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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 18.7.2007

COMMISSION DECISION

of 18 July 2007

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

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(Only the Greek 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 Cyprus 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 11 October 2006 and registered by the Commission on 13 October 2006. Cyprus requested an extension of the deadline set in the Commission's question letter and submitted additional information on the notified plan by letters dated 12 and 18 December 2006, respectively registered on 21 December 2006 and 5 January 2007, in reply to questions from the Commission, and submitted further information on the notified plan by letter dated 12 January 2007, registered on 15 January 2007. After withdrawing its original plan by letter of 15 January 2007, Cyprus notified a revised version of the plan by letter of 27 February 2006, registered on 8 March 2007, and submitted additional information on the plan by letters dated 22 May 2007, registered on 25 May 2007, in reply to questions from the Commission.
- (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

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.

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 avoiding undue distortions of competition. The Committee noted with great concern that the proposed cap by far exceeds 2005 verified emissions. The Committee called on the Commission to scrutinise projections, including those underlying the business-as-usual scenario, and assumptions outlined in the plan so as to ensure that installations are not allocated more allowances than needed. The Committee urged the Commission to make certain that no ex-post adjustments will be made to allocations to installations and also to ensure in its assessment that the scope with respect to additional combustion installations is followed by Cyprus. The Committee called on the Commission to scrutinise the reasons why Cyprus is not going to establish a double counting set-aside despite the fact that it has already approved at least one CDM project. The views of the Climate Change Committee have been taken into account.

- (3) The national allocation plan, including the annual average total quantity of allowances of 7.121498 million tonnes CO₂ equivalent (hereinafter "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 criteria³. Certain aspects of the national allocation plan have been found incompatible with those criteria, and in particular with criteria 1, 2, 3, 6 and 10 in Annex III to the Directive.
- (4) The national allocation plan contravenes criteria 1, 2 and 3 of Annex III to the Directive because the total quantity of allowances intended to be allocated is more than would be consistent with assessments of actual and projected progress made pursuant to Decision 280/2004/EC and more than would be consistent with the potential, including the technological potential, of activities covered by the Community scheme to reduce emissions. Criteria 2 and 3 provide for a methodology using the most representative emissions figures, taking into account economic growth and carbon intensity improvements. Pursuant to criterion 1, the total quantity of allowances to be allocated shall not be more than is likely to be needed for the strict application of the criteria of Annex III.
- (5) With respect to criterion 2, in the Commission's most recent assessment⁴ made pursuant to Decision 280/2004/EC, the actual greenhouse gas emissions of the sectors covered by the Community Scheme in Cyprus in 2005 are reported as 5.1 million tonnes⁵. These emission figures are the most reliable and accurate emissions figures

³ 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).

⁴ COM(2006)658 final of 27 October 2006 and Annex SEC(2006)1412 of 27 October 2006.

⁵ Chapter 3.3. of COM(2006)658 final of 27 October 2006 and Table 5 in the Annex SEC(2006)1412 of 27 October 2006. The exact figure is 5.078879 million tonnes. The publication of 2006 verified emissions figures in May 2007 shall not affect the Commission's assessment. The time horizon provided by the Directive for the assessment of national allocation plans is the second half of 2006. The deadline for notifying the plans was 30 June 2006. The final deadline foreseen by the Directive for the total quantity to be fixed by a Member State was 31 December 2006. This deadline determines the end of the relevant time horizon for the use of the relevant emissions data. In addition, the EU ETS is a common system for all Member States. This creates a need to treat all Member States equally for the Commission's assessment of second phase national allocation plans in order to avoid undue distortions

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 Cyprus 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 Cyprus in the Community scheme in the phase 2005 to 2007. Emissions figures given by Cyprus 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 Cyprus in the Community scheme, and thus they are less reliable. Therefore, it cannot be excluded that emissions figures reported by Cyprus 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 Cyprus, would be likely not to truly represent actual emissions and would not ensure that overall allocation would not 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 Cyprus in line with the Commission's guidance⁶.

