ALERT MEMORANDUM

The European Commission's "Fit for 55" Legislative Package to Meet 2030 Emissions Target

August 16, 2021

On July 14, 2021, the Commission adopted a broad-ranging package of legislative proposals to ensure the EU is on track to meet its goal of reducing net greenhouse gas ("GHG") emissions by at least 55% by 2030, compared to 1990 levels.

This "Fit for 55" package, as it has been termed, implements the European Climate Law, on which provisional agreement was reached in April 2021, and which was published in the Official Journal on July 9, 2021.[1] In addition to setting emissions targets, the European Climate Law set goals for the wholesale review of EU legislation to work towards those targets. The "Fit for 55" framework is set against the backdrop of the EU Green Deal, the von der Leyen Commission's program for climate action and sustainable investment, discussed in more detail in our alert memorandum on the EU Climate Law.

The "Fit for 55" framework extends "carbon pricing" within the EU, by expanding and revising the existing EU Emissions Trading System, amendments to the taxation of energy and emissions, as well as the creation of the EU Carbon Border Adjustment Mechanism. This serves to put a price on carbon embedded in imports into the common market, and to ensure that ambitious climate regulation within the EU does not lead to "carbon leakage" — the risk of a shift in production to jurisdictions outside of the EU with less stringent emissions frameworks. Further proposals include more stringent emission and efficiency targets on Member States, and proposals that Member States target the production of 40% renewable energy by 2030. In transport, the proposals are also sweeping, and would essentially phase-out new polluting vehicles by 2035, as well as imposing stringent requirements of emissions in shipping and aviation. This alert memorandum sets out the key takeaways from this comprehensive package.

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[1] *See* Regulation (EU) 2021/1119 establishing the framework for achieving climate neutrality ("European Climate Law"), OJ L 247.

I. The "Fit for 55" Legislative Framework

A. Reforming the EU carbon market and setting a bloc-wide carbon border tax

Since 2005, the EU's emission trading scheme ("ETS") has been the main policy underpinning the bloc's emissions reduction goals. The ETS works on the principle of "cap-and-trade", by setting maximum limits on the total amount of GHG that can be emitted each year by the entities covered by the system. Regulated entities buy or receive certain free emissions allowances annually, which they can then trade with one another. The price of carbon on the ETS is therefore determined by supply and demand of allowances.

Sectors currently covered by the ETS include power and heat generation, energy-intensive industrial sectors and aviation within Europe. The ETS was already revised in 2018, to reduce the pollution permits distributed to industry and therefore raising the price of carbon more polluting participants. This would not be enough to meet the European Climate Law's new targets.

A centerpiece of the Fit for 55 package is a proposal for a **revised ETS directive**[2]. Under the proposal, **emissions from the current EU ETS sectors plus also the maritime sector would be reduced by 61% by 2030 overall**, compared to 2005 levels (representing a 13 percentage points increase from the current 48% target). On an annual base, this will imply a **reduction of free carbon allowances of 4.2% each year** (versus the current 2.2%). The aviation sector would be particularly hit by the changes, moving to the full auctioning of emissions (*i.e.* zero free allowances) by 2027.

In addition to the ETS's expansion to the **maritime sector** (large ships), **road transport and building emissions** will be covered by a new, separate emissions trading system operational from 2025. In the case of road transport, the new system will target fuel suppliers (rather than households and drivers). A new **Social Climate Fund** (financed by the EU budget) will address the social impacts arising from the expected passing on some of the costs to consumers[3].

Finally, to address the risk of carbon leakage outside of the countries covered by the EU ETS, the "Fit for 55" package includes a **proposal for a Carbon Border Adjustment Mechanism** ("CBAM") which would tax the carbon content of products imported to the EU[4]. The proposal – designed to ensure compatibility with WTO rules – will essentially equalise the price of carbon between EU domestic products and imports, by selling carbon certificates to importers. The cost of CBAM certificates will mirror ETS prices. The system will become fully operational in 2026 (following a two-year transition period during which importers will have to report emissions embedded in their goods without paying any adjustment). It will initially concern only a selected number of products at high risk of carbon leakage such as iron, steel, cement, fertilisers, aluminium and electricity.

B. Reinforcing Effort Sharing between Member States

Since 2018, the EU's Effort Sharing Regulation ("ESR") sets national targets for emission reductions from road transport and heating of buildings (until now not covered by the ETS), plus agriculture, small industrial installations and waste management.

