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NOTE

From:	The Presidency
To:	Permanent Representatives Committee/Council
Subject:	Fit for 55 package a) Revision of Directive (EU) 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading to implement the ambition of the new 2030 climate target and related proposals (ETS) b) Revision of Regulation (EU) 2018/842 on binding annual greenhouse gas emission reductions by Member States from 2021 to 2030 (ESR) c) Revision of Regulation (EU) 2018/841 on greenhouse gas emissions and removals from land use, land use change and forestry (LULUCF) d) Revision of Regulation (EU) 2019/631 setting CO_2 emission performance standards for new passenger cars and for new light commercial vehicles e) Regulation establishing a Social Climate Fund – Policy debate

1. To guide the above discussion, which will take place during the next meeting of the Council (Environment) on 17 March 2022, the Presidency has prepared a note with two questions, as set out in the Annex to this note.

2. The Permanent Representatives Committee is invited to take note of the Presidency's note and questions, and to forward them to the Council for the abovementioned policy debate.

ANNEX

Fit for 55 package

- Presidency note -

CONTEXT

On 14 July 2021, the Commission published the first part of the Fit for 55 package, which it supplemented on 14 December 2021 with a second part comprising three files relating to energy.

The Environment Council, the Transport Council and the Energy Council examined the package proposals under their remit during their December meetings.

The Slovenian Presidency published a progress report on the entire Fit for 55 package on 22 November 2021 (13977/21), which focuses on the horizontal aspects of the package and highlights the main issues raised during the discussions at that time. In this report, the Slovenian Presidency noted that work on most of the files was still at a preliminary stage, in particular due to the scale and complexity of the proposals and their political significance. Due to the diverse nature of the proposals, discussions had not progressed at the same pace on all files. It appears that more progress has been made on some of the transport and energy proposals under the first part of the package than on the files within the remit of the Environment and ECOFIN Councils.

NEXT STEPS

The Presidency has stated its intention to continue the technical work in the working parties before the end of the first quarter, to propose, as soon as possible, revised versions of each text, to address as many technical matters as possible at working party level, and to identify possible solutions to the issues of a more political nature.

In this context, the purpose of this note is to identify, for the five texts within the remit of the Environment Council: the points on which progress has been made in the technical work carried out within the working parties, allowing compromises to be quickly identified; the points on which work is ongoing, but it seems advisable to continue the technical exchanges within the working parties in order to move towards compromises; and the points of a more political nature for which trade-offs may be necessary.

1. ETS Directive (EU Emissions Trading System)

The Presidency has continued to examine the revision of the ETS Directive and related texts (Market Stability Reserve Decision, Shipping MRV Regulation). This work has allowed progress to be achieved on a number of mainly technical issues and preparations to be made for discussions on certain topics of a more political nature.

As regards the application of the ETS to stationary installations, the Presidency has noted that progress has been made on certain technical aspects of the Commission proposal. There has thus been broad support from delegations for a number of provisions concerning the Market Stability Reserve (correction of threshold effects, inclusion of aviation and maritime transport emissions) and non-financial aspects relating to the Innovation and Modernisation Funds (list of priority investments supported by the Modernisation Fund, increase in the percentage of the Modernisation Fund devoted to these priority investments).

Other provisions concerning free allocation, such as an increase in the maximum annual reduction rate for benchmark values, were supported by a majority of delegations, in particular with the goal - shared by the majority of delegations - of avoiding triggering the cross-sectoral correction factor. Many delegations indicated that they could support the Commission's proposals regarding keeping installations under 20 MW in the ETS, as well as the biomass emissions threshold of 95 % for excluding these from the ETS. Similarly, many delegations welcomed the Presidency's proposals to increase the transparency and effectiveness of the governance of the Modernisation and Innovation Funds. However, some delegations still had doubts about the conditionality of free allocation. Further technical discussions on these provisions will be needed.

The Presidency has also identified a number of matters of a more political nature which will require further scrutiny, in particular as regards the parameters relating to the ceiling and the market stability reserve, the intervention mechanism in the event of excessive price increases (the latter not being part of the Commission proposal, but having been the subject of several written proposals for revisions), the use of ETS revenues by the Member States, including through the Innovation Fund and the Modernisation Fund, the replenishment of those funds and the trajectory of free allocations in connection with the carbon border adjustment mechanism.

As regards the proposal to extend the ETS' application to the maritime sector, the Presidency noted broad support for the Commission proposal. The geographic scope chosen for this extension was supported by delegations.

The discussions also enabled further examination of the text at technical level, in terms of scope, the duration of the gradual introduction of maritime transport requirements, reporting and review clauses (including as regards tie-in with measures envisaged by the IMO), and the administrative implementation of the measure, including amendments to the MRV Regulation on the monitoring, reporting and verification of carbon dioxide emissions from maritime transport. Some delegations wished to discuss the definition of the regulated entity. Several delegations stressed the need to more proactively prevent and limit the risk of carbon leakage. In addition, some delegations stressed the need to support, using ETS revenues, the decarbonisation of the sector. Some delegations indicated that it was still necessary to analyse the impact of the sector's inclusion on island regions, in particular as regards transport services serving them; other delegations suggested taking into account the challenges of navigation in winter.