- (6) The Commission is aware of the opinion brought forward by some Member States, but not endorsed by the Climate Change Committee, in favour of averaging independently verified emissions figures with Member States' estimates of emissions over other years in order to smooth out singular events in one particular year. However, in each year there are several factors, including weather patterns, influencing aggregate emissions that generally balance each other out over one year in their effects on total annual emissions. The Commission has examined the availability and quality of other data concerning emissions and energy use prior to 2005. The Commission does not have sufficient indications that a clear majority of exceptional circumstances manifestly pointed in one direction in 2005 and that therefore 2005 verified emissions figures cannot be regarded as representative. Consequently, the Commission considers that there are no sufficient reasons with respect to Cyprus to adjust independently verified emissions figures for 2005, taking into account, amongst others, that the Cypriot electricity generating sector does not rely on hydro-electric power, which is dependent on precipitation.
- (7) The Commission underlines that this approach is also compatible with the Commission's guidance that allocations to individual installations should not be based on changes in the emissions of those installations within the first phase⁷. 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

as much as possible. Equal treatment is in particular ensured by using the same time horizon for the assessment of verified emissions figures. Using other data for the few remaining decisions adopted after 15 May 2007 would create unequal treatment with respect to the majority of Member States already decided upon, which notified and/or completed their plans in better respect of the timelines provided by the Directive. Thus the Commission continues to make use of the 2005 verified emissions figures.

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

⁷ Chapter 3.7, point 27 of COM(2005)703 final.

allocations, but not the total quantity of allowances, as is clear from the heading of the relevant chapter⁸.

- (8) With respect to criterion 3, the Commission notes that for a national allocation plan to be consistent with the potential, including the technological potential, of activities covered by the scheme to reduce emissions requires a rigorous assessment of total allocations in accordance in particular with projections of economic growth and improvements in carbon intensity⁹. The Commission has assessed the figures at its disposal, including those in the public domain, with a view to calculating Cyprus'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 2005 verified figures to 2010. The Commission considers 2010 to constitute a representative average of the relevant five-year period from 2008 to 2012 because 2010 is the year in the middle of this period and, in the Commission's view, it is appropriate from an *ex-ante*-perspective to assume a linear trend over this five-year period. The resulting figures are compared with Cyprus's proposed allocation so as to determine to what extent it is in line with criterion 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 Cyprus in line with the Commission's further guidance¹⁰. Of all data at its disposal, including those in the public domain, the Commission considers the data indicated in the PRIMES model¹¹ as the most accurate and reliable estimations of both GDP growth¹² and carbon intensity improvement rates. The PRIMES model has been used

⁸ Chapter 3.7, point 28 of COM(2005)703 final.

⁹ See in particular point 11 of COM(2005) 703 final.

¹⁰ 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.

¹¹ 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/>.

¹² The GDP growth assumptions are based on the Commission's Economic and Financial Affairs Directorate-General's forecasts of April 2005 for the short term (2004-2006) as well as the long term (2005-2030). More specifically, short terms fore-casts are taken from European Commission Economic Forecasts, Spring 2005 (EUROPEAN ECONOMY. No. 2/ 2005. Office for Official Publications of the EC.ISBN92-894-8881-6), also published on the website: http://europa.eu.int/comm/economy_finance/publications/european_economy/2005/ee205en.pdf. Long-term forecasts are taken from European Commission, DG-ECFIN "Long Run Labour Productivity and

for analysis of energy and climate policy for a long time and the baseline assumptions¹³ are updated on a regular basis to reflect the most likely future trend. Furthermore, baseline assumptions are validated with the involvement of experts from Member States. The most recently 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.

- (9) The PRIMES model has been concretely applied on the basis of a coherent set of assumptions and methodologies for the publication "*European Energy and Transport Trends*" of the Commission's Directorate-General for Transport and Energy¹⁴ and for the publication of its Environment Directorate-General containing the calculation of baseline scenarios for the revision of the National Emission Ceilings Directive¹⁵. The figures for GDP and 2005 carbon intensity are identical in both publications, while for 2010 the figure for carbon intensity¹⁶ differs¹⁷. Where there is a low carbon constraint instead of an even less stringent one, carbon intensity will improve more over time due to the stronger incentive for operators to reduce emissions.
- (10) The introduction of the Community scheme in 2005 and the strong commitments by the EU and Member States to combat climate change provide a clear and sustained signal to installations covered by the Community scheme that there is an economic cost to emitting greenhouse gases, which will become even more important in the future. This reinforces long-term economic incentives to reduce emissions. As a consequence, carbon intensity will improve over time at least at a rate as indicated in the "low carbon constraint / no CCS"-case¹⁸.

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.

¹³ Examples for baseline assumptions are future developments in population, fuel prices, etc.

¹⁴ 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

¹⁵ 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>

¹⁶ "Carbon intensity" can be defined in various ways and is for the purpose of this Decision understood as the relationship between CO₂ emissions and a unit of GDP (see below for precise definition).

¹⁷ 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.

¹⁸ 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 "CO₂ emissions to GDP (t of CO₂/MEUR'00)", which the Commission considers the adequate expression of carbon intensity for its assessment, are indicated in the second last row.

