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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 15.5.2007

COMMISSION DECISION

of 15 May 2007

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

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(Only the Italian 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/EC¹, and in particular Article 9(3) thereof,

Whereas:

- (1) The national allocation plan of Italy 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 15 December 2006, registered on 21 December 2006. Italy submitted additional information in order to complete the notified plan by letter dated 1 March 2007, registered on 2 March 2007, in reply to questions from the Commission, and by letter dated 23 March 2007, registered on 4 April 2007.
- (2) The Climate Change Committee² 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. The Committee expressed concern that Italy relies to a large extent on other policies and measures to reduce greenhouse gases in the non-trading and trading sectors and urged the Commission to closely scrutinise the

¹ 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.

² 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.

substantiation of these measures. The Committee called on the Commission to closely examine Italy's ability to substantiate its intended use of the Kyoto mechanisms to reach its target under Decision 2002/358/EC. The Committee also called on the Commission to examine the rules governing the reserve for new entrants, including benchmarks used for new entrants; the use of advanced emissions factors; the proposed allocation to the steel and cement sectors; the reduction efforts required from the trading sector; the system of allocation by payment; and the admissibility under criterion 12 of Annex III to the Directive of the intended maximum amount of CERs³ and ERUs⁴ which may be used by operators as a percentage of the allocation of allowances to each installation. The Committee urged the Commission to ensure in its assessment of the plan that the scope with respect to combustion installations, as outlined in the Commission's 2005 guidance and as co-ordinated in the Committee meeting of 31 May 2006, is followed by Italy. The views of the Climate Change Committee have been taken into account.

- (3) The Commission notes that Italy's annual Kyoto commitment for the period from 2008 to 2012 is 485.83 million tonnes CO₂ equivalent (hereinafter "million tonnes"), while the most recent available figure for its annual total greenhouse gas emissions is 582.5 million tonnes for the year 2004⁵. The remaining gap between these two annual figures to be bridged by Italy is therefore 96.67 million tonnes.
- (4) The national allocation plan, including the total average annual quantity of allowances of 209.0 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 criteria⁶. Certain aspects of the national allocation plan have been found incompatible with those criteria, and in particular with criteria 1, 6, 10 and 12 in Annex III to the Directive.
- (5) The national allocation plan of Italy contravenes criterion 1 of Annex III to the Directive because the total quantity of allowances to be allocated according to the national allocation plan is inconsistent with achieving Italy's commitment under Decision 2002/358/EC and the Kyoto Protocol. The total quantity of allowances is considered to be more than is likely to be needed for the strict application of criterion 1 because the intended use by Italy of other policies and measures in sectors not covered by the Directive is insufficiently substantiated. Member States must substantiate intentions to use such policies and measures, and the Commission's

³ "Certified emission reduction" pursuant to Article 3(n) of the Directive.

⁴ "Emission reduction unit" pursuant to Article 3(m) of the Directive.

⁵ Commission Decision 2006/944/EC of 14 December 2006 determining the respective emission levels allocated to the Community and each of its Member States under the Kyoto Protocol pursuant to Council Decision 2002/358/EC, OJ L 358, 16.12.2006, p. 87; 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 commitment for the period from 2008 to 2012 expressed in absolute figures is obtained by dividing by a factor of five the definitive emission level allocated to Italy equivalent for the first quantified emission limitation and reduction commitment period under the Kyoto Protocol contained in the Annex to Commission Decision 2006/944/EC, which gives 485.826439 million tonnes (=2429.132197/5). Annual total greenhouse gas emissions for the year 2004 are indicated in the third column of Table 1 in the Annex to the Progress Report SEC(2006) 1412 of 27 October 2006.

⁶ 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).

assessment is based in a cumulative manner in particular on the indication of implemented and additional policies and measures, the approximate level of current greenhouse gas emissions represented by the activity targeted by each policy or measure and quantified emissions reductions, assumptions and methodologies, quantitative indicators to demonstrate the effectiveness of implemented policies and measures, how policies and measures are reflected in emissions projections presented in the plan, any developments and trends potentially counteracting the reduction effects, and any overlapping effects and how such double-counting effects have been eliminated in the estimation of quantitative reduction effects⁷.

