



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 29.11.2006

**COMMISSION DECISION**

**of 29 November 2006**

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

(Only the French 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 Luxembourg 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 18 July 2006 and registered by the Commission on 2 August 2006. Luxembourg submitted additional information on the notified plan by letters dated 20 October and 6 November 2006, registered on 13 and 21 November 2006 respectively, in reply to questions from the Commission.
- (2) The Climate Change Committee<sup>2</sup> considered the national allocation plan on 22 September 2006 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. The Committee

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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.

expressed its concern that Luxembourg's proposed cap exceeds 2005 verified emissions by more than half. The Committee urged the Commission to compare the proposed allocation to Luxembourg's projections and measures for the non-trading and trading sectors and to closely examine Luxembourg's ability to substantiate its intended use of the Kyoto mechanisms to reach its target under Decision 2002/358/EC. The Committee called on the Commission to examine the admissibility under criterion (12) of Annex III to the Directive of the intended maximum amount of CERs<sup>3</sup> and ERUs<sup>4</sup> which may be used by operators as a percentage of the allocation of allowances to each installation. The views of the Climate Change Committee have been taken into account.

- (3) The Commission notes that Luxembourg's annual Kyoto target for the period from 2008 to 2012 is 9.144 million tonnes CO<sub>2</sub> equivalent (hereinafter "million tonnes"), while the most recent available figure for its annual total greenhouse gas emissions is 12.7 million tonnes for the year 2004<sup>5</sup>. The remaining gap between these two annual figures to be bridged by Luxembourg is therefore 3.556 million tonnes.
- (4) The national allocation plan, including the total annual average quantity of allowances of 3.95 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>6</sup>. Certain aspects of the national allocation plan have been found incompatible with those criteria, and in particular with criteria 1, 2, and 3 in Annex III to the Directive.
- (5) 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<sup>7</sup> 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.
- (6) With respect to criterion 2, in the Commission's most recent assessment<sup>8</sup> made pursuant to Decision 280/2004/EC, the actual greenhouse gas emissions of the sectors

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<sup>3</sup> "Certified emission reduction" pursuant to Article 3(n) of the Directive

<sup>4</sup> "Emission reduction unit" pursuant to Article 3(m) of the Directive

<sup>5</sup> Progress Report COM(2006)658 final of 27 October 2006, Table 1 in the Annex SEC(2006) 1412 of 27 October 2006. The annual Kyoto target for the period from 2008 to 2012 expressed in absolute figures is obtained by multiplying base year emissions (second column of Table 1) with the relative Kyoto target (seventh column of Table 1), i.e.  $12.7 \times (1 - 0.28) = 9.144$ . In mathematical terms, Luxembourg's relative target of -28% is expressed as a factor of  $(1 - 0.28)$ . Annual total greenhouse gas emissions for the year 2004 are indicated in the third column.

<sup>6</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>7</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.

<sup>8</sup> COM(2006)658 final of 27 October 2006 and Annex SEC(2006)1412 of 27 October 2006.

covered by the Community Scheme in Luxembourg in 2005 are reported as being 2.6 million tonnes<sup>9</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 Luxembourg falling under the Community scheme and have been independently verified pursuant to Article 15 of the Directive. In addition, the figures correspond precisely to the scope of installations included by Luxembourg in the Community scheme in the phase 2005 to 2007. Emissions figures given by Luxembourg 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 precisely to the scope of installations included by Luxembourg in the Community scheme, and thus they are less reliable. Therefore, it cannot be excluded that emissions figures reported by Luxembourg 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 Luxembourg, would be likely not to truly represent actual emissions and would not ensure overall allocation not to be more than is needed. In this context, the Commission notes that there is no expansion in the scope of activities covered by the Directive from the first to the second phase as applied by Luxembourg in line with the Commission's guidance<sup>10</sup>.

- (7) 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 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 Luxembourg to adjust independently verified emissions figures for 2005.
- (8) 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>11</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>12</sup>.