- (11) The Commission considers that this level of carbon intensity improvement does not appropriately reflect most likely future trends because it does not take account of all relevant factors, including recent developments. In addition to the economic incentives created by the Community scheme, operators will be likely to increasingly invest in energy efficient technologies in order to lower their fuel and electricity costs. Moreover, they will increasingly be encouraged by policies and measures of the EU and Member States as well as public opinion to accelerate efforts with regard to innovation in energy saving production methods and thus take effective action against climate change. At EU level, collective efforts to reduce dependency of energy imports as well as measures identified in the new Energy Efficiency Action Plan¹⁹ with a view to realising the EU's energy saving potential, will further spur efforts to achieve better energy efficiencies, reducing in general also carbon intensity.
- (12) The Commission considers that the combined effect of reinforced energy efficiency measures identified in the Energy Efficiency Action Plan and the existence of a carbon constraint due to the Community scheme will lead to an annual improvement rate in 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%²⁰, the Commission considers that the magnitude and importance of additional measures identified in the new Energy Efficiency Action Plan justifies in principle assuming a similar quantitative effect for the latter. Recognising however the potential partial overlaps between both policy instruments and also that not all the measures identified in the Energy Efficiency Action Plan may be fully implemented by 2010, the Commission considers that the corresponding additional average annual rate for carbon intensity improvements should be adjusted downwards. More specifically, in order to exclude any potential overestimation of the total effects, the Commission takes 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%²¹ over the entire period from 2005 to 2010 compared to the "low carbon constraint"-case. Therefore, in order to appropriately reflect reality, the Commission considers it necessary to base the assessment under criterion 3 in Annex III to the Directive on a rate of carbon intensity improvement exceeding the "low carbon constraint"-case by 2.5% during the five-year period from 2005 to 2010.
- (13) In the light of the above, the following table indicates the data for the developments from 2005 to 2010 of both GDP and carbon intensity in Cyprus in absolute terms. The corresponding relative development factors and growth rates from 2005 to 2010 are also indicated:

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

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

²¹ $1.005^{5}=1.02525$, which corresponds to 2.5% (after rounding).

Calculation element	2005	2010	Relative development factor 2005-2010	Growth rate 2005-2010
GDP ²²	11.5	14.007 ²³	1.218000 ²⁴	21.8000% ²⁵
Carbon intensity ²⁶	641.8	583.1		
Carbon intensity with additional improvement of 2.5 %		568.522 ²⁷	0.885825 ²⁸	-11.4174% ²⁹

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 Cyprus 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 figure³⁰ 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 Cyprus in line with the Commission's guidance:

²² This figure is expressed in thousand million Euro value year 2000.

²³ 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.

The publication of the spring economic forecasts of its Economic and Financial Affairs Directorate-General on 7 May 2007 shall not affect the Commission's assessment. The time horizon provided by the Directive for the assessment of national allocation plans is the second half of 2006. The deadline for notifying the plans was 30 June 2006. The final deadline foreseen by the Directive for the total quantity to be fixed by a Member State was 31 December 2006. This deadline determines the end of the relevant time horizon for the use of economic growth projections. In addition, the EU ETS is a common system for all Member States. This creates a need to treat all Member States equally for the Commission's assessment of second phase national allocation plans in order to avoid undue distortions as much as possible. Equal treatment is in particular ensured by using the same time horizon for the establishment of GDP growth forecasts. Using this data for the few remaining decisions adopted after 7 May 2007 would create unequal treatment with respect to the majority of Member States already decided upon, which notified and/or completed their plans in better respect of the timelines provided by the Directive. Thus the Commission continues to make use of the GDP growth data released in November 2006. In order to take into account the 2006 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. $(14.2/11.5)^{(1/5)}$, which gives 1.043081. 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. 75 therein), i.e. the years 2006 (factor of 1.038), 2007 (factor of 1.038) and 2008 (1.039). 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. $1.038*1.038*1.039*1.043081*1.043081$.

²⁴ $14.007/11.5$

²⁵ $((14.007/11.5)-1)\%$

²⁶ This figure is expressed in terms of CO₂ Emissions to GDP (tonne of CO₂/million Euro value year 2000).

²⁷ $(583.1*(1-0.025))$

²⁸ $(583.1*(1-0.025))/641.8$

²⁹ $((583.1*(1-0.025))/641.8)-1)\%$

³⁰ As all installations in Cyprus have been verified in 2005, there is no need for a correction factor.