- (6) The following table contains specification and quantification of individual policies and measures, which the Commission finds to be insufficiently substantiated, and indicates the reasons:

Policy or measure concerned	Quantification of insufficiently substantiated part (in million tonnes CO ₂ eq., based on figures provided by Italy)	Reasons for insufficient substantiation
<p>Transport: Substitution of cars registered before 1996 with emissions above 140 gCO₂/km during the period 2007-2011</p>	<p>6.5</p>	<p>In particular, Italy fails to provide in a sufficient manner the assumptions and methodologies used for the quantification of the envisaged reduction effects of 6.5 million tonnes in 2010, i.e. the year representing the average annual reduction in the second trading period. Italy indicates only in a generic manner that emissions from new cars sold as of 2007 are assumed to be on average below 120 gCO₂/km in compliance with Community rules, that all cars registered before 1996 will be substituted, that the substitution rate is accelerated by 5% per year by this measure and that the trend in car substitution is assumed faster than in the 1990ies, that the distribution of new cars between diesel and petrol is assumed around 50% each, and that the methane- and LPG-power fleet is assumed to grow. The Commission considers these assumptions too optimistic.</p> <p>The Commission notes, amongst others, that the incentive is provided for new cars with less than 140 gCO₂/km, therefore the assumption in the model that all new cars will on average emit less than 120 gCO₂/km is not substantiated.</p> <p>The target threshold for replacement is very close to the 2004 average emission intensity of newly registered passenger cars of 148 gCO₂/km (ACEA average in 2004 according to SEC (2006)1078) and of 149 gCO₂/km (weighted average in 2004 for the associations ACEA, JAMA and KAMA combined, source COM (2006)463 final and SEC (2006)1078), which means that the reduction effect for each new car is likely to be small.</p> <p>Moreover, the target reconfirmed by the Commission in February 2007 as a result of the review of the Community strategy to reduce CO₂ emissions from light-duty vehicles (COM(2007) 19 final) is 120 gCO₂/km to be reached only as of 2012, i.e. at the end of the second trading period.</p> <p>It is not substantiated how all cars registered before 1996 can be substituted within a short period of 3-4 years. Italy fails to present quantitative indicators that demonstrate the large-scale effectiveness of the incentives for car substitution.</p> <p>Furthermore, Italy has not indicated any developments and trends of the activities targeted by this measure that could potentially counteract the envisaged reduction effects, such as an increase in car use of new passenger cars replacing those registered before 1996.</p>

⁷ As stated in paragraph 20 and Annex 6 of the Commission's guidance COM(2005)703 final.

		In view of the above, Italy's assumptions in this respect and the envisaged overall potential for further emissions reductions resulting from this measure are considered as over-stated. The Commission considers that, on the basis of the available information, the measure envisaged by Italy will not produce significant emissions reduction effects during the second trading period. Consequently, the Commission considers the envisaged reduction of 6.5 million tonnes resulting from this measure as insufficiently substantiated.
Transport: Measures for new infrastructure in public transport	4.5	Italy, amongst others, fails to provide in a sufficient manner the assumptions and methodologies used for the quantification of the envisaged reduction effects of 4.5 million tonnes in 2010, i.e. the year representing the average annual reduction in the second trading period. Italy indicates only in a generic manner that the model considers a doubling of passengers/km on metro and tramway lines and a 50% increase in passengers/km on both regional and medium-distance railway services, that coach transport, both on local and long-distance routes, is expected to increase at a lower rate, that on the whole around 38 billion passengers/km are transferred from cars to more efficient transport modes, and that the total growth in all public transport modes will be around 23%. The Commission considers that these assumptions are not plausible, too optimistic and insufficiently founded, and it is unclear which methodology has been used to achieve an overall reduction effect of 4.5 million tonnes per average year. The Commission holds in particular that it is unlikely to achieve a doubling of passenger volumes in public transport infrastructure in the short period until 2010 or 2012 as infrastructure measures usually take a long time and usually do not result in strong emission reductions in the short term. The investment budget indicated by Italy of in total 270 million Euro (90 million Euro annually from 2007 to 2009) is far too low to achieve major infrastructure improvements in public transport infrastructure for a country of the size of Italy. Italy also did not provide any detailed information on the status of planning and implementation of the new infrastructure projects that need to be considerably advanced to result in the claimed emission reduction effects in the 2008-2012 period. Moreover, the envisaged emission reduction is not in a package with other measures promoting public transport. Without further "push" measures other than indicated by Italy, such substantial growth of public transport use is unlikely to be achieved. Furthermore, Italy has not indicated any developments and trends of the activities targeted by this measure that could potentially counteract the envisaged reduction effects. In view of the above, the Commission finds the envisaged reduction of 4.5 million tonnes resulting from this measure as insufficiently substantiated.
Transport: Increase of share of biofuels from 0.5% in 2005 to 5.75% in 2010	3.8	Italy fails notably to provide in a sufficient manner the assumptions and methodologies used for the quantification of the envisaged reduction effects of 7.6 million tonnes in 2010, i.e. the year representing the average annual reduction in the second trading period. Italy has only indicated as the methodology for determination of the effects that there will be an average annual fossil fuel saving of 2.5 million tonnes of oil equivalent ("Mtoe") per year with an emission coefficient of ca. 3 million tonnes CO ₂ /Mtoe. Moreover, Italy has not indicated any developments and trends of the activities targeted by this measure that could potentially counteract the envisaged reduction effects. According to the information provided by Italy, the share of biofuels will be 2% during the first years of the commitment period. Italy has not complied with its commitments under the Biofuels Directive in the past and does not provide any information which could justify the assumption that Italy will be able to catch up in the near future. The share of biofuels was only 0.5% in 2005. The amount of biodiesel released for consumption actually decreased from 300.000 tonnes in 2004 in 200.000 tonnes in 2005. Italy still fails to clearly present information on the status of adoption of relevant legislation needed to implement an obligatory share of 5.75% of biofuels from 2010 onwards, which would go beyond the quota of 1% for biofuels in 2007 and the quota of 2% envisaged for 2008. In view of the implementation deficit accumulated from the past and the only partial information provided by Italy for the

