EUROPEAN COMMISSION

Brussels, 4.5.2016
C(2016) 2598 final

Ms Laura BOLDRINI
President of the
Camera dei Deputati
Piazza Montecitorio
IT – 00100 ROME

Dear President,

The Commission would like to thank the Camera dei Deputati for its Opinion concerning the Commission's proposal for a Directive amending Directive 2003/87/EC to enhance cost-effective emission reductions and low-carbon investments {COM (2015) 337 final}.

The Commission welcomes the Camera dei Deputati's support for key elements of the proposal as well as its appreciation of the European Union Emissions Trading System's (EU ETS) importance to effectively tackle climate change.

The Commission's proposal for the revision of the EU ETS for the period after 2020 is a key piece of legislation in the initiative for building a 'Resilient Energy Union with a Forward-Looking Climate Policy'[1] *which is in turn one of the priorities of this Commission. The proposal also constitutes an essential part of the implementation of the 2030 climate and energy policy framework endorsed by the European Council in October 2014.*

The proposal closely follows the political guidance of the European Council in several aspects, notably as regards the continuation of free allocations to sectors deemed to be exposed to a significant risk of carbon leakage as long as no comparable climate policies are undertaken in third countries. The Commission notes that the amount of free allowances is limited and declining, in line with the decreasing cap of the EU ETS and, therefore, the future use of free allocations must be even more efficient and targeted than it is today. Nevertheless, adequate protection will be provided to those sectors most exposed to the risk of carbon leakage.

Finally, the Commission takes due account of the Camera dei Deputati's concerns regarding the overall reduction of greenhouse gas emissions in the European Union. As a market-based mechanism, the EU ETS allows for cutting the emissions in the most cost-effective way, whilst at the same time providing for a sufficiently robust carbon price that also promotes

[1] COM(2015) 80 final.

investment in clean, low-carbon technologies. To this end, the European Council confirmed that the EU ETS remains the cornerstone of European climate policy. For those sectors not covered by the EU ETS, the Commission will come forward with proposals for, on the one hand, setting out Member States' targets and, on the other hand, integrating emissions and removals from land use, land use change and forestry (LULUCF) by the summer of 2016.

In response to the more technical questions in the Opinion, the Commission would like to refer the Camera dei Deputati to the attached annex.

The points made above and in the annex are based on the initial proposal presented by the Commission which is currently in the legislative process involving both the European Parliament and the Council in which your government is represented.

The Commission hopes that the clarifications provided in this reply address the issues raised by the Camera dei Deputati and looks forward to continuing our political dialogue in the future.

Yours faithfully,

Frans Timmermans *First Vice-President*	*Miguel Arias Cañete* *Member of the Commission*

ANNEX

The Commission has carefully considered each of the issues raised by the Camera dei Deputati in its Opinion and is pleased to offer the following clarifications.

On benchmarks:

The Commission's proposal is based on the European Council conclusions from October 2014 which request a regular review of the benchmark values in order to reflect technological progress. Therefore, and building on the extensive technical data collection and verification work that has gone into determining the existing 54 benchmark values, the Commission proposes to update benchmark values with three standard rates reflecting technological progress since 2008. The classification of each sector into one of the three standard rates will be based on reported improvements and confirmed by actual verified data. Such an approach offers early clarity and predictability for industry, but most importantly it spurs and rewards innovation by rewarding those sectors that are improving their efficiency fastest. Furthermore, it decreases administrative burdens.

European industries have demonstrated significant innovation capacities in the past. Efficiency gains have been realised, innovative production methods have been introduced and new products have been developed. In cases where further efficiency gains seem difficult to achieve, alternative production methods can be found. A good example is the carbon-free primary steel production method recently announced by the Massachusetts Institute of Technology (MIT).

On addressing the risk of carbon leakage:

The Camera dei Deputati believes that the EU ETS should take due account of the carbon leakage risk in order to address the competitiveness concerns of European industry.

The Commission's proposal develops predictable, robust and fair rules to address the risk of carbon leakage, thereby enabling the distribution of the available allowances in the most effective and efficient way to those sectors at highest risk of relocating their production outside the EU. The assessment of carbon leakage risk per sector is a continuation of the current approach, based on criteria of trade and emission intensities. Beyond 2020, all major industrial sectors will be considered at risk of carbon leakage.

On a harmonised system for indirect cost compensation:

An additional point raised in the Opinion of the Camera dei Deputati is the compensation of indirect carbon costs passed on by power companies to industrial consumers in the form of higher electricity prices.

Indirect carbon costs occur in many sectors across the economy and are a natural consequence of pricing carbon emissions. As a safeguard against potential carbon leakage, the ETS Directive allows Member States to compensate certain electro-intensive industries for these costs, subject to State aid control. A growing number of Member States are making use of this possibility.

Indirect cost compensation is complex and needs to be approached with care since it might convert free allocations into a production subsidy, can increase red tape and lead to a lock-in *of emission-intensive production methods. A fully harmonised indirect cost compensation system may generate windfall profits, for example in low-carbon national electricity markets or for industrial consumers with long-term contracts without or limited cost pass-through. To avoid overcompensation, an effective compensation system requires detailed control and verification for each individual company.*

Therefore, for the period after 2020, the Commission has proposed to build on the current approach, allowing Member States to provide financial compensation for indirect carbon costs to electricity-intensive industries (subject to the harmonised conditions laid down in State aid rules). Member States are actively encouraged to use auction revenues for such compensation and would also need to report on their use, guaranteeing transparency and accountability. This should facilitate a more harmonised practice regarding such compensation and ultimately the completion of the internal energy market that will bring a genuine level-playing field in Europe in terms of electricity costs.

On the validity of allowances:

The Camera dei Deputati expressed concerns that the extension of the validity of allowances could be misconstrued as implying permission for unlimited borrowing of emission allowances.

The Commission proposal does not allow for borrowing. The extension of the validity of allowances is a simplification of the system enabling allowances issued in phase 3 (period 2013-2020) to be used for compliance in phase 4 (period 2021-2030), instead of withdrawing and replacing them with phase 4 allowances. The number of allowances to be issued in each phase is limited and determined by the cap (total number of allowances in circulation in the EU ETS), and is in no way influenced by the extension of the validity of phase 3 allowances.

On the use of EU ETS auction revenues:

The Commission proposes to continue the current system, retaining the freedom for Member States to decide on the use of revenues generated from the auctioning of EU ETS allowances, but requiring that at least 50% of these revenues should be used for climate action measures. The Commission proposes several new areas for which these auction revenues can be used, including skills formation for a low-carbon transition and compensation for indirect carbon costs.

Under the Commission's proposal, Member States are able to spend a higher share of auction revenues for eligible climate measures. As shown in the 2015 Climate Action report[2], on average in 2014 Member States used or were planning to use around 87% of these revenues for climate and energy related purposes, largely to support domestic investment in climate and energy. Italy has reported that 50% of revenues from the auctioning of allowances would be used for these purposes.

[2] http://ec.europa.eu/clima/policies/strategies/progress/docs/swd_2015_246_en.pdf