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Fit-for-55, en route to Fit-for-100

Under the pressure of climate change and the urgency to act, the European Union has recently adopted the European Climate Law which enshrines into binding legislation the objective of climate neutrality by 2050 as well as an intermediate target of a 55% cut in emissions by 2030 compared to 1990 levels.

Having increased the EU's target from 40% to 55%, the new Law will require the transport, buildings, industry, agriculture, infrastructure and energy sectors to contribute their fair share to the EU's climate objective. In line with that new ambition the European Commission unleashed on 14 July a wave of new climate and energy legislation to make the EU "Fit for 55".

Lost in climate legislation

With carbon pricing at the heart of the regulatory revamp, the **EU Emissions Trading System** (ETS) will constitute a major pillar of the new "Fit-for-55" package. The Commission will tighten the supply of emission permits under the current ETS in order to accelerate the pace of decarbonisation in the power sector, industrial installations and for intra-EU flights. While maritime transport will now be integrated into the existing carbon market, a separate ETS will be created to cover emissions from road transport and buildings – previously dealt solely by the Effort-Sharing Regulation.

Unlike ETS, the **Effort-Sharing Regulation** (ESR) sets national targets for emissions reduction – rather than EU-wide goals - in sectors like road transport, buildings and agriculture. National targets differ widely, with much more stringent targets for wealthier Member States. The newly-established ETS will complement the ESR in the current scope, which strengthens incentives for national action.

The EU is also trying to export its climate rules through the proposed **Carbon Border Adjustment Mechanism** (CBAM), by imposing a levy on carbon-intensive imports from third-countries where there is less stringent climate legislation. The aim of this is to avoid "carbon leakage" – whereby high-emitting industries would relocate outside the EU to avoid tighter standards. This will however breed discontent among EU trading partners like China and Russia, which are already invoking a violation of WTO rules, claiming the EU leverages its climate policy to feed Europe's recovery budget. The imports covered would initially include electricity, cement, fertilisers, iron, steel and aluminium.

As noted during the intense debates over the Climate Law, natural carbon sinks will contribute significantly to the 55% goal, with the **Land Use and Forestry Regulation** (LULUCF) playing a key role. Currently the legislation is meant to ensure that emissions from land use, land use change and forestry are offset by an equivalent amount of nature-based carbon removals – but the reviewed version goes beyond that. The European Commission wants to increase the capacity of the EU's carbon sinks and proposes to expand the scope of the regulation to include non-CO2 agricultural emissions - hence the rebranding as "Regulation on Climate-Neutral Land Use, Forestry and Agriculture".

Energy production, a story of the past?

Since the development of the EU's energy policy, decision-makers in Brussels have focused primarily on how to "green" energy production. As a result, boosting renewable electricity production was prioritised alongside incentivising higher uptake of biofuels.

Yet there is a marked shift in the debate under the new political leadership of the Commission from energy supply to energy demand. The **Energy Efficiency Directive** will therefore largely contribute to reducing energy demand across sectors of the economy by setting a legally binding, EU-wide target of 36% energy savings for 2030.

Nevertheless, the reviewed **Renewable Energy Directive** (RED) will remain the centrepiece of the EU's energy legislation. At the core of intense debates between NGOs, industry and Member States, the new RED should result in the EU's energy mix comprising 40% of renewables by 2030. To help realise this, there are new provisions tightening the sustainability criteria of solid biomass and biofuels as well as measures to stimulate the uptake of renewable electricity and hydrogen in buildings, transport and industry. The million-dollar question, however, is what will happen if the forest biomass restrictions for energy production enter into force? Given that bioenergy represents the lion's share of the EU's total renewable energy – and which is mainly based on forest biomass – how would the EU replace that share, and with which renewable sources?

