonia has increased the scope of activities covered by Directive 2003/87/EC from the first to the second period in line with the Commission's guidance⁴. The actual greenhouse gas emissions of the sectors covered by the Community scheme in Estonia in 2008 are reported as being 13.540891 million tonnes, and these figures correspond exactly to the scope of installations included by Estonia in the Community scheme in the second period. The Commission has compared this figure to the Estonian proposed annual average allocation of 24.375045 million tonnes, which is more than 10 million tonnes (or 80%) higher than the actual figures reported by Estonian installations for 2008.
- (8) The verified emission figures mentioned in recitals 6 and 7, in particular the overestimation of emissions in 2008 by more than 10 million tonnes, put also into question the reliability of the methodology of the national allocation plan and its emission projections for the years 2009 to 2012.
- (9) With respect to criterion 3, the Commission notes that for a national allocation plan to be consistent with the potential, including the technological potential, of activities covered by the scheme to reduce emissions requires assessment of total allocations in accordance in particular with projections of economic growth and improvements in carbon intensity⁵. The Commission has assessed the figures at its disposal, including those in the public domain, with a view to comparing these to Estonia's projected emissions. In order to estimate which total quantity of allowances is consistent with the potential, including the technological potential, of activities covered by the Community scheme to reduce emissions, the 2005 aggregate independently verified emission figures of installations in the Community scheme have been multiplied with two factors: firstly, the projected gross domestic product (thereafter "GDP") growth rate and, secondly, the rate for carbon intensity improvement, each in the period from those independently 2005 verified figures to 2010. The Commission considers 2010 to constitute a representative average of the relevant five-year period from 2008 to 2012 because 2010 is the year in the middle of this period. The resulting figures are compared with Estonia's proposed allocation so as to determine to what extent it is in line with criterion 3, taking into account the expansion in the scope of activities covered by Directive 2003/87/EC from the first to the second period as applied by

⁴ Point 36 of COM(2005)703 final, as clarified by the "co-ordinated definitions" of additional combustion installations contained in the minutes of the Climate Change Committee of 31 May 2006.

⁵ See in particular point 11 of COM(2005)703 final.

Estonia in line with the Commission's further guidance⁶. Of all data at its disposal, including those in the public domain, the Commission considers the data indicated in the PRIMES model⁷ reliably estimates both GDP growth⁸ and carbon intensity improvement rates, for comparison with Estonia's proposed figures. The PRIMES model has been used for analysis of energy and climate policy for a long time (including the impact assessment of the climate & energy package)⁹ and the baseline assumptions¹⁰ are updated on a regular basis to reflect the most likely future trend. Furthermore, baseline assumptions are validated with the involvement of experts from Member States. Calculating technical potential based on these factors and on data available at the time C(2007) 1978 final was adopted yields the following results:

2005 verified emissions (in t CO ₂ eq.)	GDP development factor 2005-2010	Carbon intensity improvement factor 2005-2010	Resulting estimated emissions in 2010 (in t CO ₂ eq.)	Scope change from the first to the second trading period (in t CO ₂ eq.)	Resulting annual average estimated emissions during the second trading period (in t CO ₂)
12621824	1.456375	0.674742	12403181	313883	12717064

- (10) The Commission notes that this estimate of emissions, consistent with the potential of activities covered by the Community scheme to reduce emissions, is 0.7 million tonnes lower than the reported verified emissions of Estonia in 2008. Consideration of recent GDP data, which leads to a lower GDP development factor¹¹, indicates that the technical potential to reduce emissions could result in emissions significantly lower than 12.7 million tonnes per year, although this may be partly compensated by an

⁶ Point 36 of COM(2005)703 final, as clarified by the "co-ordinated definitions" of additional combustion installations contained in the minutes of the Climate Change Committee of 31 May 2006.

