

Brussels, 9 January 2006

Questions & Answers on national allocation plans for 2008-2012

What are national allocation plans and what is their purpose?

National allocation plans (NAPs) are plans that set out each Member State's allocation of CO₂ emission allowances under the EU emissions trading scheme (ETS). NAPs fix both the total of emission allocations available in each member state and the allocation made to each installation covered by the scheme. By placing a cap on the total number of emission allowances, NAPs create the scarcity needed for a functioning market in allowances to develop. This in turn enables companies to limit or reduce their emissions at least cost.

When must the next NAPs be ready?

Member States are required to draw up their NAP well in advance of each ETS trading period and to have it approved by the European Commission. NAPs for the second ETS trading period, running from 2008 to 2012, must be submitted to the Commission by 30 June 2006. This deadline needs to be respected so that the Commission can take decisions on all 25 NAPs and member states can take their final allocation decisions by the end of 2006, well before the second trading period starts.

The second trading period under the ETS coincides with the five-year period – known as the 'first commitment period' - in which the EU and member states must meet their targets for limiting or reducing emissions of greenhouse gases under the Kyoto Protocol on climate change. For many Member States the NAPs for 2008-2012 are likely to play an important part in ensuring their targets are achieved.

How will the Commission assess the NAPs?

The Commission will check NAPs for their conformity with a set of 12 criteria laid down in the directive that establishes the ETS.¹ For the first ETS trading period (2005-2007), only 11 of the criteria were relevant. The application of the criteria and lessons learnt from the first trading period are further explained in two guidance communications from the Commission. The first of these was issued in January 2004 and the second, focusing on NAPs for the second trading period, in late December 2005.

Under the first of the 12 criteria, it will be necessary to assess whether a Member State's NAP, together with other policies and measures, will guarantee the achievement of its Kyoto target. Member States relying on government purchases of emission credits obtained through the Protocol's mechanisms to promote emission-savings projects in third countries – known as Joint Implementation (JI) and the Clean Development Mechanism (CDM) - will need to substantiate their intentions more thoroughly than for the first trading period and demonstrate progress in making these purchases.

¹ Directive 2003/87/EC, as amended by Directive 2004/101/EC

Similarly, Member States relying on additional policies and measures will need to substantiate the effects better and demonstrate progress in implementing or adopting them.

There are also criteria that seek to ensure non-discrimination between companies and between the different sectors as well as compliance with the EU's competition and state aid rules. Other criteria relate to provisions in the plan for new entrants, the accommodation of early reduction efforts and clean technology.

The final criterion, which was not in place for the 2005-2007 trading period, requires NAPs to specify the maximum amount of JI and CDM credits that may be used for compliance purposes by installations under the ETS.

What are the Commission's powers concerning NAPs?

The Commission must take a decision on each NAP within three months of the NAP having been notified to it.

If the Commission does not reject any aspect of a NAP, the Member State can take a final decision on the allocation to individual installations.

If the Commission finds that a NAP is not in line with the agreed criteria or with the EU Treaty it can reject it partially or in full. A rejection of a national allocation plan means that the Member State may not proceed to implement the plan as it stands, i.e. may not allocate the number of allowances proposed. The Commission must give its reasons for rejecting a NAP, and these reasons give guidance on how the Member State can make the plan compatible with the allocation criteria.

If Member States whose plans are partially rejected implement the proposed changes they do not have to submit their plans to the Commission a second time but can proceed to take their final allocation decision.

Can a Member State make changes to the plan after Commission approval?

Once the Commission has approved a plan, or the amendments requested have been undertaken, the allocation process is completed with a final allocation decision at national level and the allocation of allowances in the Member State's electronic registry. For the second trading period the deadline for the final allocation decision is 31 December 2006.

Until the final allocation decision is taken, the Member State can make certain changes, for instance to the number of allowances for individual installations if improved data have become available, eg on historic emissions. Each NAP decision by the Commission specifies which types of amendments need to be accepted by the Commission before they can be implemented. The Commission will not accept NAP amendments notified after 31 December 2006, other than those required by the Commission's decision on a given NAP.

Once the final allocation decision has been taken at national level and the final NAP is published, no more changes to the number of allowances in total or per installation can be made. The final allocation decision concludes the allocation process and formally opens the market for allowances in the respective Member State.

Do Member States have a say in each other's NAPs?

While the Commission has sole responsibility for assessing NAPs, the ETS directive provides that the Climate Change Committee, consisting of Member State representatives, considers each plan. This Committee provides a forum to debate each NAP. The Commission, as the Committee's chair, takes the Committee's conclusions into account in its assessments.

Can a member state issue as many emission allowances as it wants?

No. The directive does not explicitly prescribe a given number of emission allowances but the quantity member states may issue is governed by various criteria. If a member state were over-generous in issuing allowances, its NAP would fail to comply with these criteria.