With regard to the ETS as applied to the aviation sector and the application of the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA), the Presidency noted broad support from delegations for the Commission proposal, in particular the proposal for a delineation between the application of the ETS to intra-European flights (including to the United Kingdom and Switzerland) and the application of CORSIA only to international flights to or from third countries. The trajectory for the abolition of free allocations proposed by the Commission was supported by many delegations; several of them considered that the abolition should be accelerated while others called for a more gradual approach. Some delegations also raised concerns about connectivity and competitiveness challenges for the sector, linked to the cumulative impact on aviation of the Fit for 55 package, while recognising the sector's responsibility to contribute its fair share.

With regard to the proposal to create a new ETS applicable to the road transport and buildings sectors, which was scrutinised at technical level in the working party on 7 February and discussed at Coreper level on 4 March, the Presidency noted significant differences of opinion on the Commission proposal at this stage of the discussions and noted that the related social, economic and financial issues had a strong political dimension. Several delegations expressed opposition or reservations at this stage regarding the Commission proposal, mainly for reasons of social acceptability, in particular for households. However, most delegations acknowledged the reality of the problem of increasing emissions in the road transport and buildings sectors.

Some delegations criticised the relevance of the mechanism for achieving the objectives of the Fit for 55 package, with some suggesting that a strengthening of the standards and objectives provided for in other texts in the package should be considered in order to achieve the EU's objective for reducing greenhouse gas emissions by 2030. Other delegations seemed to consider that the difficulty was due to the lack of sufficient financial means to support households. Finally, other delegations considered that the date of entry into force was too early or the implementation too quick.

Conversely, several delegations considered it essential to introduce a new ETS for these two sectors, in addition to existing instruments, in order to achieve the climate objectives of the Union and its Member States. They also defended the usefulness of the instrument as a revenue-generating tool. Some delegations also supported the extension of the new ETS to all fossil fuels.

2. Effort Sharing Regulation (ESR)

The French Presidency has continued to examine the revision of the Effort Sharing Regulation at technical level. The Union's new emission reduction target in sectors falling within the scope of the ESR was widely supported by delegations. The Presidency also noted delegations' overall support for keeping the scope of the Regulation unchanged, for maintaining the rules in force for annual emission allocations in 2021 and 2022, and for Malta's access to ETS flexibility being increased to 7%. The proposal to create an additional optional reserve was widely supported by delegations, although some delegations expressed doubts about its added value.

The Presidency identified a number of subjects on which technical discussions should continue in order to make progress towards a compromise text. A number of delegations stressed the need to better reflect convergence in the text with a view to achieving climate neutrality for 2050. The importance of predictability for annual emission allocations was raised by several delegations, in connection with the proposed update in 2025 of the 2026-2030 trajectory in light of the effects of the COVID-19 pandemic. As regards flexibilities, different avenues could be explored while ensuring that balance with the proposal's environmental integrity is preserved. Some delegations proposed improving the transparency of transfers of annual emission allocations between Member States. Some delegations expressed the desire to explore changes to flexibility available through the ETS, for example relaxing the conditions for the use of flexibility, and a few delegations reiterated the need to assess the impact on the ETS. Delegations expressed divergent views on the proposal to divide the flexibility available through LULUCF into two periods; this, however, seems to have a significant link to compliance with the European Climate Law as regards the maximum contribution of sinks.

In addition, several delegations expressed concerns about the level of ambition of their proposed national target, while others could accept the target proposed by the Commission.

3. <u>Regulation on Land use, Land-use Change and Forestry (LULUCF)</u>

The French Presidency has continued to examine the revision of the Regulation on Land Use, Land-use Change and Forestry at a technical level. The discussions have enabled progress on the examination of the text, clarified certain technical aspects of the proposal and examined a number of initial compromise options proposed by the Presidency. The target of 310 million tonnes of net CO_2 eq removals at EU level by 2030 was widely supported by delegations. The Presidency also noted the overall agreement of delegations on a number of provisions proposed by the Commission, in particular on the scope up to 2030, the commitments for the period 2021-2025, and the use of revenue from LULUCF credits as well as the link between LULUCF transfers and specific mitigation projects, additional compensations under Article 13a or other technical adjustments. In addition, the Presidency and the Commission provided clarification on the functioning of the technical correction, allowing progress to be made towards a shared understanding of this mechanism.