Through the "Fit for 55" package, the Commission is proposing **amendment to the ESR** that would further reduce the range of Member States' 2030 emissions per capita compared to the current targets[5]. In order to ensure a fair distribution of

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[2] *See* Proposed Directive amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 ("Proposal"). This Proposal also contains an explanatory memorandum ("Explanatory Memorandum"), and an impact assessment ("Impact Assessment") which consolidate both the Proposal for the Regulation and Directive, as well as the accompanying Explanatory Memorandum and Impact Assessment Report.

[3] *See* Proposal for a Regulation establishing a Social Climate Fund.

[4] *See* Proposal for a Regulation establishing a Carbon Border Adjustment Mechanism.

[5] *See* Proposal for a Regulation amending Regulation (EU) 2018/842 on binding annual greenhouse gas

these efforts, the new system would impose more ambitious emission reduction targets on countries with a higher GDP per capita, with some adjustments to reflect local cost effectiveness. In order to allow some additional level of flexibility, EU Member States will be allowed to "bank and borrow" their allowances from one year to the next, as well as buy and sell allocations between themselves (similarly to companies that are within the scope of the ETS).

The "Fit for 55" package contains other proposals concerning the Energy Efficiency Directive, Renewable Energy Directive, CO2 standards for cars and vans, Alternative Fuels Infrastructure Regulation and emissions trading to help Member States reach their targets under the ESR.

C. Harmonizing Energy Taxation within the EU

Consistent with the Commission's intention to set a comprehensive price for carbon across the EU, the Commission proposes a recast Council Directive restructuring the EU framework for the taxation of energy products and electricity, to revise the prior Energy Taxation Directive, dating from 2003.[6]

The **recast Energy Taxation Directive** aims to change the approach to the taxation of energy across the EU, proposing that energy be **taxed a certain minimum rate on the basis of energy content and environmental performance** rather than, as currently, by volume. This would involve grouping energy products (used as motor or heating fuels) and ranking them according to their environmental performance. Conventional fossil fuels, such as gas oil and petrol will be taxed at the highest rate. Less polluting fossil fuels, such as natural gas, liquefied petroleum gas and hydrogen of fossil origin fall into the category with the second highest rates, followed by sustainable but non-advanced biofuels. The lowest rate would apply to electricity usage (regardless of its origin), as well as biofuels, bio-liquids and biogases and hydrogen of renewable energy origin.[7] The proposed Directive would come into effect from 2023,[8] with minimum tax rates being revised every year starting from 2024.[9]

Separately, the proposed recast Energy Taxation Directive would eliminate certain exemptions and reduced rates that currently encourage the use of fossil fuels, by reviewing exemptions for gas oil and coal or fossil fuels used by energy intensive industries, as well as removing exemptions for the aviation, waterborne navigation and fishing sectors.[10]

D. Increasing the EU's Reliance on Renewable Energy

Given that the energy sector is responsible for 75% of total GHG emissions in the EU, the Commission has proposed an **amended Renewable Energy Directive**[11] to catalyze the transition of the EU energy sector to renewable energy.

- *Increased targets for renewable energy production:* The current target, under the prior Renewable Energy Directive, aims to reach a share of at least 32% of energy from renewable sources in the EU's gross final consumption of energy by 2030. The proposed amended Renewable Energy Directive would revise that target to **40% by 2030** to meet the emissions targets under the European Climate Law.[12] Given renewable energy shares across the EU Member States currently stand at approximately 20% according to the Commission's impact assessment,[13] renewable energy usage across

emission reductions by Member States from 2021 to 2030 contributing to climate action to meet commitments under the Paris Agreement.

[6] *See* Proposal for a Council Directive restructuring the Union framework for the taxation of energy products and electricity (recast) (July 14, 2021).

[7] Explanatory Memorandum, p. 3.

[8] Explanatory Memorandum, p. 12.

[9] Proposal, Article 5(2).

[10] Explanatory Memorandum, pp. 2-3.

[11] *See* Proposal for a Directive of the European Parliament and of the Council amending Directive (EU) 2018/2001 of the European Parliament and of the Council, Regulation (EU) 2018/1999 of the European Parliament and of the Council and Directive 98/70/EC of the European Parliament and of the Council as regards the promotion of energy from renewable sources, and repealing Council Directive (EU) 2015/652 (July 14, 2021). *See* Proposal, recital 2.

