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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 16.04.2007

**COMMISSION DECISION**

**of 16 April 2007**

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

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

(Only the Hungarian text is authentic)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community,

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/EC<sup>1</sup>, and in particular Article 9(3) thereof,

Whereas:

- (1) The national allocation plan of Hungary for the period 2008-2012, developed under Article 9(1) of Directive 2003/87/EC (hereinafter "the Directive"), was notified to the Commission by letter dated 23 January 2007, registered on the same day. Hungary submitted additional information completing and amending the notified plan by letter dated 2 April 2007, registered on 12 April 2007, in reply to questions from the Commission.
- (2) The Climate Change Committee<sup>2</sup> considered 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 great concern that the proposed cap by far exceeds 2005 verified emissions. The Committee called on the Commission to scrutinise Hungary's allocation to the electricity sector,

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<sup>1</sup> 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/EC, OJ L 275, 25.10.2003, p. 32, as amended by Directive 2004/101/EC of the European Parliament and of the Council of 27 October 2004, amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community, in respect of the Kyoto Protocol's project mechanisms, OJ L 338, 13.11.2004, p. 18.

<sup>2</sup> Decision 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 Protocol, OJ L 49, 19.02.2004, p. 1, established under Article 9 thereof.

including assumptions made on growth rates and export/import trends, in the light of corresponding allocations and projections made by neighbouring countries. The Commission should examine power sector projections, which are partly not based on data established independently from production companies, as to whether they are realistic and adequately explained. The Committee urged the Commission to scrutinise the proposed allocation also with respect to its compatibility with Hungary's potential to reduce emissions. In addition, the Committee called on the Commission to examine the rules governing the reserve for new entrants, including rules for access and definitions used. Moreover, the Committee is concerned that the 6-year guarantee applicable to allocation to new entrants could lead to serious distortions of competition in the internal market and called on the Commission to take appropriate action. The views of the Climate Change Committee have been taken into account.

- (3) The national allocation plan, including the total average annual quantity of allowances of 30.7 million tonnes stated therein, has been evaluated against the criteria contained in Annex III to and Article 10 of the Directive, taking into account the Commission's guidance to Member States on the implementation of these criteria<sup>3</sup>. Certain aspects of the national allocation plan have been found incompatible with those criteria, and in particular with criteria 1, 2, 3 and 10 in Annex III to the Directive.
- (4) The national allocation plan contravenes criteria 1, 2 and 3 of Annex III to the Directive 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 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 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 is likely to be needed for the strict application of the criteria of Annex III.
- (5) With respect to criterion 2, in the Commission's most recent assessment<sup>4</sup> made pursuant to Decision 280/2004/EC, the actual greenhouse gas emissions of the sectors covered by the Community Scheme in Hungary in 2005 are reported as being 26.0 million tonnes<sup>5</sup>. These emission figures are the most reliable and accurate emissions figures for the Commission to use as a starting point for the assessment under criteria 2 and 3 because they have been reported by individual installations in Hungary falling under the Community scheme and have been independently verified pursuant to Article 15 of the Directive. In addition, the figures correspond to the scope of installations included by Hungary in the Community scheme in the phase 2005 to 2007. Emissions figures given by Hungary in respect of earlier years have not been independently and consistently verified with a comparably high degree of accuracy and it is not clear that they correspond as closely to the scope of installations included

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<sup>3</sup> Commission Communication on guidance to assist Member States in the implementation of the criteria listed in Annex III to Directive 2003/87/EC (COM(2003)830 final) and Commission Communication on further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emission Trading Scheme (COM(2005)703 final).

<sup>4</sup> COM(2006)658 final of 27 October 2006 and Annex SEC(2006)1412 of 27 October 2006.

<sup>5</sup> Chapter 3.3. of COM(2006)658 final of 27 October 2006 and Table 5 in the Annex SEC(2006)1412 of 27 October 2006. The exact figure is 26.039009 million tonnes as indicated in the Community Independent Transaction Log.

by Hungary in the Community scheme, and thus they are less reliable. Therefore, it cannot be excluded that emissions figures reported by Hungary in respect of earlier years overstate actual emissions. A starting point, which would be calculated as the average of independently verified emissions figures from 2005 and other figures proposed by Hungary, would be likely not to truly represent actual emissions and would not ensure overall allocation not to be more than is needed. As a matter of fact, the Commission takes into account in its assessment that the expansion in the scope of activities covered by the Directive from the first to the second phase as applied by Hungary in line with the Commission's guidance<sup>6</sup> may lead to an increase to the total quantity of allowances.