The Presidency identified a number of topics on which there was a need for further technical discussions, leading to the drafting of an initial partially revised version of the proposal. The Presidency put forward a package of compromise proposals aimed at striking a balance between, on the one hand, additional flexibility so as to address concerns about the level of ambition regarding targets, the inter-annual variability of the LULUCF sector and the inclusion, in particular, of natural disturbances and, on the other hand, the environmental integrity of the LULUCF Regulation. As regards the linear trajectory and governance of the targets, delegations welcomed the initial options proposed by the Presidency to take better account of the inter-annual variability of the sectors covered by the Regulation. Several delegations stressed the need to view the flexibilities in an overarching framework, including the need to take links with the ESR proposal into account. Several delegations suggested removing the measure set out in Article 13c concerning governance of the targets. Delegations expressed diverging views on removing the option of 'banking' LULUCF credits, moving these from 2021-2025 to 2026-2030. Several delegations stated that they could support the Presidency's proposals on a new distribution of the maximum amount under the flexibility mechanism provided for under Annex VII, on relaxing the conditions for triggering the flexibility mechanism set out under Article 13b, and on extending the scope of the provisions on natural disturbances to all land categories. Several delegations expressed an interest in the possibility of maintaining the application of accounting rules for natural disturbances for the period 2026-2030. Further discussions are expected on how best to take into account the impact of natural disturbances. The COREPER meeting on 4 March confirmed that, at a technical level, there was a need for further consideration of ways in which to add more flexibility to the Regulation, while ensuring its environmental integrity.

During discussions at technical level, several delegations also expressed their concerns about the proposed national targets for 2030, including the level of ambition of those targets, the criteria for calculating them and the annual trajectory. Delegations expressed diverging views on the proposed post-2030 framework: several delegations considered that it was premature to introduce post-2030 provisions, while some other delegations were in favour. Discussions on these issues could continue at a later stage.

4. Regulation on CO_2 standards for cars and vans

The French Presidency continued work on the revision of Regulation on CO_2 standards during the first quarter. It appears that most of the outstanding issues are of a political nature.

In this context, the exchanges focused on three main topics: quantified CO_2 emissions reduction targets for cars and vans; the removal of the derogation for manufacturers with a small number of registrations and the removal of the incentive mechanism for zero- and low-emission vehicles; the content and timing of the progress and evaluation reports provided for in the draft regulation.

As regards the quantified targets, several delegations expressed their support for the Commission proposal for both cars and vans in 2025, 2030 and 2035. Several delegations advocated increasing and/or bringting forward certain targets, or introducing intermediate targets; on the other hand, other delegations called for a more gradual approach, or even postponing the decision on the 100 % emissions reduction target beyond 2035, as regards all light vehicles or for vans only.

As regards the incentive mechanism for low- and zero-emission vehicles, several delegations supported the Commission's proposal for the removal of the mechanism in 2030; some delegations wished to retain the mechanism beyond 2030, making it more targeted; a few delegations wished to keep it unchanged; other delegations, however, were in favour of removing the mechanism at an earlier date. As regards the removal of the derogation for manufacturers with a small number of registrations in 2030, several delegations were able to support the Commission proposal; a few delegations wanted to keep the current derogation; other delegations, on the other hand, wanted to bring forward its removal.

As regards the arrangements for reviewing the Regulation, several delegations expressed support for the Commission's proposal to schedule this for 2028; a few delegations preferred to have the review carried out before 2028. Several delegations also wished to add more to the content of the progress reports provided for in the Regulation.

5. Regulation establishing a Social Climate Fund (SCF)

The French Presidency has started the examination of the text of the SCF Regulation, article by article. During the initial discussions at technical level, some Member States stated that they were generally in favour of the idea and principle of a fund; other Member States expressed doubts about the proposed concept; others had concerns about setting up a new fund; others also had a negative view of the proposal on account of their objection to the creation of an ETS for the road transport and buildings sectors, or because they already had a similar carbon taxation system.

The Presidency noted a convergence of views among delegations on a number of the provisions: limiting the content of Social Climate plans to what is necessary so as to avoid an excessive administrative burden; specifying that the Fund can support existing and new arrangements in the Member State; introducing a reference to a Commission methodology to help Member States estimate the impacts of the new ETS.

The Presidency identified a number of topics on which there was a need for further technical discussions so as to agree on a compromise text: the possibility for the Member States to finance technical assistance expenditure linked to SCF management and control. The relevant sum would be covered in the budgetary discussion; the validation process for the plans; the content of the plans; the proportionality of the reporting burden.

The Presidency also identified several topics of a more political nature which will need further examination, in particular as regards the way in which the fund will be managed, the scope of the fund and the possibility of direct income support (the latter two topics have budgetary implications).

QUESTIONS FOR THE MINISTERS

1. *To what extent do you consider an ETS for the road transport and buildings sectors (ETS RTB) to be an effective tool with which to reduce emissions with a view to reaching the -55 % target in 2030? What options and key parameters (timetable, scope, etc.) would you consider to be the most relevant to improve the acceptability of such a scheme while guaranteeing its effectiveness? In the event of strong reservations, what other concrete options would you consider introducing at European level to ensure that these sectors adequately contribute to achieving the EU's climate targets?*

2. *If the ETS RTB is set up, what parameters should be set for the Social Climate Fund, so that it can effectively support the most vulnerable groups?*