

EXPLANATORY MEMORANDUM TO
THE COMMUNITY EMISSIONS TRADING SCHEME (ALLOCATION OF
ALLOWANCES FOR PAYMENT)(AMENDMENT) REGULATIONS 2008

2008 No. 1939

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 The regulations amend the Community Emissions Trading Scheme (Allocation of Allowances for Payment) Regulations 2008 (SI 2008/1825). They create a criminal offence of wrongful disclosure of confidential information. They also make a minor amendment in order to permit allowances to be allocated to an account holder following an auction as a consequence of a review, carried out under the Treasury Scheme, of a decision made by the person conducting an auction.

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

3.1 None.

4. Legislative Background

4.1 Section 164 of the Finance Act 2008 ("the 2008 Act") adds a new subsection (6A) into the Section 16 of the Finance Act 2007(a) ("the 2007 Act") that enables HM Treasury to impose criminal penalties in respect of the allocation for payment of Community tradeable emissions allowances. This is the first use of the power under section 164 of the Finance Act 2008.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The Community Emissions Trading Scheme (Allocation of Allowances for Payment) Regulations 2008 (SI 2008/1825) (hereinafter referred to as "the Principal Regulations") introduced provisions for the allocation of European

Union Emissions Trading Scheme (“EU ETS”) allowances in return for payment. These Regulations amend the Principal Regulations in order to create an offence of wrongful disclosure of confidential information in allocations for payment, and to provide for an amendment to Regulation 7 (allocation following review) to deal with the consequences of a review under the accompanying Scheme (made pursuant to section 16(5) of the 2007 Act) of a decision by the person conducting an auction to reject a bid.

- 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 In Phase II of the EU ETS, which runs from 2008-2012, 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 New Entrant Reserve. 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. The Principal 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.
- 7.4 The UK will soon be holding auctions of EU ETS allowances. Participants in the EU ETS and carbon traders will place bids for allowances in the auctions, and some of these bids will be submitted in the auction through agents. The bid information is highly commercially sensitive, as it relates to the plans and strategy that a company has for reducing emissions. It is also market sensitive: disclosure could lead to market disturbances in a new and important global market in carbon.
- 7.5 The existence of the criminal offence is intended to be a strong deterrent to any person who is privy to confidential bid information against releasing it. If such information is wrongfully released, it could have an impact on the carbon price, and/or auction revenues. A significant impact upon the carbon price (for example, disclosing that a major user of allowances actually values carbon very cheaply) would both reduce the environmental effectiveness and credibility of the EU ETS, as well as reducing revenues from the auctioning of allowances both in the UK and other Member States. There could be a substantial financial incentive to a person or firm to disclose such bid information – substantial gains could be made by knowledge of a confidential bidding strategy and the value that a person or firm places on carbon allowances. For this reason, a criminal conviction is required to deter such wrongful behaviour.
- 7.6 The Principal Regulations are also amended to allow allocation of allowances following a review of specified decisions in the Scheme. This is to ensure that decisions in auctions that result in allowances not being allocated can result in an

allocation after an auction has taken place and ensures that the consequence of a review is the same, regardless of whether the original decision is made under the Regulations or under the Scheme.

- 7.7 There will be limited interest in these Amendment Regulations outside those companies who have an interest in Government auctions of EU ETS allowances. The companies who have an interest are those in sectors covered by the EU ETS and those interested in trading in EU ETS allowances. A consultation on the Principal Regulations in Spring 2008 raised the possibility that criminal offences may need to be introduced, and sought views on this. There were a limited number of responses to the consultation, coming mainly from installations in sectors covered by the EU ETS and those interested in trading in EU ETS allowances. Consultees did not put forward any views on the proposed creation of such a criminal offence.

8. Impact

No Regulatory Impact Assessment has been prepared because 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. It is also relevant that such companies that wish to act as agents to submit bids in an auction will have a choice as to whether they wish to take on such a role.

9. Contact

Eleanor Bennett at HMT (Tel: 020 7270 5177 or e-mail: eleanor.bennett@hm-treasury.gsi.gov.uk) or Shalyni Saravanann at HMT (Tel: 020 7270 6184 or email Shalyni.Saravanann@hm-treasury.gsi.gov.uk) can answer any queries regarding the instrument.

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