- (6) The Commission is aware of the opinion brought forward by some Member States, but not endorsed by the Climate Change Committee, in favour of averaging independently verified emissions figures with Member States' estimates of emissions over other years in order to smooth out singular events in one particular year. However, in each year there are several factors, including weather patterns, influencing aggregate emissions that generally balance each other out over one year in their effects on total annual emissions. The Commission has examined the availability and quality of other data concerning emissions and energy use prior to 2005. The Commission does not have sufficient indications that a clear majority of exceptional circumstances manifestly pointed in one direction in 2005 and that therefore 2005 verified emissions figures cannot be regarded as representative. Consequently, the Commission considers that there are no sufficient reasons with respect to Hungary to adjust independently verified emissions figures for 2005.
- (7) The Commission underlines that this approach is also compatible with the Commission's guidance that allocations to individual installations should not be based on changes in the emissions of those installations within the first phase<sup>7</sup>. The determination of the total quantity of allowances, on the one hand, and the distribution of the total quantity to individual installations, on the other hand, are separate issues and subject to different considerations. Similarly, the Commission's guidance concerning the reward for early action relates to sector and installation level allocations, but not the total quantity of allowances, as is clear from the heading of the relevant chapter<sup>8</sup>.
- (8) 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 a rigorous assessment of total allocations in accordance in particular with projections of economic growth and improvements in carbon intensity<sup>9</sup>. The Commission has assessed the figures at its disposal, including those in the public domain, with a view to calculating Hungary's projected emissions. In order to derive the total quantity of allowances that 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

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<sup>6</sup> 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.

<sup>7</sup> Chapter 3.7, point 27 of COM(2005)703 final.

<sup>8</sup> Chapter 3.7, point 28 of COM(2005)703 final.

<sup>9</sup> See in particular point 11 of COM(2005) 703 final.

(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 and, in the Commission's view, it is appropriate from an *ex-ante*-perspective to assume a linear trend over this five-year period. The resulting figures are compared with Hungary'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 the Directive from the first to the second phase as applied by Estonia in line with the Commission's further guidance<sup>10</sup>. Of all data at its disposal, including those in the public domain, the Commission considers the data indicated in the PRIMES model<sup>11</sup> as the most accurate and reliable estimations of both GDP growth<sup>12</sup> and carbon intensity improvement rates. The PRIMES model has been used for analysis of energy and climate policy for a long time and the baseline assumptions<sup>13</sup> 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. The most recently updated baseline was published in 2006. There is no other data source at the disposal of the Commission, which offers a comparable degree of consistency and uniform accuracy across all Member States, thus ensuring equal treatment of Member States.

- (9) The PRIMES model has been concretely applied on the basis of a coherent set of assumptions and methodologies for the publication "*European Energy and Transport Trends*" of the Commission's Directorate-General for Transport and Energy<sup>14</sup> and for

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<sup>10</sup> 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.

<sup>11</sup> PRIMES is a modelling system that simulates a market equilibrium solution for energy supply and demand in the EU 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. It covers a medium to long-term horizon. It is modular and allows either for a unified model use or for partial use of modules to support specific energy studies. More information can be found on the following website: <http://www.e3mlab.ntua.gr/>.

<sup>12</sup> 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 forecasts 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](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 on ageing populations)", ECFIN/50485/04-EN.

<sup>13</sup> Examples for baseline assumptions are future developments in population, fuel prices, etc.

<sup>14</sup> European Energy and Transport, Trends to 2030 – update 2005, European Commission, Directorate-General for Energy and Transport, 2006, prepared by the Institute of Communication and Computer Systems of National Technical University of Athens (ICCS-NTUA), E3M-Lab, Greece, Authors: Dr. L. Mantzos and Prof. P. Capros, published on the Commission's website under the following hyperlink:

the publication of its Environment Directorate-General containing the calculation of baseline scenarios for the revision of the National Emission Ceilings Directive<sup>15</sup>. The figures for GDP and 2005 carbon intensity are identical in both publications, while for 2010 the figure for carbon intensity<sup>16</sup> differs<sup>17</sup>. Where there is a low carbon constraint instead of an even less stringent one, carbon intensity will improve more over time due to the stronger incentive for operators to reduce emissions.

