

The effective method of free allowances allocation to be defined by the Regulation on Activity Level Changes (ALCR)

The revised EU ETS Directive provides for a **special support scheme for the district heating sector** involving installations in Poland, Latvia, Bulgaria, and the Czech Republic. The idea of the mechanism, set up in Art. 10b(4) of the EU ETS Directive is to **receive additional free emission allocations between 2026 and 2030 for investments to accelerate carbon reduction efforts by 2030**. In order to receive additional free allocation, the following conditions must be met:

- ensure that the volume of investment corresponding to the value of the additional free allocation received is invested to achieve significant emission reductions before 2030
- by 1 May 2024, operators of district heating installations shall establish a climate neutrality plan for their installations with targets and milestones to measure, by 31 December 2025 and by 31 December of each fifth year thereafter, progress made towards reaching climate – neutrality.
- the achievement of the targets and milestones shall be verified by 31 December 2025 and by 31 December 2030 of each fifth year thereafter, in accordance with the verification and accreditation procedures.

While the mechanism for granting the additional allocation has already been set out in the implementing regulations and the Commission's guidelines, **a key issue remains to be decided: the manner in which additional allowances will be distributed**. This is to be sanctioned through an amendment to the Commission implementing regulation (EU) 2019/1842, the publication of which is planned for Q1 2025¹.

It should be emphasised that many district heating companies across the Europe are in a difficult situation related both to fuel cost increases and inflation in general. These factors combined with regulated heat prices and concerns around energy poverty have led to massive reductions in profit margins.

The district heating sector is also committed to invest in their energy transition. This entails meeting new requirements to continue complying with the efficient district heating classification (laid down in Article 26 of the Energy Efficiency Directive), as early as 2028. As an example, the total costs of implementing the Fit for 55 package for the district heating sector in Poland is estimated to range between EUR 61 billion to EUR 93 billion². Depending on the country, technologies chosen and starting point, the costs will vary.

Given the importance of energy affordability in the current context, energy companies try to avoid passing all their energy transition investments and other additional cost on to their customers. Therefore, the support provided by the additional allocation is key to compensate for additional costs significantly increasing the final heat price. **For this to be achieved, the support shall be transferred on an annual basis, rather than at end of the allocation period.**

¹ Commission Implementing Regulation (EU) 2019/1842 of 31 October 2019 laying down rules for the application of Directive 2003/87/EC of the European Parliament and of the Council as regards further arrangements for the adjustments to free allocation of emission allowances due to activity level changes

² Assessment of the impact of the EU „Fit for 55” package on the transformation of the district heating sector in Poland, 30th May 2023, PTEZ.

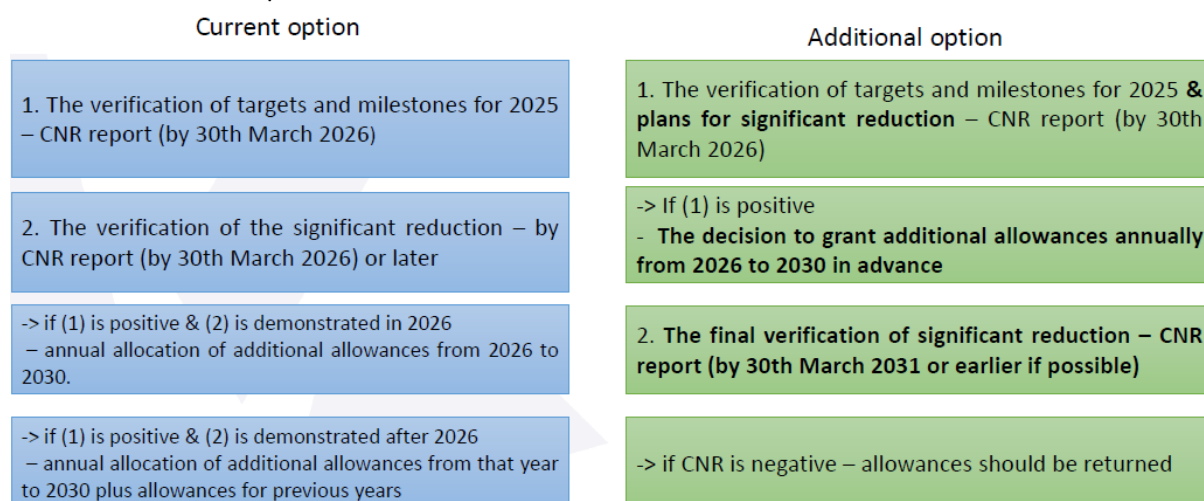
The annual allocation method has a legal precedent, namely the allocation method of conditional free allowances upon the achievement of milestones and targets as set in the CNP for installations whose specific emissions are higher than the 80th percentile value of their benchmark curve in percentile value of their benchmark curve in 2016/2017.

In the view of the district heating sector, **support in the form of additional allowances should take place also in parallel to the investments carried out by the district heating companies.** In fact, companies must accelerate their investments in order to meet the conditions set by the Commission in order to fulfil the mechanism.

The ALCR should **allow the flexibility to choose between two allocation methods, depending on the circumstances of the beneficiary:**

- **one-time allocation method, for cases when emission reductions are achieved soon before 2030 or**
- **annual basis allocation method, for cases when investments and emission reductions are achieved more gradually between now and 2030.**

The details for both options are elaborated below:



The additional option allows for the annual allocation of allowances in advance, on condition of positive verification of planned investments aimed at achieving significant reductions in Climate Neutrality Plans, which would take place during the verification of targets and milestones for 2025 (by Climate Neutrality Report in March 2026). If the verification is positive, it would constitute a decision to grant additional allowances every year from 2026. The final verification of significant reduction with the investments costs incurred should then be carried out after 2030. And if the reduction is not achieved, allowances should be returned.

We believe that by introducing the additional option of distributing allowances, the district heating sector in Poland, Czech Republic, Bulgaria and Latvia will enable accelerated investments in clean heat.

The proposed solution will:

- constitute support proportionate to the efforts made by the companies, especially for long-term investments (until 2030);
- allow easier and broader use of other forms of State aid for example the Modernisation Fund;
- prevent volatility in the allowance market if allowances are allocated every year;
- allow district heating companies to reduce the cost for end-users smoothly and avoid heat price volatility and excessive burden for consumers.