⁷ PRIMES is a modelling system that simulates a market equilibrium solution for energy supply and demand in the Member States. The model determines the equilibrium by finding the prices of each energy form such that the quantity producers find best to supply match the quantity consumers wish to use. The equilibrium is static (within each time period) but repeated in a time-forward path, under dynamic relationships. The model is behavioural but also represents in an explicit and detailed way the available energy demand and supply technologies and pollution abatement technologies. The system reflects considerations about market economics, industry structure, energy/environmental policies and regulation. These are conceived so as to influence market behaviour of energy system agents. The modular structure of PRIMES reflects a distribution of decision making among agents that decide individually about their supply, demand, combined supply and demand, and prices. Then the market integrating part of PRIMES simulates market clearing. PRIMES is a general purpose model. It is conceived for forecasting, scenario construction and policy impact analysis. More information can be found on the following website: <http://www.e3mlab.ntua.gr/>.

⁸ The GDP growth assumptions are based on the Commission's Economic and Financial Affairs Directorate-General's forecasts of April 2005 for the short term (2004-2006) as well as the long term (2005-2030). More specifically, short terms fore-casts are taken from European Commission Economic Forecasts, Spring 2005 (EUROPEAN ECONOMY. No. 2/ 2005. Office for Official Publications of the EC.ISBN92-894-8881-6), also published on the website: http://europa.eu.int/comm/economy_finance/publications/european_economy/2005/ee205en.pdf. Long-term forecasts are taken from European Commission, DG-ECFIN "Long Run Labour Productivity and Potential Growth Rate Projections For the EU25 countries up to 2050 (information note for Members of the EPC's working group an ageing populations)", ECFIN/50485/04-EN.

⁹ See: http://ec.europa.eu/environment/climat/pdf/climat_action/analysis.pdf

¹⁰ Examples for baseline assumptions are future developments in population, fuel prices, etc.

¹¹ Combining actual real growth data from 2005 to 2008, the DG ECFIN October forecast for 2009 to a 2011 for Estonia yields a GDP development factor of 0.980033 for the period 2006 to 2010 and even lower (0.928953) for 2007 to 2011

(See: http://ec.europa.eu/economy_finance/publications/publication16055_en.pdf).

induced slower decrease in the carbon intensity factor. Nevertheless, statistical data available from the national allocation plan (Table IIa) for the years 1993 to 2004 show that carbon intensity dropped by more than 50% over these years.

- (11) The methodology used in the Estonian plan assumes growth rates over the trading period 2008 to 2010 of 7.4 to 7.7% per year (Table IIa). The plan points out that economic growth is the major reason for the rise in electricity production (page 22 of the national allocation plan). These GDP growth estimates are significantly higher than the more recent GDP estimates, which are -3.7% for 2008, -13.7% for 2009, -0.1% for 2010 and 4.2% for 2011.¹² This implies that the need for allowances is significantly overestimated in the power sector as well as the industrial sector since the national allocation plan relies to a great degree on these GDP projections.
- (12) The "top-down" and "bottom-up" assessments in the Estonian national allocation plan are inconsistent. The "top-down" approach uses aggregate data for GDP and CO₂ emissions. The "bottom-up" method uses forecasts primarily provided by individual companies and sector associations. The "top-down" approach shows that Estonia has reduced and aims at further reducing the energy intensity and greenhouse gas intensity of output (see sections 2.2, 3.4 and Annex IIa). The "bottom-up approach" used to determine allowance allocations to individual installations (see section 4.3) results in a contradicting trend.
- (13) Under the national allocation plan, the largest amount of allowances is to be allocated to heat and power generation. Since GDP is overestimated, electricity demand both domestically as well as due to exports (see Figure 7 in the national allocation plan) seems also overestimated. This is confirmed by recent empirical data. According to the Eesti Energia¹³ domestic sales of electricity dropped by 10% in the first half of the 2009/10 financial year, partly as a result of the recession and drop in industrial output. During the first quarter of the 2009/10 financial year the company sold a total of 1.49 TWh of electrical energy on the domestic market, constituting a 7.9% decrease from the preceding year¹⁴. The Estonian NAP also assumes a significant increase in electricity exports from around 4.8 TWh in 2008 to around 6.3 TWh in 2012 (see Figure 7, page 28, of the national allocation plan). Around 1.6 TWh is to be exported to Finland, the remainder (3.2 to 5.7 TWh/year) to Latvia and Lithuania. These exports contradict the national allocation plans of Latvia and Lithuania that give a total net import of 1.1 TWh/year and only 0.5 TWh could come from Estonia¹⁵. Recent information shows that all importing countries expect their electricity consumption to decrease. According to Statistics Finland's preliminary data¹⁶, electricity consumption in Finland decreased by 10% in the first half of 2009 compared to the first half of 2008. Net import decreased by 32% during the first half of 2009. According to the

