EXPLANATORY MEMORANDUM TO

THE COMMUNITY EMISSIONS TRADING SCHEME (ALLOCATION OF ALLOWANCES FOR PAYMENT) REGULATIONS 2008

SI 2008 1825

1. This explanatory memorandum has been prepared by Her Majesty's Treasury ("HMT") and is laid before the House of Commons by Command of Her Majesty.

2. Description

2.1 These regulations exercise new powers to provide for the allocation of Community tradeable emissions allowances in return for payment. This will enable the allocation for payment of European Union Emissions Trading Scheme ("EU ETS") allowances.

2.2 A Treasury Scheme about the conduct and the terms of those allocations will be published before any allocation takes place.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Legislative Background

4.1 Section 16 of the Finance Act 2007(a) enables HMT to impose charges by providing, in regulations, for Community tradeable emissions allowances to be allocated in return for payment. No specific undertakings were given to Parliament in relation to the Regulations during the passage of the Finance Bill 2007.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Minister has made the following statement regarding Human Rights:

In my view the provisions of the Community Emissions Trading Scheme (Allocation of Allowances for Payment) Regulations 2008 are compatible with the Convention rights.

7. Policy background

7.1 There is currently no provision for the allocation of EU ETS allowances in return for payment. To date most allowances have been allocated free of charge. These Regulations provide for the allocation of EU ETS allowances in return for payment.

7.2 The EU ETS is the main policy that has been introduced across Europe to tackle emissions of carbon dioxide and other greenhouse gases and combat the serious threat of climate change. The EU ETS was established by Directive 2003/87 of the European Parliament and Council establishing a scheme for greenhouse gas emission allowance trading within the Community and amending Council Directive 96/61/EC (the "Directive").

7.3 The EU ETS commenced on 1 January 2005. The first phase ran from 2005-2007 and the second phase runs from 2008-2012 to coincide with the first Kyoto Commitment Period.

7.4 The EU ETS is a "cap and trade" scheme. EU Member State governments are required to set an emission cap for all installations covered by the EU ETS. Each installation is then allocated allowances for the particular commitment period in question. The total number of allowances to be allocated to installations in the UK for each phase and the manner in which they will be distributed is set down in a document called the National Allocation Plan.

7.5 In Phase I, almost all allowances were distributed for no charge. The EU ETS provides for Member States to set aside a number of allowances to be issued to eligible new entrants. The number of allowances in the New Entrant Reserve ("NER") increases or decreases due to companies closing down or new entrants respectively. Government sold a small number of surplus Phase I NER allowances in February 2007, under the provisions of Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations 2007 (S.I. 2007/465).

7.6 In Phase II, most allowances will be distributed to installations for no charge but the Directive allows Member States to auction up to 10% of total allowances and the UK has chosen to auction 7%, plus any surplus from the NER. As set out in the 2006 UK Vision on Emissions Trading, the UK supports a greater use of auctioning to ensure a more efficient allocation of allowances. The other objectives of auctioning are to provide value for money for the taxpayer, and to achieve a trustworthy market price. These Regulations provide the legislative framework for auctioning in Phase II of EU ETS. Key features of auction design that enable Government to meet its objectives are simplicity, transparency, accessibility, resistance to market manipulation and low cost.

7.7 There will be limited interest in these Regulations outside the sectors covered by the EU ETS and those interested in trading in EU ETS allowances. We consulted on these regulations and there were a limited number of responses, coming mainly from installations in sectors covered by the EU ETS and those interested in trading in EU ETS allowances. Consultees wanted to see more details such as: specific time limits for the performance of certain actions under the Regulations, the process for appointing the independent observer, methodologies for calculating deposits and the reserve price, and the registration process for bidders. Many of these details will be covered in the Scheme, which will be published well in advance of the first allocation of allowances for value. There were no comments on the details of the Regulations, and consultees used the opportunity to set out views on the wider policy.

7.8 Guidance for participants on allocations of allowances for payment will be published on the Defra/DMO websites in advance of the first allocations for payment.

8. Impact

No Regulatory Impact Assessment has been prepared because these Regulations provide the framework for allocating allowances in return for payment, and as such no administrative impact in the private sector is foreseen. The administrative impact of allocations in return for payment will depend on the detailed design of the auction or other allocation method. The Government consulted on auction design and other methods for allocations for payment at the end of 2007 and a full impact assessment accompanied that consultation. The Impact Assessment can be found at www.defra.gov.uk. Treasury will publish a Scheme, which will cover the conduct and terms of allocation, along with the detailed design of the auctions or other allocation methods, and the requirements in order to participate. An updated impact assessment will be published along with the Scheme.

9. Contact

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