- (10) The introduction of the Community scheme in 2005 and the strong commitments by the EU and Member States to combat climate change provide a clear and sustained signal to installations covered by the Community scheme that there is an economic cost to emitting greenhouse gases, which will become even more important in the future. This reinforces long-term economic incentives to reduce emissions. As a consequence, carbon intensity will improve over time at least at a rate as indicated in the "low carbon constraint / no CCS"-case<sup>18</sup>.
- (11) The Commission considers that this level of carbon intensity improvement does not appropriately reflect most likely future trends because it does not take account of all relevant factors, including recent developments. In addition to the economic incentives created by the Community scheme, operators will be likely to increasingly invest in energy efficient technologies in order to lower their fuel and electricity costs. Moreover, they will increasingly be encouraged by policies and measures of the EU and Member States as well as public opinion to accelerate efforts with regard to innovation in energy saving production methods and thus take effective action against climate change. At EU level, collective efforts to reduce dependency of energy imports as well as measures identified in the new Energy Efficiency Action Plan<sup>19</sup> with a view to realising the EU's energy saving potential, will further spur efforts to achieve better energy efficiencies, reducing in general also carbon intensity.
- (12) The Commission considers that the combined effect of reinforced energy efficiency measures identified in the Energy Efficiency Action Plan and the existence of a carbon constraint due to the Community scheme will lead to an annual improvement rate in

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[http://ec.europa.eu/dgs/energy\\_transport/figures/trends\\_2030\\_update\\_2005/energy\\_transport\\_trends\\_2030\\_update\\_2005\\_en.pdf](http://ec.europa.eu/dgs/energy_transport/figures/trends_2030_update_2005/energy_transport_trends_2030_update_2005_en.pdf)

<sup>15</sup> Directive 2001/81/EC of the European Parliament and of the Council of 23 October 2001 on national emission ceilings for certain atmospheric pollutants. The baseline scenarios are published on the Commission's website under the following hyperlink: <http://ec.europa.eu/environment/air/baseline.htm>

<sup>16</sup> "Carbon intensity" can be defined in various ways and is for the purpose of this Decision understood as the relationship between CO<sub>2</sub> emissions and a unit of GDP (see below for precise definition).

<sup>17</sup> Due to the effect of the introduction of a low carbon constraint, the carbon intensity in 2010 is improved in the "low carbon constraint"-scenario in the publication containing the calculation of baseline scenarios for the revision of the National Emission Ceilings Directive, whereas the scenario established in the publication "*European Energy and Transport Trends*" is based on an even less stringent carbon constraint.

<sup>18</sup> Taking into account that carbon capture and sequestration ("CCS") is highly unlikely to already be available to a significant extent during the period 2008-12. The "low carbon constraint / no CCS"-scenario for the respective Member State is published on the Commission's website under the following hyperlink: <http://ec.europa.eu/environment/air/baseline.htm>. Both relevant figures are indicated for the respective Member State on the sheet "Summary Energy Balance and Indicators (B)" under "Main Energy System Indicators". Under this heading, the figures for "GDP (in 000 MEUR'00)" are indicated in the second row, and the figures for "CO<sub>2</sub> emissions to GDP (t of CO<sub>2</sub>/MEUR'00)", which the Commission considers the adequate expression of carbon intensity for its assessment, are indicated in the second last row.

<sup>19</sup> Action Plan for Energy Efficiency: Realising the Potential, Communication from the Commission, COM(2006)545 final

carbon intensity for each Member State in excess of the rate reflected in the "low carbon constraint"-case. Consequently, the Commission considers it necessary to further improve the absolute value of carbon intensity arising from the "low carbon constraint"-case. While the "low carbon constraint" under the Community scheme leads at EU level to an average annual improvement rate in carbon intensity of 2.37%<sup>20</sup>, the Commission considers that the magnitude and importance of additional measures identified in the new Energy Efficiency Action Plan justifies in principle assuming a similar quantitative effect for the latter. Recognising however the potential partial overlaps between both policy instruments and also that not all the measures identified in the Energy Efficiency Action Plan may be fully implemented by 2010, the Commission considers that the corresponding additional average annual rate for carbon intensity improvements should be adjusted downwards. More specifically, in order to exclude any potential overestimation of the total effects, the Commission takes a conservative estimate of an additional average annual rate of 0.5% for carbon intensity to improve further, which corresponds to a total additional carbon intensity improvement of 2.5%<sup>21</sup> over the entire period from 2005 to 2010 compared to the "low carbon constraint"-case. Therefore, in order to appropriately reflect reality, the Commission considers it necessary to base the assessment under criterion 3 in Annex III to the Directive on a rate of carbon intensity improvement exceeding the "low carbon constraint"-case by 2.5% during the five-year period from 2005 to 2010.