The Commission's December 2005 guidance sets out a methodology for calculating a benchmark for the caps by Member State for the 2008-2012 trading period. It is based on analysis of the combined effect of annual economic growth and carbon intensity (i.e. the quantity of greenhouse gases needed to produce one unit of output) over time. According to this methodology, caps should not increase in any Member State from the first to the second trading period. Member States that are well on track to meeting their Kyoto targets may maintain their first phase cap. Member States which are not sufficiently on track must reduce the cap from the first to the second trading period. Overall this methodology would lower the annual EU-wide ETS cap in the second phase by some 6% compared with the first phase cap. This reduction would ensure that the EU and all Member States achieve their agreed Kyoto targets.

Is there a limit on the use of JI and CDM credits by companies in the second trading period?

An amendment to the ETS directive, known as the Linking Directive,² allows companies in the second trading period to use credits from JI and the CDM, up to a certain proportion of their allocation of emission allowances, to cover their emissions. The degree of use must be supplemental to reductions achieved through domestic policy action, and needs to be fixed by each Member State in its NAP by specifying the maximum amount of such credits. Member States are free to choose whether to apply the limit individually in respect of each installation, or collectively to all installations. For greater flexibility, the Commission is recommending that Member States apply the limit for the entire trading period and collectively to all installations.

The limit on the use of credits does not imply that a company cannot generate and sell more of them. In fact, even if the limit should be reached in a Member State, the credits could be used by other companies in other Member States. And even if the limit were reached in all Member States, a company could sell credits to governments (both in Europe and beyond) or to other companies (both in Europe and beyond), or could keep them for the next ETS trading period.

What lessons have been learned from the first allocation exercise that can be applied to the second one?

The first allocation process, for the 2005-2007 period, yielded many important lessons which have been reflected in the Commission's December 2005 guidance for the second trading period.

Chief among these is that the process is very time-consuming. Timely notification of NAPs to the Commission as well as timely final allocation decisions are therefore important for giving companies certainty well before a trading period starts.

² Directive 2004/101/EC amending Directive 2003/87/EC

Another important lesson is that the NAPs for the first trading period were too complex and not sufficiently transparent. Complexity makes it hard for companies and other market actors to understand a NAP and thereby creates uncertainty. Also, a lack of transparency makes it very difficult for stakeholders to understand and form a view on plans.

The Commission's guidance thus emphasises the need to make the second period NAPs simpler and more transparent. To ensure greater transparency, the Commission has drawn up a number of standardised tables to summarise key information contained in NAPs. To move to simpler NAPs the Commission encourages Member States to review critically the administrative rules created in the first NAP round.

Which installations are covered by the ETS?

Annex I of the directive defines the installations covered by the ETS. Included are those installations performing specified activities (energy, ferrous metals, mineral industry, as well as pulp, paper and board) above certain capacity thresholds, which generally cause high CO₂ emissions. Combustion processes involving crackers, carbon black, flaring, furnaces and integrated steelworks, which are typically carried out in larger installations causing considerable emissions, also fall under Annex I. They therefore need to be included by all Member States in the second trading period in order to ensure a uniform coverage of combustion installations by the ETS.

What can be done with regard to installations emitting small amounts of carbon dioxide?

The Commission is aware that some installations emitting relatively low amounts of CO₂ per year are covered by the ETS, and that concerns have been raised regarding the cost-effectiveness of including these 'small installations' in the scheme.

For the purposes of drawing up the second NAPs, the legislative framework for small installations is unchanged. However, the Commission invites Member States to explore the flexibility already offered by the current framework. It is also considering looking at measures to make the situation easier for small installations in its forthcoming review of the ETS. In this context it will consider proposing an amendment to the directive to enable the removal of some small installations in the course of the second trading period.

In addition, the Commission is paying particular attention to realising the potential for cost savings for the smallest installations in its ongoing review of the ETS monitoring and reporting guidelines. The Commission aims to have these in force by the start of the second trading period on 1 January 2008.

What are the next steps in the review of the EU ETS?

The Commission closely monitors the functioning of the ETS. By 30 June 2006 it is required to present a review of the scheme to the Council and the European Parliament which will look at a range of issues, including whether further sectors and greenhouse gases should be included. The results of a survey of stakeholders launched in June 2005 will feed into the review and can also inform NAPs for the second trading period.

The Commission's report may be accompanied by proposals for amending the scheme, but the resulting changes would most likely not take effect until the third trading period beginning in 2013. There are three main reasons for this. First, any amendments have to be adopted by the Parliament and Council in co-decision, a procedure which can take two to three years. Second, operators need regulatory stability, which means they should be given time to adapt before the amendments enter into force. Third, any amendments cannot be reflected in the NAPs for the second trading period since these have to be submitted by 30 June 2006 as well.

For more comprehensive information on the EU emissions trading scheme, see [MEMO/05/84](#)