One solution might lie with the **Energy Taxation Directive**, which could provide the impetus for a higher uptake of renewable electricity and sustainable low-carbon fuels in transport and heating. The proposed revision aims to correct the mistakes of the past, and to achieve a level-playing field between surcharged electricity and undertaxed fossil fuels. As a result, electricity from renewable sources, renewable hydrogen and advanced sustainable biofuels would be eligible for national tax exemptions under the new rules.

Other rules limiting transport emissions?

Beyond the ETS extension to road transport, the **Regulation on CO2 Emission Performance Standards for Cars and Vans** which applies to car manufacturers - has been reviewed to incentivise zero and low-carbon emission vehicles. Unsurprisingly, the final proposal confirmed some of the previous speculations of a steep CO2 reduction target by 2030 and the de facto phaseout of the internal combustion engine technology in terms of new car & vans sales after 2035. With tougher CO2 objectives, consumers will enjoy better access to electric cars as the purchase price of these cars will continue to drop.

Solving the chicken and egg problem

While the CO2 standards regulation should help bring down the purchase price of battery electric vehicles (BEVs), the availability of publicly accessible charging stations is an absolute necessity for BEV drivers to be able to move around without disruption. In general, refuelling infrastructure investors require customers but customers require infrastructure. Which comes first? The updated **Alternative Fuels Infrastructure Directive** (AFID) which the Commission would like to turn into a Regulation, will attempt to deal with the issue and will set requirements to expand the EU's network of recharging and refuelling stations for alternative vehicles fuels, notably BEVs and hydrogen. A rapid roll-out of such infrastructure may encourage people to purchase low and zero-emission vehicles.

Are we done on July 14?

The "Fit-for-55" package is a complex and vast set of legislative proposals impacting almost every industry. Considering the thorny issues at stake, the publication day marks only the beginning of a long battle involving the European institutions as well as the complicated web of stakeholders including NGOs, trade associations, companies and foreign governments. The negotiation process will most likely take between 18-24 months before any final text is adopted, potentially prolonging the implementation phase even further.

The launch of an adjacent ETS to cover the road transport and building sectors is seen as particularly controversial by several NGOs and Member States including France, Italy and Poland. Opponents emphasise the risk of a social backlash, similar to the yellow vests movement in France triggered by an increase in fuel prices. The main point of debate will be how the revenue generated through this newly established ETS will be redistributed – both between EU citizens and Member States. The topic of revenue will also be central to debates around CBAM, as under the current proposal Member States will not profit directly from the mechanism. Rather, it will be diverted by the Commission to help repay the borrowings which served to finance the recovery from COVID-19 (and constitutes what the EU labels as an 'own resource').

On the renewables front, the new RED is expected to spark outcry from some Member States on bioenergy restrictions. These include countries heavily reliant on their forest-based industry such as Sweden and Finland which have been increasingly vocal against Brussels-driven actions to limit the exploitation of their natural resources.

Both the revised AFID and the revised Regulation on CO2 emission performance standards for cars and vans will also be subject to intense debates. In order to be able to meet the more stringent CO2 emission standards, the automotive industry had been advocating for increased and binding requirements for charging points. The lack of ambition within the current AFID proposal could therefore endanger the successful implementation of the Regulation on CO2 emission performance standards. To top it all off, the Commission is internally divided on some issues including the reform of the ETS and RED further complicating the negotiation process. While some proposals are likely to be watered down, the Commission will have to decide which proposals to prioritise. It is expected that those providing the EU with additional revenue, such as the ETS or CBAM, will be put at the forefront.

In conclusion, while the Commission is proposing an all-encompassing plan which sets ambitious requirements and targets across a vast number of sectors, there is a big question whether all the individual pieces do truly add up to a coherent whole. It appears that many of the individual proposals, which make up the "Fit-for-55" package, have been developed in isolation from each another and therefore are not truly interconnected. By doing this, the Commission has put the climate ambition for 2030 at risk of being attacked and weakened on multiple fronts simultaneously.

The coming months will determine whether the package will indeed put the EU on track to meet its climate neutrality commitments and be truly *en route* to a "Fit-for-100".

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