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<sup>9</sup> Chapter 3.3. of and Table 5 in the annex to COM(2006)658 final of 27 October 2006. The exact figure is 2.603349 million tonnes as indicated in the Community Independent Transaction Log on 31 October 2006.

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

<sup>12</sup> Chapter 3.7, point 28 of COM(2005)703 final.

- (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 a rigorous assessment of total allocations in accordance in particular with projections of economic growth and improvements in carbon intensity<sup>13</sup>. The Commission has assessed the figures at its disposal, including those in the public domain, with a view to calculating Luxembourg'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 (thereafter "GDP") growth rate and, secondly, the rate for carbon intensity improvement, each in the period from those independently 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 Luxembourg's proposed allocation so as to determine to what extent it is in line with criteria 2 and 3, taking into account that there is no expansion in the scope of activities covered by the Directive from the first to the second phase as applied by Luxembourg in line with the Commission's further guidance<sup>14</sup>. Of all data at its disposal, including those in the public domain, the Commission considers the data indicated in the PRIMES model<sup>15</sup> as the most accurate and reliable estimations of both GDP growth<sup>16</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>17</sup> are updated on a regular basis to reflect the most likely future trend.

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<sup>13</sup> See in particular point 11 of COM(2005) 703 final.

<sup>14</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>15</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>16</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>17</sup> Examples for baseline assumptions are future developments in population, fuel prices, etc.

Furthermore, baseline assumptions are validated with the involvement of experts from Member States. The most recently up-dated 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.

- (10) 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>18</sup> and for the publication of its Environment Directorate-General containing the calculation of baseline scenarios for the revision of the National Emission Ceilings Directive<sup>19</sup>. The figures for GDP and 2005 carbon intensity are identical in both publications, while for 2010 the figure for carbon intensity<sup>20</sup> differs<sup>21</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.
- (11) 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>22</sup>.
- (12) 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.

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<sup>18</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: [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>19</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>20</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>21</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>22</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.

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>23</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.

- (13) 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 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>24</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 mentioned above 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>25</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.
- (14) 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 Luxembourg 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
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<sup>23</sup> Commission Communication on an Action Plan for Energy Efficiency: Realising the Potential (COM(2006)545 final).

<sup>24</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)<sup>1/5</sup>, which gives 0.9763 or 2.37%.

<sup>25</sup> 1.005<sup>1/5</sup>=1.02525, which corresponds to 2.5% (after rounding).

GDP <sup>26</sup>	24.6	31.3 <sup>27</sup>	1.272358 <sup>28</sup>	27.2358% <sup>29</sup>
Carbon intensity <sup>30</sup> under the "low carbon constraint"-case	392.1	326.7		
Carbon intensity with additional improvement of 2.5%		318.53 <sup>31</sup>	0.812376 <sup>32</sup>	-18.76243% <sup>33</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 Luxembourg 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>34</sup> and the relative development factors of GDP and carbon intensity from 2005 to 2010, as indicated in the above table. There is no need for an addition as there is no increase in scope from the first to the second trading phase as applied by Luxembourg in line with the Commission's guidance:

<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	2005 verified emissions multiplied by relative development factors 2005-2010 for GDP and carbon intensity	Resulting allowed annual average total quantity from 2008-2012	Annual average allocation on basis of proposed national allocation plan	Annual average excess allocation
2.603349	2.690906 <sup>35</sup>	2.690906 <sup>36</sup>	3.95	1.259094 <sup>37</sup>

<sup>26</sup> This figure is expressed in thousand million Euro value year 2000.

<sup>27</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.  $(37.7/24.6)^{(1/5)}$ , which gives 1.052022. 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. 81 therein), i.e. the years 2006 (factor of 1.055), 2007 (factor of 1.045) and 2008 (1.042). 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 factors, i.e.  $1.055 * 1.045 * 1.042 * 1.052022 * 1.052022$ .

<sup>28</sup>  $31.3/24.6$

<sup>29</sup>  $((31.3/24.6)-1)\%$

<sup>30</sup> This figure is expressed in terms of CO2 Emissions to GDP (tonne of CO2/million Euro value year 2000).