¹² See: http://ec.europa.eu/economy_finance/publications/publication16055_en.pdf

¹³

[http://www.energia.ee/index.php?id=126&L=1&tx_ttnews\[tt_news\]=3055&tx_ttnews\[backPid\]=183&cHash=ab0af3fef7](http://www.energia.ee/index.php?id=126&L=1&tx_ttnews[tt_news]=3055&tx_ttnews[backPid]=183&cHash=ab0af3fef7)

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[http://www.energia.ee/index.php?id=189&L=1&tx_ttnews\[cat\]=4%2C2&tx_ttnews\[pS\]=1230760800&tx_ttnews\[pL\]=31535999&tx_ttnews\[arc\]=1&tx_ttnews\[tt_news\]=2978&tx_ttnews\[backPid\]=188&cHash=7fb4d3f992](http://www.energia.ee/index.php?id=189&L=1&tx_ttnews[cat]=4%2C2&tx_ttnews[pS]=1230760800&tx_ttnews[pL]=31535999&tx_ttnews[arc]=1&tx_ttnews[tt_news]=2978&tx_ttnews[backPid]=188&cHash=7fb4d3f992)

¹⁵

Lithuanian's National Allocation Plan for Greenhouse Gas Emission Allowances for the period 2008 to 2012, Ministry of Environment of the Republic of Lithuania, version 29/12/2006, Table IIb. Emisijas kvotu sadales plans 2008. -2012 gadam, Latvijas Republikas Vides Ministrija, 9 August 2006, Annex IIb.

¹⁶

http://www.stat.fi/til/ehkh/2009/02/ehkh_2009_02_2009-09-17_tie_001_en.html

Latvijas Statistika¹⁷, electricity consumption in Latvia decreased from 4.964 to 4.583 TWh during the first 8 months of 2009. In 2009, the Riga TEC-2 unit was commissioned and electricity imports are expected to decrease by 1.4 TWh in 2010 onwards. According to Lietuvos Energija¹⁸, electricity consumption in Lithuania dropped during the first 9 months of 2009 from 7.5 TWh in 2008 to around 6.7 TWh. After closure of Unit 2 of Ignalina Nuclear Power Plant, Lithuania expects to meet its electricity demand partly by imports from Estonia, Russia and Ukraine. Lietuvos Energija states¹⁹ that Lithuania will purchase 1 TWh based on a forward contract with Estonia, though no details were provided and the governmental plan requires all electricity to be purchased at market conditions. Therefore domestic electricity consumption and electricity exports and hence the need for allowances for power generation in Estonia are significantly overestimated.

- (14) These observations together demonstrate a very significant allocation of allowances to the heat and power sector in excess of needs. This is also supported by the latest "Report pursuant to Article 3(2) of Monitoring Decision" by the Estonian Ministry of the Environment of May 2009. According to that report, CO₂ emissions of energy industries (excluding transport) will decrease significantly between 2006 and 2010 from 12.979 million tonnes to 10.134 million tonnes and remain on a similar level of 10.344 million tonnes in 2015.
- (15) Accordingly, the Commission finds that the Estonian proposed figure of 24.375045 million tonnes for each of the years 2008 to 2012 is inconsistent with criteria 1, 2 and 3 of Annex III to Directive 2003/87/EC.
- (16) Pursuant to criterion 5 of Annex III to Directive 2003/87/EC, the Commission has also examined compliance of the national allocation plan of Estonia with the provisions of the Treaty on the Functioning of the European Union (hereinafter "TFEU"), and in particular Articles 107 and 108 thereof. The Commission considers that the allocation of allowances free of charge to certain activities confers a selective economic advantage to undertakings which has the potential to distort competition and affect trade between Member States. The allocation of allowances for free appears to be imputable to the Member State and to entail the use of State resources to the extent that more than 90% of allowances are given for free. The aspects of imputability and State resources are further strengthened in the second trading period as the participation as of 2008 in international emissions trading and in the other flexible mechanisms, the Joint Implementation and the Clean Development Mechanism, enables the Member States to take further discretionary decisions influencing their budgets and the number of EU allowances granted to industry. In particular, as all allocations must as from the start of the second trading period be covered by Assigned Amount Units in accordance with Article 45 of Regulation (EC) No 2216/2004, which are tradable between contracting parties, any allocation directly reduces the quantity of Assigned Amount Units that the Member State can sell to other contracting parties or increases the need to buy such Assigned Amount Units. The Commission therefore at this stage considers that the plan could potentially imply State aid pursuant to Article 107(1) TFEU. On the basis of information provided by Estonia, the Commission at this stage cannot consider with certainty that any potential aid granted under the national allocation plan is consistent with and is necessary to achieve the overall