- (13) In the light of the above, the following table indicates the data for the developments from 2005 to 2010 of both GDP and carbon intensity in Hungary in absolute terms. The corresponding relative development factors and growth rates from 2005 to 2010 are also indicated:

Calculation element	2005	2010	Relative development factor 2005-2010	Growth rate 2005-2010
GDP <sup>22</sup>	60.6	71.3 <sup>23</sup>	1.176568 <sup>24</sup>	17.6568% <sup>25</sup>

<sup>20</sup> As indicated in the "low carbon constraint"-case for "EU25" in the baseline scenarios for the revision of the National Emission Ceilings Directive under <http://ec.europa.eu/environment/air/baseline.htm>, the absolute figure for the EU's absolute carbon intensity in 2005 is 391.0 tonnes per million Euro GDP (in year 2000 value). For 2010, the corresponding figure is 346.8 tonnes per million Euro GDP. Therefore, the total improvement in the period from 2005 to 2010 can be calculated as 346.8/391, which gives 0.887 or 11.3%. The EU's annual average carbon intensity improvement rate is calculated as  $(346.8/391)^{1/5}$ , which gives 0.9763 or 2.37%.

<sup>21</sup>  $1.005^5 = 1.02525$ , which corresponds to 2.5% (after rounding).

<sup>22</sup> This figure is expressed in thousand million Euro value year 2000.

<sup>23</sup> The Commission's Economic and Financial Affairs Directorate-General released in November 2006 its "Economic Forecasts Autumn 2006", published in EUROPEAN ECONOMY. No. 5/2006, Office for Official Publications of the EC, ISSN 0379-0991, and on the Commission's website under the following hyperlink: [http://ec.europa.eu/economy\\_finance/publications/european\\_economy/2006/ee506en.pdf](http://ec.europa.eu/economy_finance/publications/european_economy/2006/ee506en.pdf). In order to take into account these most recent figures available to the Commission, the GDP figure for 2010 indicated in the above-mentioned publications "European Energy and Transport Trends" and the one for the calculation of baseline scenarios for the revision of the National Emission Ceilings Directive has been adapted as follows: In a first step, the average annual GDP development factor from 2005 to 2010 is calculated on the basis of the figures contained in the publication "European Energy and Transport Trends", i.e.  $(72.7/60.6)^{1/5}$ , which gives 1.037080. In a second step, this annual average development factor is replaced by the more recent development factors from the "Economic Forecasts Autumn 2006" for those years, for which they are available (see p. 83 therein), i.e. the years 2006 (factor of 1.400), 2007 (factor of 1.024) and 2008 (factor of 1.027). For the years 2009 and 2010, the average annual development factor as calculated in the first step is taken. In a third step, the overall development factor from 2005 to 2010 is calculated by multiplying the indicated annual development



Carbon intensity <sup>26</sup>	932	794.9		
Carbon intensity with additional improvement of 2.5%		775.0 <sup>27</sup>	0.831575 <sup>28</sup>	-16.8425% <sup>29</sup>

On the basis of this, the following table shows the calculation of the annual excess allocation for the period from 2008 to 2012, i.e. the difference between the annual average allocation proposed by Hungary and the allocation resulting from the strict application of criteria 2 and 3. Concretely, the latter is calculated as the product of the total 2005 verified emissions figure<sup>30</sup> for installations included in the period 2008-2012 and the relative development factors of GDP and carbon intensity from 2005 to 2010, as indicated in the above table. In addition, the resulting amount is increased to take into account the effect from the increase in scope from the first to the second trading phase in line with the Commission's guidance, while using the overall figure envisaged by Hungary to be allocated to these additional installations concerned:

<b>Calculation of the annual excess allocation for the period from 2008 to 2012</b> (all figures in million tonnes CO2 eq.)					
2005 verified emissions of existing installations included in first phase national allocation plan	2005 verified emissions multiplied by relative development factors 2005-2010 for GDP and carbon intensity	Annual effect from increase in scope from 1 <sup>st</sup> to 2 <sup>nd</sup> phase	Resulting allowed annual average total quantity for 2008-2012	Annual average allocation on basis of proposed national allocation plan	Annual average excess allocation
26.039009	25.476664 <sup>31</sup>	1.432188	26.908852 <sup>32</sup>	30.733313	3.824461 <sup>33</sup>

Accordingly, given that in the years 2008 to 2012 proposed allocations exceed emissions taking into account GDP growth and carbon-intensity improvements, the Commission finds that the annual average excess allocation by Hungary in the period 2008 to 2012 amounts to 3.824461 million tonnes, which contravenes criteria 1, 2 and 3.

factors, i.e.  $1.040 \times 1.024 \times 1.027 \times 1.037080 \times 1.037080$ . The interim forecast of February 2007 published by the Commission's Economic and Financial Affairs Directorate-General on 16 February 2007 contains figures only for seven Member States. The Commission has not taken into account the latter figures for any Member State because they do not constitute a sufficiently consistent and equal data basis across the entire EU.