[12] *See* Proposal, recital 3.

[13] Impact Assessment Report (July 14, 2021), pp. 66-67.

the block will need to double by the end of the decade to meet the new proposed targets.

- *A step change in offshore renewable generation:* Under the EU Offshore Renewable Energy Strategy, all the EU's sea basins would need to collectively produce the ambitious goals of **300 GW of offshore wind and 40 GW of ocean energy** (meaning wave, tidal and ocean thermal) **by 2050**. Intermediate steps are set for 2030 and 2040.[14]

- *Greening the construction sector and built environment:* The proposed amended Renewable Energy Directive would ensure that the use of renewable energy in heating and cooling in buildings becomes mainstream by next decade, setting an indicative target of at least a **49% share of energy from renewable sources in the building sector by 2030**.[15]

E. Improving Energy Efficiency

To improve energy efficiency, the Commission has proposed a **recast Energy Efficiency Directive**, to replace the prior amended Energy Efficiency Directive from 2018.[16]

- *Targets for energy use reduction:* The Commission notes that its 32.5% energy efficiency target for 2030 under the existing framework would lead to a reduction of approximately 45% of GHG emissions by 2030,[17] falling below the European Climate Law's target. The Commission therefore proposes an **additional reduction of 9% by 2030** compared to the 2020 reference projections.[18] These energy efficiency targets apply at the EU level, leaving the implementation to Member States.

- *A "renovation wave" in the construction sector:* Buildings are responsible for approximately 40% of the EU's total energy consumption,[19] and 75% of building stock across the EU has a poor energy performance.[20] By introducing efficiency targets, the Commission hopes to prompt a so-called "renovation wave" to combat energy ineffiency and energy poverty, creating opportunities for the construction sector as a result. The Commission's proposal invites Member States to set their own renovation rates.[21]

- *Leadership by the public sector:* The public sector is responsible for 5-10% of total energy consumption in the EU.[22] The draft Energy Efficiency Directive proposes that the public sector take an "exemplary role" in leading energy efficiency, and would require Member States to **reduce the total energy consumption of all public bodies combined by at least 1.7% each year**.[23] To that end, the Directive proposes that energy efficiency obligations apply to the public sector procurement of goods, services, works and buildings. For public buildings in particular, the Directive proposes that at least 3% of public buildings in each Member State be renovated each year to transform them to be nearly zero-energy.[24]

F. Transforming the Transportation Sector

The EU's climate neutrality goal by 2050 requires a 90% reduction in transport emissions.[25] To achieve that, the Commission sets out sweeping plans to transform transportation across the EU, both to introduce zero-emission cars and accompanying infrastructure, and also to adopt novel measures to

[14] *See* Proposal, recital 8.
[15] Proposal, Article 1(5).
[16] *See* Proposal for a Directive of the European Parliament and of the Council on Energy Efficiency (Recast) (July 14, 2021).
[17] Proposal, recital 21.
[18] Proposal, recital 24.
[19] Proposal, recital 32.
[20] Explanatory Memorandum, p. 3.
[21] Proposal, recital 32.
[22] Proposal, recital 26.
[23] Proposal, Article 5.
[24] Proposal, Article 6.
[25] Proposal for a Regulation of the European Parliament and of the Council on the use of renewable and low-carbon fuels in maritime transport and amending Directive 2009/16/EC (July 14, 2021), Explanatory Memorandum, p. 1.

curb emissions in the aviation and maritime transportation sectors.

- *A phase-out of polluting cars by 2035*: An **amending Regulation regarding vehicle emission standards**[26] would drastically reduce emissions from road transportation, which currently amount to nearly 20% of total EU GHG emissions.[27] The Regulation proposes the **reduction in the average emissions of new passenger cars by 55% compared to 2021 targets**, amending the prior 37.5% target of the 2019 Regulation.[28] **By 2035, the Regulation would require all new passenger cars and light commercial vehicles registered in the Union to be zero-emission.**[29]

- *Investment in alternative fuels infrastructure*: To accompany the intended phase-out of emitting vehicles, the "Fit for 55" package includes proposals to **scale up recharging and refueling infrastructure for zero-emission cars** across the EU, with sustainable mobility being a key component of the EU Green Deal (as discussed further in our dedicated alert memorandum). The Commission's proposed **Regulation on the deployment of alternative fuels infrastructure**[30] would require Member States to expand recharging and refueling infrastructure in line with vehicle sales in that State, and ensure publicly accessible recharging pools at intervals of no more than 60km across core routes.[31]

- *Sustainability in aviation*: The Commission proposes to **amend Directive 2003/87/EC as regards aviation's contribution to EU emissions targets**. It would phase out free emission allowances for aviation under the ETS, and implement a Carbon Offsetting and Reduction Scheme for International Aviation for flights coming into and flying out of the EEA.