		<p>future, the Commission considers the intended emissions reduction effect of 7.6 million tonnes as insufficiently substantiated. However, the Commission considers realistic to assume that the measures envisaged by Italy will have a certain reduction effect. In the absence of detailed information from Italy, the Commission assumes as an approximation that Italy will be able to realise at most 50% of the envisaged effects, i.e. 3.8 million tonnes. Therefore, the Commission does not recognise the remainder of the envisaged reduction effects of 3.8 million tonnes.</p>
Buildings: Enforcement of EU Directive 2002/91/EC on energy performance of buildings	4.75	<p>Italy, in particular, fails to provide in a sufficient manner the assumptions and methodologies used for the quantification of the envisaged reduction effects of 4.75 million tonnes in 2010, i.e. the year representing the average annual reduction in the second trading period. Italy has, amongst others, indicated as the methodology for determination of the effects that for existing buildings it assumes a comprehensive restructuring of ca. 50% (in 2007) until 80% (in 2012) of all buildings for which a request was made in 2005 (about 342,000 restructurings/year), while for new buildings a restructuring rate of 1.75%/year is assumed. The Commission considers these indications unrealistic and insufficiently founded. Moreover, Italy has not indicated in a sufficient manner any developments and trends of the activities targeted by this measure that could potentially counteract the envisaged reduction effects. Furthermore, the Commission considers that measures in the building sector usually show very slow results as the impact is mainly from the construction of new buildings which represent a small share compared to the total building stock. The Commission considers highly unlikely that the envisaged emission reduction of 5 million tonnes, which corresponds to ca. 6% of emissions from buildings in Italy, can be achieved through an enforcement of the Directive on energy performance of buildings in view of the large stock of buildings and long renovation cycles and given that the implementation of this measure has been subject to significant delays in the past. Consequently, the Commission finds the envisaged reduction effect of 4.75 million tonnes as insufficiently substantiated.</p>
Energy efficiency: Extension of white certificates scheme	4.56	<p>The envisaged emission reductions of 6.85 million tonnes resulting from the intended extension of the white certificates scheme in sectors not covered by the Directive ("non-trading sectors") are unlikely to occur to the extent claimed by Italy. In the Commission's assessment, it is wrongly assumed that most emission reductions (4.90 out of 6.85 million tonnes) occur in the non-trading sectors as emission reductions undertaken reduce mainly electricity demand and thus emissions in the sectors covered by the Directive. Moreover, the targets for the years 2008 and 2009 have already been fixed. So an extension of the scheme will only affect three years (2010 – 2012) of the second trading period. Therefore, the Commission considers it not credible that Italy will achieve in such a short time period, given the long life-time of many appliances, an additional average emission reduction from the extension of the scheme of 6.85 million tonnes on average over the entire second trading period. The adoption and ambition of a target for the period after 2009 seems to be still unclear and not decided. In conclusion, out of the 6.85 million tonnes of emissions reductions envisaged by Italy, the Commission recognises overall only one third, i.e. 2.28 million tonnes, as substantiated, while two thirds, i.e. 4.56 million tonnes, of the envisaged measures are considered insufficiently substantiated and/or subject to double-counting.</p>
Promotion of small and medium sized CHP plants	6.36	<p>Italy expects through this measure a total cut in electricity consumption by 20% and emissions reductions of 12.72 million tonnes, of which it assumes 6.2 million tonnes to occur in the trading sector and 6.52 million tonnes in the non-trading sectors. However, the Commission considers that this measure does not result in emission reductions in the non-trading sector but only in the trading sector and would therefore lead to double-counting of emissions reductions. Despite that, Italy has not sufficiently indicated and taken into account overlapping effects and how such double-counting effects have been eliminated in the estimation of quantitative reduction effects. Small and medium sized CHP plants are usually understood as plants with a thermal firing</p>