¹⁷ <http://www.csb.gov.lv/csp/content/?cat=2383>

¹⁸ <http://www.lpc.lt/en/main/news/press?ID=1047>

¹⁹ <http://www.lpc.lt/en/main/news/press?ID=999>

environmental objective of Directive 2003/87/EC. Non-compliance with criteria 1, 2 and 3 fundamentally jeopardises the overall environmental objective of the Community scheme. The Commission considers that in such a case the environmental benefit of any aid included in the allowances may not be sufficient to outweigh the distortion of competition. The Commission notes in particular that an allocation exceeding projected emissions will not require beneficiaries to deliver an environmental counterpart for the benefit they receive. The Commission at this stage therefore cannot exclude that any aid involved would be found incompatible with the common market should it be assessed in accordance with Articles 107 and 108 TFEU.

- (17) Pursuant to criterion 5 of Annex III to Directive 2003/87/EC, the Commission has also examined the methodology by which Estonia intends to allocate allowances at installation level. It appears that the information from the benefiting installations has not been sufficiently verified by independent experts. Therefore, due to the lack of sufficient safeguards, the proposed allocation methodology may lead to undue advantages to certain sectors or installations and the Commission at this stage and on the basis of the currently available information cannot exclude that State aid involved in the allocations may partially be found incompatible with the common market should it be assessed in accordance with Articles 107 and 108 TFEU.
- (18) Moreover, pursuant to criterion 5 of Annex III to Directive 2003/87/EC, the Commission has examined the application of a bonus for early action pursuant to Chapter 6.2 of the plan. Since these bonuses are granted in addition to the allocations supposedly based on expected needs of certain installations, they necessarily lead to individual allocations exceeding their expected needs. Moreover, the level of the bonuses appears to depend arbitrarily on actual emissions in one single year, i.e. the final year of the reference period. The wish to encourage early action may justify a certain differentiation of allocations, but it cannot justify allocations to certain installations going beyond their expected needs. Therefore, the Commission considers that this constitutes undue favouring of certain installations in breach of criterion 5 of Annex III to Directive 2003/87/EC. For the same reasons, the Commission at this stage and on the basis of the currently available information cannot exclude that State aid involved in the allocations may partially be found incompatible with the common market should it be assessed in accordance with Articles 107 and 108 TFEU.
- (19) Pursuant to criterion 6 of Annex III to Directive 2003/87/EC, the plan shall contain information on the manner in which new entrants will be able to begin participating in the Community scheme. The Commission notes that the plan contravenes criterion 6 because the information contained therein, in particular the proposed methods of allocation to new entrants, is insufficient for the Commission to ensure that the other criteria of Annex III to and Article 10 of Directive 2003/87/EC are respected.
- (20) Therefore the Commission concludes that the national allocation plan contravenes criteria 1, 2, 3, 5, 6 of Annex III to Directive 2003/87/EC and must therefore be rejected.
- (21) In order to bring the national allocation plan in conformity with the criteria listed in Annex III to Directive 2003/87/EC, Estonia should notify to the Commission a new national allocation plan without undue delay.
- (22) Pursuant to Article 9(3), second sentence, of Directive 2003/87/EC, the Member State shall only take a decision under Article 11(2) of Directive 2003/87/EC if the new national allocation plan is accepted by the Commission.

HAS ADOPTED THIS DECISION:

Article 1

The Commission rejects the national allocation plan of Estonia for the first five-year period mentioned in Article 11(2) of Directive 2003/87/EC.

Article 2

This Decision is addressed to the Republic of Estonia.

Done at Brussels, 11 December 2009

For the Commission