24

71.3/60.6

25

$((71.3/60.6)-1)\%$

26

This figure is expressed in terms of CO2 Emissions to GDP (tonne of CO2/million Euro value year 2000).

27

$794.9 \times (1-0.025)$ . The additional improvement of 2.5% is mathematically expressed with the factor of  $(1-0.025)$ .

28

$794.9 \times (1-0.025)/932$

29

$((794.9 \times (1-0.025)/932)-1)\%$ . The negative figure indicates an improvement in carbon intensity, meaning that the amount of CO2 emitted to produce one unit of GDP decreases over time.

30

As all installations in Hungary have been verified in 2005, there is no need for a correction factor.

31

$26.039009 \times 1.176568 \times 0.831575$

32

$25.476664 + 1.432188$

33

$30.733313 - [(26.039009 \times 1.176568 \times 0.831575) + 1.432188]$

- (14) Hungary has proposed to include 1.432188 million tonnes of allowances in the total quantity in respect of emissions of these additional combustion installations annually, which have not been included in the first period plan. Allocations to these installations need to take place in accordance with the general methodologies stated in the national allocation plan, and only take place to the extent that the emissions of these installations have been substantiated and verified.
- (15) Pursuant to Article 3(1) of Decision 2006/780/EC<sup>34</sup>, Hungary is required to include in the total quantity of allowances for the period 2008 to 2012 a set-aside of allowances drawn up for each project activity if, prior to the deadline for the notification of its national allocation plan set out in Article 9(1) of the Directive, Hungary has issued letters of approval as a host country, pledging to issue emission reduction units ("ERUs") for project activities which result in emission reductions or limitations in installations falling under the scope of the Directive. Pursuant to Article 3(2) of Decision 2006/780/EC, Hungary may also include in the total quantity of allowances for the period 2008 to 2012 an additional set-aside of allowances if after the decision pursuant to Article 11(2) of the Directive it intends to issue letters of approval for JI projects that pledge to issue ERUs before 31 December 2012 for project activities which result in emission reductions or limitations in installations falling under the scope of the Directive. According to its national allocation plan and the replies to the questions from the Commission, Hungary has approved such projects and has indicated that pursuant to Article 3(1) of Decision 2006/780/EC a set-aside is proposed to be established.
- (16) The size of a set-aside for allowances drawn up by Hungary pursuant to Article 3(1) or 3(2) of Decision 2006/780/EC needs to be included in the total quantity of allowances of 26.908852 million tonnes calculated in accordance with criteria 1, 2 and 3 of Annex III to the Directive before the final national allocation decision pursuant to Article 11(2) of the Directive is taken. Reductions or limitations in emissions of installations falling under the scope of the Directive due to project activities for which Hungary as host of the project activity issues ERUs lead to lower emissions in the relevant activities covered by the Directive and therefore to a corresponding improvement of the potential of the relevant activities covered by the Directive to reduce emissions pursuant to criterion 3 of Annex III to the Directive so that only a correspondingly lower allocation to installations carrying out these relevant activities may take place. However, Hungary may increase the average annual total quantity in respect of emissions of project activities which were already operational in 2005 and resulted in 2005 in emission reductions or limitations in installations falling under the scope of the Directive to the extent that the resulting emission reductions or limitations due to these project activities have been substantiated and verified. This is because, in the latter case, potential double-counting effects are already reflected in the 2005 verified emissions data for the activities falling under the Directive and thus also in the calculation of the total quantity of allowances permissible under criterion 1, 2 and 3 of the Directive.

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<sup>34</sup> Commission Decision 2006/780/EC of 13 November 2006 on avoiding double counting of greenhouse gas emission reductions under the Community emissions trading scheme for project activities under the Kyoto Protocol pursuant to Directive 2003/87/EC of the European Parliament and of the Council, OJ L 316/12, 16.11.2006.

- (17) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined compliance of the national allocation plan of Hungary with the provisions of the Treaty, and in particular Articles 87 and 88 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 intra Community trade. 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<sup>35</sup>, 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 87(1) of the Treaty. On the basis of information provided by Hungary, 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 environmental objective of the Directive. Non-compliance with criteria 1, 2 and 3 fundamentally jeopardises the overall environmental objective of the emission trading 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 referred to above. 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 87 and 88 of the Treaty.
- (18) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined the methodology by which Hungary intends to allocate allowances at sector and installation level. Hungary does not provide sufficiently substantiated information on the methodology applied with respect to allocations on the level of installations and the quantitative effects of assumptions used. Moreover, it does not demonstrate that information provided by associations or companies has been systematically verified by independent experts. Therefore, due to the lack of sufficient safeguards, the proposed allocation methodology may lead to undue and discriminatory advantages to certain installations. For these 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 incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.