		capacity below 20 MW. They are therefore generally not covered by the Community scheme. CHP plants produce electricity and steam more efficiently than by means of separate generation and they displace electricity generation available through the grid, which largely comes from installations covered by the scheme. If the CHP plants are not covered by the Community scheme, the promotion of CHP plants will result in additional fuel consumption in the non-trading sector (except for biomass CHP plants) and less electricity generation in power plants covered by the Community scheme. Thus, contrary to what has been assumed by Italy, this measure will even have the potential to result in an increase of emissions in the non-trading sector and decrease of emissions in the trading sector, which would lead to double-counting of emissions reductions. For the large emission reduction effects assumed from new biomass CHP plants, Italy fails to provide assumptions and methodologies used for the quantification of the emission reduction effects mainly in the agriculture sector. In view of the above, the Commission considers the intended emissions reduction effect of 12.72 million tonnes as insufficiently substantiated. However, the Commission considers realistic to assume that the measures envisaged by Italy will have a certain reduction effect. In the absence of detailed information from Italy, the Commission assumes as an approximation that Italy will be able to realise at most 50% of the envisaged effects, i.e. 6.36 million tonnes. Therefore, the Commission does not recognise the remainder of the envisaged reduction effects of 6.36 million tonnes.
Increase of power production from renewable sources	3.35	The Commission considers that the increase of power production from renewable sources will not result in emission reductions in the non-trading sector. Instead, it will most likely result in less electricity generation in power plants covered by the Community scheme. Italy wrongly assumes that this measure of an estimated total reduction effect of 5.22 million tonnes will result in a higher share of reductions (3.35 million tonnes) in the non-trading sector, while only 1.87 million would be achieved in the trading sector. The Commission considers that the full reduction effect of 5.22 million tonnes will occur in the trading sector because the relevant power production is to a very large extent covered by the Community scheme. Thus, 3.35 million tonnes cannot be recognised as a sufficiently substantiated measure to reduce emissions in the non-trading sector.
Remaining gap	0.41	In view of the lower overall reduction achieved through other policies and measures on the basis of the revision by Italy contained in its replies to the Commission compared to the originally notified plan (41.74 million tonnes instead of 42.15 million tonnes), a gap of 0.41 million tonnes remains between Italy's Kyoto target and projected annual average emissions in the trading period. Italy fails to indicate any policies and measures to close this gap, the coverage of which remains therefore unsubstantiated.
Total	34.23	

- (7) As indicated in the table and in the preceding recital, the total amount, with respect to which policies and measures are insufficiently substantiated, is 34.23 million tonnes per year during the period referred to in Article 11(2) of the Directive. By this amount, the Commission lacks sufficient reassurance that Italy will achieve its Kyoto commitment unless increased efforts are made. These increased efforts to be made by Italy need to take place in the sectors covered by the Directive or those not covered. As Italy has not sufficiently demonstrated to the Commission that it can make these increased efforts solely in the sectors not covered by the Directive, the sectors covered by the Directive need to carry at least a proportionate burden, measured by the relative size of 38.719% of their emissions with respect to overall greenhouse gas emissions⁸.

⁸ More specifically, the trading sector's share is most accurately calculated as 2005 verified emissions for the trading sector divided by 2004 total greenhouse gas emissions of Italy according to the Progress

This leads to a necessary reduction of 13.253514⁹ million tonnes per year to be borne by the sectors covered by the Directive, by which amount the total quantity of allowances for these sectors thus needs to be reduced.

- (8) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined compliance of the national allocation plan of Italy 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 Units¹⁰, 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 Italy, 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 criterion 1 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.
- (9) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined the methodology by which Italy intends to allocate allowances at sector level. Allocations at sector level are based on 2007 sector allocations, but for certain sectors the levels are adjusted on the basis of 2005 verified emission data, expected growth and certain sector specific considerations. The Commission notes, however, that none of these adjustments are made in a consistent way for all sectors involved. In addition, Italy has not provided solid underpinning of the sector specific considerations taken into account. Therefore, the Commission cannot exclude that

Report COM(2006)658 final of 27 October 2006 and the most recent figure for Italy's 2005 verified emissions, i.e. 225.539681/582.5.