<sup>31</sup>  $326.7 * (1-0.025)$ . The additional improvement of 2.5% is mathematically expressed with the factor of  $(1-0.025)$ .

<sup>32</sup>  $326.7 * (1-0.025) / 392.1$

<sup>33</sup>  $((326.7 * (1-0.025) / 392.1) - 1)\%$ . 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.

<sup>34</sup> As all installations in Luxembourg have been verified in 2005, there is no need for a correction factor.

<sup>35</sup>  $(2.603349) * 1.272358 * 0.812376$

<sup>36</sup>  $(2.603349) * 1.272358 * 0.812376$



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 Luxembourg in the period 2008 to 2012 amounts to 1.259094 million tonnes, which contravenes criteria 1, 2 and 3.

- (15) The Commission does not consider that the total quantity of allowances needs to be increased in the case of a smaller economy in order to take account of the alleged phenomenon that investments by individual new entrants would imply the use a relatively larger share of the total quantity. The potential arrival of new entrants is a phenomenon common to both larger and smaller Member States. The GDP growth rate includes economic growth stemming from operators newly entering the market. The Commission holds that there is no presumption that there will be a higher proportion of operators newly entering the market in smaller Member States. Consequently, the Commission does not consider it justified to increase the total quantity of allowances resulting from the strict application of criteria 1, 2 and 3 in the case of smaller Member States to take account of the potential arrival of new entrants.
- (16) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined compliance of the national allocation plan of Luxembourg 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>38</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 Luxembourg, 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

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<sup>37</sup> 3.95-2.690906

<sup>38</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.

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.

- (17) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined the methodology by which Luxemburg intends to allocate allowances at installation level. This methodology relies significantly on the use of prognosis factors based on installation specific factors, in particular planned growth of output, which is difficult to verify in an objective manner. Luxembourg confirmed that the prognosis factors have been established with independent experts, but does not provide any details concerning this procedure. 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 based on the currently available information cannot exclude that potential aid involved may be partially incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.
- (18) 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 Luxembourg as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay. Were Luxembourg 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's observations in recital 17, 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.
- (19) 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 notably to certain statements in the national allocation plan that installations qualifying as new entrants in the period from 2008 to 2012 might receive a specific treatment with respect to the calculation of the allocation basis in subsequent trading periods, which may be different from that of other existing installations in those subsequent trading periods.
- (20) 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.
- (21) 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, decreasing the share of allocation of allowances free of charge 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 decrease 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.

- (22) 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.
- (23) Accordingly, Member States are not entitled to propose any amendments to national allocation plans, including to the total quantity of allowances stated therein, after the deadline of 31 December 2006 specified in Article 11(2) of the Directive, other than those foreseen in the respective Commission decision on a national allocation plan<sup>39</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 aspect of the national allocation plan of Luxembourg for the first five-year period mentioned in Article 11(2) of the Directive is incompatible with criteria 1, 2 and 3 of Annex III to the Directive: the part of the intended total quantity of allowances, amounting to 1.259094 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.

#### *Article 2*

No objections shall be raised to the national allocation plan, provided that the following amendment to the national allocation plan is 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: the total quantity to be allocated for

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<sup>39</sup> 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).

the Community scheme is reduced by 1.259094 million tonnes CO2 equivalent of allowances per year.

#### *Article 3*

1. The total annual average quantity of allowances of 2.690906 million tonnes to be allocated by Luxembourg 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 reduce the share of the allocation of allowances free of charge within the limits set in Article 10 of the Directive.
3. Any other amendments of the national allocation plan, apart from those made to comply with Article 2 of this Decision, must be notified by the deadline of 31 December 2006 referred to in Article 11(2) of the Directive and require prior acceptance by the Commission pursuant to Article 9(3) of the Directive.

#### *Article 4*

This Decision is addressed to Luxembourg.

Done at Brussels, 29 November 2006

*For the Commission*