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<sup>35</sup> Article 45 of the 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 Council, OJ L 386, 29.12.2004, p. 1.

- (19) The intention of Hungary to adjust the allocation of allowances to installations listed in the national allocation plan and operating in its territory in application of the procedures provided in the plan, as outlined in the below recitals, contravenes criterion 10 in Annex III to the Directive which requires the quantity of allowances to be allocated to each installation to be stated *ex-ante* in the national allocation plan covering the period referred to in Article 11(2) of the Directive and not to adjust the allocation of allowances set out in the national allocation plan after the adoption of the decision referred to in Article 11(2) of the Directive. Following the final allocation decision the number of allowances to be allocated and issued for each installation is fixed and may not be changed, except in the case of full closure and withdrawal of the greenhouse gas permit of that same installation.
- (20) In this respect, the Commission has examined the provisions in the proposed plan relating to the envisaged allocation of allowances from the new entrants' reserve for an increase in production and corresponding emissions whereby the capacity of the relevant emission-related activity carried out in that installation and covered by the Directive remains the same. The Commission finds that any such production increase subsequent to the notification to the Commission of the national allocation plan cannot be subsumed under the definition of "new entrant" pursuant to Article 3(h) of the Directive according to which a "new entrant" means any "installation carrying out one or more of the activities indicated in Annex I, which has obtained a greenhouse gas emissions permit or an update of its greenhouse gas emissions permit because of a change in the nature of functioning or an extension of the installation, subsequent to the notification to the Commission of the national allocation plan". The Commission interprets this definition in the light of the objective of the Directive "to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner" and its rationale. Accordingly, any "extension of the installation" can only relate to extensions of capacities of activities in an installation which have a direct bearing on emissions and which would require a new or an update of the respective greenhouse gas emission permit pursuant to the Directive. As the Directive applies to installations carrying out the various activities set out in Annex I of the Directive, any "change in the nature of functioning or an extension of the installation" needs to occur strictly with regard to the activity by virtue of which the particular installation is falling under the Directive, regardless of any other activities that may be carried out in that installation. Therefore, if an activity is not defined in Annex I to the Directive by referring to its final product (e.g. steel), but rather to the process (e.g. combustion of a fuel) that is taking place in the installation (as is the case for "combustion installation"), the extension of an installation's production capacity that is not accompanied by the extension of the relevant activity indicated in Annex I to the Directive cannot be considered a new entrant. In other words, it is decisive that the emission-relevant activity of the installation covered by the Directive is extended, since for mere extensions of production capacity, in particular productions not covered by the Directive, a new greenhouse gas permit or update of an existing greenhouse gas permit is not mandatory.
- (21) Accordingly, the extension of an installation's production capacity that is not accompanied by the extension of the relevant activity indicated in Annex I to the Directive constitutes an internal change concerning the same installation and cannot be considered a new entrant under the Directive. Therefore, the number of allowances to be allocated and issued to that installation is fixed and may not be changed following

the final allocation decision. Consequently, the Commission finds that the provisions contained in chapter 11.2 c)<sup>36</sup> of the proposed plan relating to "*developments not belonging to group b*) which are realised in order to meet legal provisions – without regard to the extent of change in the built-in capacity – and as a result of which carbon dioxide emissions per product increase at the installation compared to the state on 31st of December 2005" and entitling installations for allocation of allowances from the new entrants' reserve constitute an ex-post adjustment that contravenes criterion 10 in Annex III to the Directive.

- (22) In addition, the Commission considers an ex-post adjustment being in contravention of criterion 10 the provisions contained in chapter 5.8<sup>37</sup> relating to the cancellation of allowances in case an allocation has been based on false data or was erroneous. Also under these provisions, Hungary intends to change the allocation based on events taking place after the final national decision with respect to the allocation to individual installations concerned has been taken.
- (23) Such ex-post adjustments contradict the essential concept of a "cap-and-trade" system as conceived by the Directive. Under the Community scheme, each installation is allocated a certain amount of allowances in the decision referred to in Article 11(2) of the Directive, whose value it can freely dispose of with a view to taking optimal economic decisions. Three major alternatives exist, which are equally legitimate: investing in emissions reductions and selling freed allowances, reducing production volume and selling freed allowances, or maintaining/expanding production volume while buying additional allowances needed.
- (24) The Commission considers that there is no administrative need or any other justification for ex-post adjustments. Member States are required to use the best data available when deciding on allocations up-front. As a matter of fact, the use of prognoses always requires to a certain degree an ex-ante estimation of emissions the actual volume thereof may eventually deviate in reality. This is an inherent feature of any "cap-and-trade" scheme and can thus certainly not justify a retroactive change to the allocation already decided upon up-front. Moreover, the reasons for such a deviation cannot be reliably identified and may well be the result of emissions reductions due to real investments having been carried out by operators in line with the economic incentives created by the scheme.
- (25) The Directive allows only for two adjustments following the decision referred to in its Article 11(2) where such retroactive change does not occur or does not have a detrimental impact on the functioning of the Community scheme: firstly, where an installation is closed during the trading period, that Member States determine that there is no longer an operator to whom allowances will be issued; and, secondly, where allocation takes place to new entrants from the reserve, that Member States determine the exact allocation to each new entrant.
- (26) In order to bring the national allocation plan in conformity with the criteria listed in Annex III to the Directive, the plan should be amended. The Commission should be notified of the amendments made to the plan in accordance with this Decision by Hungary as soon as possible, taking into account the time-scale necessary to carry out