- *Sustainability in maritime transportation*: International maritime transport "has been the only means of transportation not included in the Union's past commitments to reduce greenhouse gas emissions.,"[32] The "Fit for 55" package brings fresh scrutiny to the sector. The Commission proposed a **Regulation on the use of renewable and low-carbon fuels in maritime transport**,[33] which contributes to approximately 75% of EU external trade volumes and 31% of EU internal trade volumes.[34] The **FuelEU Maritime initiative**, of which this proposed Regulation forms part, proposes a common EU regulatory framework to **increase the share of renewable and low-carbon fuels** used in international maritime transportation. To that end, the proposed Regulation sets a maximum limit on the GHG content of the energy used by large ships calling at European ports, regardless of their flag, with such limit becoming more stringent over the period from 2025 to 2050.[35]

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[26] *See* Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) 2019/631 as regards strengthening the CO2 emission performance standards for new passenger cars and new light commercial vehicles in line with the Union's increased climate ambition.
[27] Explanatory Memorandum, p. 2.
[28] Proposal, Article 1(a).
[29] Proposal, Article 1(b).
[30] *See* Proposal for a Regulation of the European Parliament and of the Council on the deployment of alternative fuels infrastructure, and repealing Directive 2014/94/EU of the European Parliament and of the Council (July 14, 2021).
[31] Proposal, Article 3.
[32] Proposal for a Directive of the European Parliament and of the Council amending Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union, Decision (EU) 2015/1814 concerning the establishment and operation of a market stability reserve for the Union greenhouse gas emission trading scheme and Regulation (EU) 2015/757 (July 14, 2021), recital 14.
[33] *See* Proposal for a Regulation of the European Parliament and of the Council on the use of renewable and low-carbon fuels in maritime transport and amending Directive 2009/16/EC (July 14, 2021).
[34] Explanatory Memorandum, p. 1.
[35] Proposal, Articles 2, 4.

G. Increasing Carbon Capture through the Land Use, Agriculture and Forestry Sectors

To reach its 2030 emissions targets, the Commission aims to accelerate the removal of GHG emissions using natural carbon sinks, such as agriculture and forestry. As noted in our alert memorandum on the European Climate Law, the 55% emissions target for 2030, compared to 1990 levels, is a net target, and includes the removal of GHG emissions via carbon sinks, translating to a gross reduction of 52.8%. To that end, the Commission has proposed a **revision of the Land Use, Land Use Change and Forestry Regulation** (the "LULUCF Regulation").[36]

To increase the removal of GHGs via carbon sinks, the proposed LULUCF Regulation would set an overall **EU target for removals by natural sinks equivalent to 310 million tons of CO_2 emissions, by 2030.**[37] The EU's reliance on carbon sinks is criticized as an attempt to play catch-up using the forestry sector, to the extent other polluting sectors fail to reach their emissions targets.

The LULUCF Regulation aims to achieve collective climate neutrality at the EU level in the land use, forestry and agriculture sectors by 2035. Unlike the EU target for removals by natural sinks, which relates only to CO_2 emissions, the climate neutrality target in this sector also includes agricultural emissions of other GHGs.[38]

II. Future Directions

In addition to the above, the fourth quarter of 2021 will see a series of other important interventions and revisions by the Commission, coherently with its presentation of the European Green Deal earlier this year and with the goal of eliminating greenhouse gas emissions by 2050.