⁹ 34.23*0.38719

¹⁰ 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.

certain sectors benefit from unduly favourable treatment. Moreover, in some sectors different shares of the allowances are intended to be allocated "by payment", which either constitutes an advantage to other sectors not having to pay for part of their allocation or constitutes an advantage to the receiving sectors to the extent that otherwise no additional allowances would be allocated and the beneficiaries pay a price below the market value. In both situations, the advantages seem difficult to justify. Therefore, the Commission at this stage and on the basis of the currently available information cannot exclude that State aid involved in the allocations to these sectors may partially be found incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.

- (10) In addition, pursuant to criterion 5 of Annex III to the Directive, the Commission has examined the methodology by which Italy intends to allocate allowances to installations in the energy sector. The Commission notes that the intended allocations discriminate between various types of installations, the fuels used, and whether or not installations benefit from incentives deriving from the so-called CIP/6-status. In addition, only part of the allocations to coal-fired power plants is allocated "by payment" instead of for free. It is, however, not clear to which extent the differentiation can be justified by environmental considerations and whether undue advantages to certain installations are entirely excluded. Therefore, the Commission at this stage and on the basis of the currently available information cannot exclude that State aid involved in the allocations may partially be found incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.
- (11) Pursuant to criterion 5 of Annex III to the Directive, the Commission has examined the methodology by which Italy intends to calculate allowances at installation level. In this respect, the Commission notes that the proposed methodology may well lead to an allocation beyond expected needs to those installations that have highest energy efficiency, that have carried out early actions to reduce emissions and have most strongly expanded production over the past years. The indexes that are applied in the allocation formula, in particular when positive outcomes cumulate for the same installation, may well exceed expected sector growth. The wish to encourage early action, the use of renewable resources of energy and co-generation may justify a certain differentiation of allocations, but it cannot justify allocations to installations going beyond their expected needs. Therefore, the Commission at this stage and on the basis of the currently available information cannot exclude that State aid involved in these allocations may partially be found incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.
- (12) Pursuant to criterion 6 of Annex III to the Directive, the plan shall contain information on the manner in which new entrants will be able to begin participating in the Community scheme. The Commission notes, in particular, that Italy, instead of specifying the necessary information in the plan, still intends to issue a regulation defining the detailed procedures for new entrants and closures, and that the plan does not contain provisions on the use of allowances left over in the new entrants' reserve at the end of the trading period. This contravenes criterion 6 because the information contained is insufficient to assess whether the other criteria of Annex III to the Directive and Article 10 thereof are respected.
- (13) The list of installations set out in the national allocation plan is incomplete and therefore contravenes criterion 10 of Annex III to the Directive since it does not

include all relevant combustion installations, as outlined in the Commission's further guidance for the second trading period¹¹.

- (14) The term “combustion” is used in a wide range of Community legislation including not only the Emissions Trading Directive and the IPPC-Directive¹², but also the LCP-Directive¹³ and the Sulphur in Liquid Fuels-Directive¹⁴. The meaning of combustion in the context of the Emissions Trading Directive has to be interpreted within the framework of other Community legislation where definitions are included. The Sulphur in Liquid Fuels-Directive in its Article 2(5) and the LCP-Directive in its Article 2(7) define ‘combustion plant’ as “any technical apparatus in which fuels are oxidised in order to use the heat thus generated”. The LCP-Directive lists in the same Article a range of combustion plants which are specifically excluded from the scope of the LCP-Directive. The Emissions Trading Directive does not provide for such exclusion¹⁵. Given that the Emissions Trading Directive makes no similar specific exclusions, the types of combustion installations excluded by Article 2(7) of the LCP-Directive are included within the scope of the Emissions Trading Directive where the threshold is met or exceeded.
- (15) Support for this interpretation comes also from Annex I to the Emissions Trading Directive itself. Annex I specifically excludes municipal and hazardous waste incineration facilities from the scope of the scheme. The combustion of e.g. hazardous waste is clearly an integrated part of the normal process undertaken by hazardous waste incinerators. If, in the absence of this specific exclusion, the Directive were to be interpreted as not applying to such installations where combustion takes place as an integrated part of the installation’s processes, municipal and hazardous waste installations would not need to have been specifically excluded as they would in any case have fallen outside its scope. Their specific exclusion is further confirmation that it is the presence of a combustion process with a rated thermal input exceeding 20MW that determines the Directive’s coverage of stationary combustion installations.
- (16) It is also commonly accepted that the term “combustion installation” for the purposes of the IPPC-Directive covers not just the power generation industry but also other industries where fuels are burned. Thus the heading “Energy industries” in the context of the IPPC Directive does not imply a narrow restriction of coverage of the term “combustion installations” to combustion processes that produce energy independently, but rather also includes combustion processes taking place as an

¹¹ COM(2005)703 final, chapter 4.1. (points 34 to 36) and Annex 8 thereto.