Calculation of the annual excess allocation for the period from 2008 to 2012 (all figures in million tonnes CO ₂ 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
5.078879	5.479780 ³¹	5.479780 ³²	7.121498	1.641718 ³³

Accordingly, given that in the years 2008 to 2012 proposed allocations exceed emissions taking into account GDP growth, carbon-intensity improvements and the effect from the increase in scope as indicated in the table, the Commission finds that the annual average excess allocation by Cyprus in the period 2008 to 2012 amounts to 1.641718 million tonnes, which contravenes criteria 1, 2 and 3.

- (14) 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.
- (15) The Commission takes also note of the government of Cyprus' intention to increase desalination. Electricity demand from such plants is part of the overall electricity consumption for the tertiary sector in the PRIMES model and any increase is taken into account by means of the aggregated GDP growth and carbon intensity development factors. The Commission notes that the impacts of these plants on electricity demand, expected carbon intensity and GDP growth trend development are at the most marginal. There are continuous developments of a similar nature in all sectors and Member States, which go in both directions - increasing or decreasing emissions - and overall balance each other out. Consequently, the Commission considers the 2005 PRIMES baseline scenario as representative and does not consider it justified to increase the total quantity of allowances resulting from the strict application of criteria 1, 2 and 3 beyond what it is already projected by the application of the above indicated methodology of the Commission.
- (16) Pursuant to criterion 5 of Annex III to the Directive, the Commission has also examined compliance of the national allocation plan of Cyprus 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

³¹ 5.078877*1.218000*0.885825

³² 5.078877*1.218000*0.885825

³³ 7.121498-(5.078877*1.218000*0.885825)

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 the number of EU allowances granted to industry. 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 Cyprus, the Commission at this stage cannot consider with certainty that any potential aid granted under the national allocation plan is consistent with and is necessary to achieve the overall environmental objective of the Directive. Non-compliance with criteria 1, 2 and 3 fundamentally jeopardises the overall environmental objective of the emission trading scheme. The Commission considers that in such a case the environmental benefit of any aid included in the allowances may not be sufficient to outweigh the distortion of competition referred to above. The Commission notes in particular that an allocation exceeding projected emissions will not require beneficiaries to deliver an environmental counterpart for the benefit they receive. The Commission at this stage therefore cannot exclude that any aid involved would be found incompatible with the common market should it be assessed in accordance with Articles 87 and 88 of the Treaty.

- (17) 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 that the methodology used to allocate to new entrants remains intransparent as it does not explain consistently which allocation criteria are applied, in particular on which capacity use allocation is based and which best-available technologies are used. 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.
- (18) The intention of Cyprus to adjust the allocation of allowances to an installation listed in the national allocation plan and operating in its territory in the event of partial or temporary closure of an installation 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. The Commission therefore finds that the elements on partial and temporary closures, which contain provisions for ex-post adjustments are in contravention to criterion 10 in Annex III to the Directive.
- (19) 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) 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.
- (21) The Directive allows only for two adjustments following the decision referred to in its Article 11(2) where such retroactive change does not occur or does not have a detrimental impact on the functioning of the Community scheme: firstly, where an installation is closed during the trading period, that Member States determine that there is no longer an operator to whom allowances will be issued; and, secondly, where allocation takes place to new entrants from the reserve, that Member States determine the exact allocation to each new entrant.
- (22) 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 Cyprus as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay. Were Cyprus to amend its national allocation plan in a non-discriminatory manner in accordance with Article 2 of this Decision, 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.
- (23) 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.
- (24) 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.
- (25) 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.

- (26) The whole procedure comprising the notification to, consideration 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.
- (27) 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 plan³⁴. 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 Cyprus for the first five-year period mentioned in Article 11(2) of the Directive are incompatible respectively with:

1. criteria 1, 2 and 3 of Annex III to the Directive: the part of the intended total quantity of allowances, amounting to 1.641718 million tonnes CO₂ 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;
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;

³⁴ 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 intention of Cyprus to adjust the allocation of allowances to an installation listed in the national allocation plan and operating in its territory in the event of partial or temporary closure of an installation.

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 the sum of 1.641718 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. 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 event of partial or temporary closure of an installation.

Article 3

1. The annual average total quantity of allowances of 5.479780 million tonnes to be allocated by Cyprus 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 amendments of the national allocation plan made to correct the incompatibilities indicated in Article 1 of this Decision but deviating from those referred to in Article 2 must be notified as soon as possible, taking into account the time-scale necessary to carry out the national procedures without undue delay, and require prior acceptance by the Commission pursuant to Article 9(3) of the Directive. Any other amendments of the national allocation plan, apart from those made to comply with Article 2 of this Decision, are inadmissible.

Article 4

This Decision is addressed to the Republic of Cyprus.

Done at Brussels, 18 July 2007

For the Commission