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<sup>36</sup> P. 26 of the plan.

<sup>37</sup> P. 20 of the plan.

the national procedures without undue delay. Were Hungary to amend its national allocation plan in a non-discriminatory manner in accordance with Article 2 of this Decision and duly taking into account the Commission observations in recital 18, the Commission considers that any potential aid is likely to be compatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.

- (27) Information in the national allocation plan not relevant for the allocation of allowances for the period referred to in Article 11(2) of the Directive has not been taken into account for the purposes of this Decision. This applies also to the allocation guarantees intended to be granted for investments carried out as from 2008, independently of the year they are implemented, for a 6-year period on the condition that "*after 2012 not more than 20% of the emission units are allocated for a charge to the installations, and that the investment shall use the best available and most energy efficient technology*", as set out in Chapter 11.5. of the plan. The Commission takes the view that in case Hungary were to maintain or introduce these allocation guarantees in national provisions any such provisions must be notified by Hungary to the Commission and would be likely to become subject of a separate State aid investigation procedure to be opened by the Commission pursuant to Article 88 of the Treaty. The Commission at this stage considers that any State aid involved would be likely to be found incompatible with the common market should it be assessed in accordance with Article 87 and 88 of the Treaty.
- (28) The reports on the implementation of policies and measures and the use of the Kyoto Protocol's mechanisms submitted by Member States pursuant to Decision 280/2004/EC are important sources of information for the evaluation of the national allocation plans pursuant to criterion 2 of Annex III to the Directive.
- (29) Pursuant to Article 9(3), second sentence, of the Directive, the Member State shall only take a decision under Article 11(2) of the Directive if proposed amendments are accepted by the Commission. The Commission accepts all modifications of the allocation of allowances to individual installations within the total quantity to be allocated to installations listed therein resulting from technical improvements to data quality. No further prior assessment and acceptance by the Commission is necessary because the allocation methodology and the total quantity of allowances remain unchanged. As the modification is limited to mechanically adjusting the result from the use of data of higher quality having become available more recently to the intended allocation, any such modification cannot be conceived to be incompatible with the criteria of Annex III to or Article 10 of the Directive. Similarly, changing the share of allocation of allowances free of charge in a non-discriminatory manner within the limits set in Article 10 of the Directive is accepted, since it requires no prior assessment by the Commission. The Commission considers that such a change cannot *per se* be conceived to discriminate between companies or sectors in such a way as to unduly favour certain undertakings or activities in the light of criterion 5 or contravene any other criteria of Annex III to the Directive.
- (30) The whole procedure comprising the notification to, assessment and possible rejection by the Commission of the national allocation plans and the final allocation decisions to be taken by Member States is foreseen by the Directive in a short schedule and implemented by the decisions taken pursuant to its Article 9(3) so as to ensure that the system operates effectively with a minimum of uncertainty for market participants.

- (31) Accordingly, Member States are not entitled to propose any amendments to national allocation plans, including to the total quantity of allowances stated therein, given that the deadline of 31 December 2006 specified in Article 11(2) of the Directive has expired, other than those made to correct the incompatibilities indicated in the respective Commission decision on a national allocation plan<sup>38</sup>. The interpretation of the deadline of 31 December 2006 specified in Article 11(2) as a "cut-off deadline" is proportionate in balancing the interest of a Member State to exert its discretion on substantive issues and the interest of the Community to ensure the functioning of the emissions trading scheme,

HAS ADOPTED THIS DECISION:

#### *Article 1*

The following aspects of the national allocation plan of Hungary for the first five-year period mentioned in Article 11(2) of the Directive are incompatible respectively with:

1. criteria 1, 2 and 3 of Annex III to the Directive: the part of the intended total quantity of allowances, amounting to 3.824461 million tonnes CO<sub>2</sub> equivalent per year, that is not consistent with assessments made pursuant to Decision 280/2004/EC and not consistent with the potential, including the technological potential, of activities to reduce emissions; this part being reduced in respect of emissions of project activities which were already operational in 2005 and resulted in 2005 in emission reductions or limitations in installations falling under the scope of the Directive to the extent that the resulting emission reductions or limitations due to these project activities have been substantiated and verified; in addition, the part of the total quantity potentially amounting to 1.432188 million tonnes of allowances in respect of additional emissions of combustion installations annually to the extent that this is not justified in accordance with the general methodologies stated in the national allocation plan and on the basis of substantiated and verified emission figures;
2. criterion 10 of Annex III to the Directive: the provisions of the national allocation plan contained in:
  - chapter 11.2 c);
  - chapter 5.8 relating to the cancellation of allowances in case an allocation has been based on false data or was erroneous;

to adjust the allocation of allowances to an installation listed in the national allocation plan and operating in its territory after the decision pursuant to Article 11(2) of the Directive has been taken.

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See Court of First Instance, ruling of 23 November 2005 in case T-178/05, OJ C 22, 28.1.2006, p. 14, full text <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:62005A0178:EN:HTML>; point 7 of the Commission Communication on further guidance on allocation plans for the 2008 to 2012 trading period of the EU Emission Trading Scheme, COM(2005)703 final, published under [http://ec.europa.eu/environment/climat/pdf/nap\\_2\\_guidance\\_en.pdf](http://ec.europa.eu/environment/climat/pdf/nap_2_guidance_en.pdf); Commission Decision of 22 February 2006 concerning the proposed amendment to the national allocation plan for the allocation of greenhouse gas emission allowances notified by the United Kingdom in accordance with Directive 2003/87/EC of the European Parliament and of the Council, C (2006) 426 final, published under [http://ec.europa.eu/environment/climat/pdf/uk\\_final\\_2006\\_en.pdf](http://ec.europa.eu/environment/climat/pdf/uk_final_2006_en.pdf).

## *Article 2*

No objections shall be raised to the national allocation plan, provided that the following amendments to the national allocation plan are made in a non-discriminatory manner and notified to the Commission as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay:

1. the total quantity to be allocated for the Community scheme is reduced by 3.824461 million tonnes CO<sub>2</sub> equivalent of allowances per year, and the quantities allocated to additional combustion installations are determined in accordance with the general methodologies stated in the national allocation plan and on the basis of substantiated and verified emission figures, with the total quantity being further reduced by any difference between the allocations to these installations and the 1.432188 million tonnes set aside annually for these installations; and the total quantity being increased in respect of emissions of project activities which were already operational in 2005 and resulted in 2005 in emission reductions or limitations in installations falling under the scope of the Directive to the extent that the resulting emission reductions or limitations due to these project activities have been substantiated and verified;
2. the allocation of allowances to an installation listed in the national allocation plan and operating in its territory, contrary to what is provided by the plan in:
  - chapter 11.2 c),
  - chapter 5.8 relating to the cancellation of allowances in case an allocation has been based on false data or was erroneous;is not adjusted after the decision pursuant to Article 11(2) of the Directive has been taken.

## *Article 3*

1. The total average annual quantity of allowances of 26.908852 million tonnes, reduced by any difference between the allocations to additional combustion installations and the 1.432188 million tonnes set aside annually for these installations, and increased in respect of emissions of project activities which were already operational in 2005 and resulted in 2005 in emission reductions or limitations in installations falling under the scope of the Directive to the extent that the resulting emission reductions or limitations due to these project activities have been substantiated and verified, to be allocated by Hungary according to its national allocation plan to installations listed therein and to new entrants shall not be exceeded.
2. The national allocation plan may be amended without prior acceptance by the Commission if the amendment consists in modifications of the allocation of allowances to individual installations within the total quantity to be allocated to installations listed therein resulting from improvements to data quality or to change the share of the allocation of allowances free of charge in a non-discriminatory manner within the limits set in Article 10 of the Directive.
3. Any amendments of the national allocation plan made to correct the incompatibilities indicated in Article 1 of this Decision but deviating from those referred to in Article



2 must be notified as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay, and require prior acceptance by the Commission pursuant to Article 9(3) of the Directive. Any other amendments of the national allocation plan, apart from those made to comply with Article 2 of this Decision, are inadmissible.

*Article 4*

This Decision is addressed to the Republic of Hungary.

Done at Brussels, 16 April 2007

*For the Commission*