¹² Directive 96/61/EC of the Council of 24 September 1996 concerning integrated pollution prevention and control, OJ L 257, 10.10.1996, p. 26, as amended by Directive 2003/35/EC of the European Parliament and of the Council of 26 May 2003, OJ L 156, 25.6.2003, p. 17, Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003, OJ L 275, 25.10.2003, p. 32, and Regulation (EC) No 1882/2003 of the European Parliament and of the Council of 29 September 2003, OJ L 284, 31.10.2003, p. 1.

¹³ Directive 2001/80/EC on the limitation of emissions of certain pollutants into the air from large combustion plants, OJ L 309, 27.11.2001, p. 1.

¹⁴ Directive 1999/32/EC relating to a reduction in the sulphur content of certain liquid fuels, OJ L 121, 11.05.1999, p. 13.

¹⁵ Certain activities that are specifically excluded by the LCP-Directive are also excluded from the Emissions Trading Directive, such as “(h) any technical apparatus used in the propulsion of a vehicle, ship or aircraft” because the Emissions Trading Directive only applies to stationary technical units (Article 3(e)). The Emissions Trading Directive therefore covers neither transportation in general nor greenhouse gas emissions arising from traffic on the site of an installation.

integrated part of another production process. The heading “Energy activities” used in the Emissions Trading Directive, if anything, would be broader, so at least the same conclusion would apply. This therefore provides additional support for the argument that “combustion installations” in the Emissions Trading Directive not only covers combustion installations that are part of the energy industry, but also combustion installations in other industry sectors, including sectors that are not explicitly listed in its Annex I.

- (17) It is well-established that industries can fall under more than one activity category of the IPPC-Directive. Integrated steel works for example carry out several Annex I activities, and refineries include combustion installations of more than 50MW. Considering the similarities between the IPPC-Directive and the Emissions Trading Directive, there is no reason to take a different approach to the interpretation of the latter in this respect. In particular, a different approach cannot be justified by the separate listing of the steel and cement industries, given that both produce substantial CO₂ emissions from (chemical) processes in addition to their emissions from combustion.
- (18) Therefore, the Commission considers all combustion processes, i.e. those involving oxidation of fuels, fulfilling the specified capacity to be subject to the Directive. More specifically, any installation, which includes one or more piece of stationary technical apparatus in which a combustion process takes place and that together on the same site and under the responsibility of the same operator has a rated thermal input exceeding 20MW, is covered by Annex I to the Directive. This includes apparatus where the heat is used in another piece of apparatus, through a medium such as electricity or steam, and apparatus where the heat resulting from combustion is used directly within that apparatus, for example, for melting, drying, flares or units providing heat input to chemical reactors. The purpose to which the product of an activity is put should not be a determining characteristic as to whether or not an installation is subject to the Directive, as this would introduce subjectivity into its scope. Energy produced by combustion may be in the form of electricity, heat, hot water or steam, and the distance between the production of energy and its eventual use is not relevant for competent authorities to decide whether or not an installation is subject to the Directive.
- (19) However, considering the on-going process related to the review of the Directive pursuant to its Article 30, the Commission recognises that it is not useful at this stage to enforce in the second trading period against the expressed will of a Member State the inclusion of additional combustion processes which are typically carried out by smaller installations. Therefore, Member States must in any case include only combustion processes typically carried out in larger installations causing considerable emissions. As stated in point 36 of its further guidance for the second trading period¹⁶, combustion processes involving crackers, carbon black, flaring¹⁷, furnaces¹⁸ and integrated steelworks¹⁹ have been identified by the Commission, in close collaboration with Member States in the Climate Change Committee, as being typically carried out in larger installations causing considerable emissions. The Climate Change Committee

¹⁶ COM(2005)703 final.

¹⁷ Including off-shore.

¹⁸ Including rock wool.

¹⁹ Including rolling mills, re-heaters, annealing furnaces and pickling.

has elaborated and endorsed more concrete definitions of these activities mentioned in the Commission's further guidance²⁰ to ensure a consistent application throughout the entire Community scheme.

- (20) Contrary to that, Italy proposes in its plan to apply a scope, which is more narrow and therefore in contravention of criterion 10, since the list of installations of its plan does not include all installations to be covered under the Community scheme. Consequently, Italy is required to include in its national allocation plan all additional installations carrying out combustion processes involving the categories mentioned above and list these installations concerned in the plan with the quantities of allowances intended to be allocated to each. Accordingly, Italy must amend its plan by including the additional combustion installations concerned and by correspondingly increasing the average annual total quantity in respect of allocations to these additional combustion installations. Allocations to these installations need to take place in accordance with the general methodologies stated in the national allocation plan and must be based on substantiated and verified emissions of these installations.
- (21) The intention of Italy to adjust the allocation of allowances to installations listed in the national allocation plan and operating in its territory in the events of a physical extension of the network of a CHP²¹ installation causing an increase of emissions of more than 10%²², of a "restart of operation from closure/suspension 2nd period"²³, of a "partial interruption of services"²⁴, of a "partial temporary suspension of services"²⁵ and, to the extent that the operator may maintain part of the allocated allowances, of a "closure due to processes of production rationalisation"²⁶ 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.
- (22) Such so-called 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.