- *Revision of the Energy Performance of Buildings Directive (Directive 2010/31/EU):* The revision will focus on building renovation. The goal is to achieve a high energy efficient and decarbonized building stock by 2050 and to facilitate the financing of the renovation of buildings, in accordance with the recovery plans. This initiative is in line with the Commission's recent notice dated July 29, 2021, relating to technical guidance on the climate proofing of infrastructures for the period between 2021 and 2027, pursuant to Article 8(6) of the EU Regulation 2021/523, which requires the Commission to develop sustainability guidance and set out standards for climate change mitigation and adaptation.
- *Revision of the third energy package for gas*: In the context of the ambition of reducing greenhouse gas emissions by at least 55% by 2030, the Commission's 2021 work program foresees a revision of the third energy package for gas. This review will be coordinated with other important initiatives that will be taken in the framework of the Green Deal such as the Renewable Energy Directive and the Energy Efficiency Directive.
- *Circular Economy Action Plan*: A Circular Economy Action Plan will strengthen European industrial base[39]. The purpose of the plan is to accelerate circularity and economical dematerialization through the adoption of innovative business models characterized by closer relations with customers and powered by digital technologies. In order to put the plan into practice, a series of important initiatives have been planned in relation to *(A)* the revision of the Eco-design Directive and the sustainable product policy; and *(B)* circular electronics. The first initiative is of legislative nature and has the aim of extending the applicability of eco-design to a

[36] *See* Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) 2018/841 as regards the scope, simplifying the compliance rules, setting out the targets of the Member States for 2030 and committing to the collective achievement of climate neutrality by 2035 in the land use, forestry and agriculture sector, and (EU) 2018/1999 as regards improvement in monitoring, reporting, tracking of progress and review (July 14, 2021).

[37] Proposal, Article 4(2).

[38] Proposal, Article 4(4).

[39] *See* https://ec.europa.eu/environment/pdf/circular-economy/new_circular_economy_action_plan.pdf.

wide range of products also beyond the energy sector by *(i)* improving product durability; *(ii)* enabling high-quality recycling; *(iii)* reducing carbon and environmental footprints; and *(iv)* restricting single use of products. The second, will be an non-legislative initiative to reduce the growing electronic waste (so called e-waste) and extend the lifespan of electronic devices by promoting repair, recycling and efficient use of resources.

- *Revision of the packaging and packaging waste Directive (Directive 94/62/EC27):* Amongst the main concerns addressed by the EU Green Deal is that of improving biodiversity and creating a toxic-free environment. The revision of the Directive 94/62/EC27 on packaging and packaging waste will reinforce the mandatory requirements for packaging in the unique market in order to mitigate the worrying record reached in 2017 equal to 173kg of packaging waste per inhabitant. The Commission wants to drastically reduce packaging/packaging waste as well as reinforcing packaging material reuse and recycling.

- *Towards a green, smart and affordable mobility:* Finally, the Commission has programmed a fundamental transport transformation for green, smart and affordable mobility. This will be implemented through the development of post 6/VI emission standards for cars, vans, lorries and buses in order to restrict, to the maximum extent possible, air pollutant emission standards in relation to combustion-engine vehicles. A series of milestones have been planned. For instance, by 2030 the Commission's aim is to have 30 million zero-emission cars on European roads with at least 100 European cities being climate neutral. The ultimate goal by 2050, would be for all combustion-engine vehicles to be zero-emission and to implement a Trans-European Transport Network (TEN-T) for sustainable high-speed connectivity.

- *REFIT initiatives planned for the fourth quarter of 2021*[40]*:* The Commission has planned various revaluations and adequacy checks of existing legislative initiatives. In particular, such checks will be conducted in regards to *(i)* geographical indicators (GIs); *(ii)* the ozone layer protection rules; *(iii)* packaging and packaging waste rules (Directive 94/62/EC, as already mentioned above); and *(iv)* rules on industrial emissions (Directive 2010/75/EU). In relation to GIs, the proposal will have the scope of increasing their applicability in respect to farmers and other producers of sustainable products as well as cover any legislative gap that may be present in member states that are "low users" of GIs. When considering the ozone layer's rules, the Commission shall focus on updating the existing Regulation (Regulation 2009/1005/EC) in light of the latest technological developments, whilst in relation to packaging and packaging waste as well as industrial emissions, the Commission will implement essential packaging requirements to increase their reuse and recycling and revise Directive 2010/75/EU in order to minimize pollution to the maximum extent possible

We monitor the evolving European framework related to sustainability and parallel developments globally. For more information, including thought leadership publications, see the website of our Sustainability Practice Group, available here.

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[40] Annex II of the "*Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions*". These initiatives shall be subject to evaluations and fitness checks by the Commission. *See* https://eurlex.europa.eu/legalcontent/EN/TXT/?uri=CELEX%3A52020DC0690&qid=1603369244688.