²⁰ "Co-ordinated definitions" of additional combustion installations contained in the minutes of the Climate Change Committee of 31 May 2006.

²¹ Abbreviation for "combined heat and power".

²² Chapter 6.2.1.2 of the plan, second last paragraph.

²³ Chapter 6.2.3 of the plan.

²⁴ Chapter 6.6 of the plan, point a) relating to partial closures.

²⁵ Chapter 6.6 of the plan, point b) relating to partial closures.

²⁶ Chapter 6.7 of the plan, first paragraph.

- (23) 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 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.
- (24) 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 of that same installation 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.
- (25) Pursuant to criterion 12 of Annex III to the Directive, the Commission has assessed the maximum amount of CERs and ERUs which may be used by operators in the Community scheme as a percentage of the allocation of the allowances to each installation that is consistent with Italy's supplementarity obligations under the Kyoto Protocol and decisions adopted pursuant to the UNFCCC or the Kyoto Protocol. Decision 2/CMP.1²⁷ requires that use of the mechanisms be supplemental to domestic action, with a view to narrowing per capita differences in emissions between developed and developing countries. In order to obtain a quantified figure for supplementarity, the Commission applies a formula which takes into account the effort undertaken by each Member State, which is expressed in terms of the difference between actual emissions and the absolute Kyoto commitment, and the intended government purchase of Kyoto units to the extent that it is sufficiently substantiated. The effort undertaken by each Member State is calculated by taking the highest figure out of the following three conceivable alternatives: deducting the absolute Kyoto commitment from, first, total base year greenhouse gas emissions; second, the most recent total greenhouse gas emissions, i.e. the year 2004; or, third, projected 2010 total greenhouse gas emissions, representing the average actual emissions in the first Kyoto commitment period. The Commission holds that the notion of supplementarity implies in any event that use by operators may not lead to a situation where more than half of the effort undertaken by a Member State, taking into account government purchase, is made through Kyoto flexible mechanisms. In order to ensure this, the Commission divides the effort undertaken by each Member State by a factor of two and calculates the permitted maximum absolute amount for use by operators by deducting the volume of substantiated government purchases from this figure. Finally, the respective relative figure is obtained by dividing the permitted maximum absolute amount by the allowed total quantity of allowances.

²⁷ Decision 2/CMP.1 of the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol "Principles, nature and scope of the mechanisms pursuant to Articles 6, 12 and 17 of the Kyoto Protocol" of December 2005, FCCC/KP/CMP/2005/8/Add. 1, page 4.

- (26) In application of this method, the effort undertaken by Italy is 96.67 million tonnes²⁸. Taking into account that all of Italy's intended government purchases of Kyoto flexible mechanisms can be recognised as sufficiently substantiated, the total envisaged volume of 19 million tonnes needs to be deducted from 50% of the effort undertaken, i.e. 48.34 million tonnes. This gives the figure of 29.34 million tonnes, which constitutes the maximum absolute amount for operators' use per year permitted for Italy. The relative maximum figure for use by operators is obtained by dividing the absolute amount by the total quantity of allowances of 195.746486 million tonnes allowed under this Decision, which gives 14.989%²⁹. Consequently, the maximum amount of CERs and ERUs of 25%, as indicated in Italy's national allocation plan, which may be used by operators in the Community scheme as a percentage of the allocation of the allowances to each installation is inconsistent with Italy's supplementarity obligations under the Kyoto Protocol and decisions adopted pursuant to the UNFCCC or the Kyoto Protocol, to the extent that it exceeds 14.989%.
- (27) 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 Italy as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay. Were Italy 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 recitals 9, 10 and 11, 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.
- (28) 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.
- (29) 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.
- (30) 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

²⁸ Italy's Kyoto commitment, expressed in absolute figures, is 485.83 million tonnes. Base year emissions are 519.6 million tonnes, 2004 emissions are 582.5 million tonnes and 2010 projected emissions with existing policies and measures are 580.4 million tonnes according to the Progress Report COM(2006)658 final of 27 October 2006, Tables 1 and 2 in the Annex SEC(2006) 1412 of 27 October 2006. The 2004 emissions figure being the highest of these three alternatives, the relevant effort with respect to the Kyoto commitment is 96.67 million tonnes. Dividing this effort by two gives 48.34 million tonnes, representing the maximum absolute amount, up to which Italy's operators may use CERs and ERUs, unless it is used up by sufficiently substantiated government purchases.

²⁹ 29.34/195.746486

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.

- (31) 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.
- (32) 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 plan³⁰. 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 Italy for the first five-year period mentioned in Article 11(2) of the Directive are incompatible respectively with:

1. criterion 1 of Annex III to the Directive: the part of the intended total quantity of allowances related to Italy's intended use of policies and measures that is insufficiently substantiated in relation to Italy achieving its commitment under Decision 2002/358/EC, amounting to the equivalent of on average 13.253514 million tonnes per year;
2. criterion 6 of Annex III to the Directive: the information on the manner in which new entrants will be able to begin participating in the Community scheme;

³⁰ 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; 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.

3. criterion 10 of Annex III to the Directive: the lack of a complete list of installations covered by the Directive in Italy with respect to additional combustion installations, to which the Directive applies, in particular those carrying out combustion processes involving crackers, carbon black, flaring³¹, furnaces³² and integrated steelworks³³, including the quantities of allowances intended to be allocated to each installation concerned; correspondingly, the annual average total quantity of allowances may be increased in respect of emissions of such combustion installations, to the extent that this is justified in accordance with the general methodologies stated in the national allocation plan and on the basis of substantiated and verified emissions of these installations;
4. criterion 10 of Annex III to the Directive: the intention of Italy to adjust the allocation of allowances to an installation listed in the national allocation plan and operating in its territory in the events of a physical extension of the network of a CHP installation causing an increase of emissions of more than 10%, of a "restart of operation from closure/suspension 2nd period", of a "partial interruption of services", of a "partial temporary suspension of services" and, to the extent that the operator may maintain part of the allocated allowances, of a "closure due to processes of production rationalisation";
5. criterion 12 of Annex III to the Directive: the maximum overall amount of CERs and ERUs of 25% which may be used by operators in the Community scheme as a percentage of the allocation of the allowances to each installation that is inconsistent with Italy' supplementarity obligations under the Kyoto Protocol and decisions adopted pursuant to the UNFCCC or the Kyoto Protocol, to the extent that it exceeds 14.989%.

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 13.253514 million tonnes CO₂ equivalent of allowances per year;
2. information is provided on the manner in which new entrants will be able to begin participating in the Community scheme, in a way that complies with the criteria of Annex III to the Directive and Article 10 thereof;
3. a complete list of all installations covered by the Directive in Italy, including additional combustion installations carrying out combustion processes involving crackers, carbon black, flaring³⁴, furnaces³⁵ and integrated steelworks³⁶, is provided

³¹ Including off-shore.

³² Including rock wool.

³³ Including rolling mills, re-heaters, annealing furnaces and pickling.

³⁴ Including off-shore.

³⁵ Including rock wool.

³⁶ Including rolling mills, re-heaters, annealing furnaces and pickling.

with the quantities of allowances intended to be allocated to each installation; correspondingly, the total quantity of allowances may be increased in respect of emissions of such additional combustion installations, to the extent that this is justified in accordance with the general methodologies stated in the national allocation plan and on the basis of substantiated and verified emissions of these installations;

4. the quantity of allowances allocated to an installation that is listed in the national allocation plan and operating in its territory is not subject to adjustments in the events of a physical extension of the network of a CHP installation causing an increase of emissions of more than 10%, of a "restart of operation from closure/suspension 2nd period", of a "partial interruption of services", of a "partial temporary suspension of services" and, to the extent that the operator may maintain part of the allocated allowances, of a "closure due to processes of production rationalisation";
5. the overall maximum amount of CERs and ERUs which may be used by operators in the Community scheme as a percentage of the allocation of the allowances to each installation is reduced to no more than 14.989%.

Article 3

1. The total average annual quantity of allowances of 195.746486 million tonnes, increased by the annual average total quantity in respect of emissions of additional combustion installations carrying out combustion processes involving crackers, carbon black, flaring³⁷, furnaces³⁸ and integrated steelworks³⁹, to the extent that this is justified in accordance with the general methodologies stated in the national allocation plan and on the basis of substantiated and verified emissions of these installations, to be allocated by Italy 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.

³⁷ Including off-shore.

³⁸ Including rock wool.

³⁹ Including rolling mills, re-heaters, annealing furnaces and pickling.

Article 4

This Decision is addressed to the Italian Republic.

Done at Brussels, 15 May 2007

For the Commission