

**EXPLANATORY MEMORANDUM TO  
THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT)  
REGULATIONS 2006**

**2006 No. 737**

**1.** This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs and is laid before Parliament by Command of Her Majesty.

**2. Description**

2.1 This instrument amends the Greenhouse Gas Emissions Trading Scheme Regulations 2005 (SI 2005/925) (“the 2005 Regulations”) for a number of purposes.

2.2 They put into effect the remaining elements of the national allocation plan for the phase 2005 to 2007. They provide the legal process which will enable the operators of installations which have joined the scheme late to obtain the allowances that have been set aside for them. They also make a number of other minor amendments.

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

None.

**4. Legislative Background**

4.1 These regulations are made under section 2(2) European Communities Act 1972 and section 2(1) of the Pollution Prevention and Control Act 1999. They amend the 2005 regulations in order to make some changes to the UK’s implementation of the Emissions Trading Directive (Directive 2003/87/EC).

4.2 The 2005 Regulations were made on 23rd March 2005 and came into force on 21st April 2005, revoking and replacing the Greenhouse Gas Emissions Trading Scheme Regulations 2003 (S.I. 2003/3311). The 2005 Regulations now require amendments to include provisions for allocations of allowances to late entrants to the EU Emissions Trading Scheme and a number of other provisions.

4.4 Regulation 20 of the Greenhouse Gas Emissions Trading Scheme Regulations requires the Secretary of State to develop a national allocation plan<sup>1</sup> for each scheme phase. The national allocation plan for the first phase of the Scheme (2005-2007) has been developed, was approved by the European Commission and published by Defra on 24th May 2005.

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<sup>1</sup> See: <http://www.defra.gov.uk/environment/climatechnage/trading/eu/nap/approved.htm>

4.5 Appendix C of the national allocation plan makes provisions for missing and late entrants into the scheme to receive some allowances from the UK's total allowance.

4.6 However, the 2005 regulations contain no power for the Secretary of State or regulator to allocate these allowances to installations that emerge late. Therefore these amendment regulations establish an application process whereby an installation may apply to the Secretary of State for an allocation of allowances from this reserve, and allows the Secretary of State to allocation allowances to these operators.

4.7 The regulations also contain a number of other minor amendments to the 2005 Regulations which deal with the surrender of permits, power to delay issue of allowances, provisions for registry charges, offshore charging scheme and power to make available information related to the EU Emissions Trading Scheme.

## **5. Extent**

5.1 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 EU Emissions Trading Scheme is one of the policies being introduced across Europe to tackle emissions of carbon dioxide and other greenhouse gases and combat the serious threat of climate change.

7.2 The scheme commenced on 1 January 2005. The first phase runs from 2005-2007 and the second phase will run from 2008-2012 to coincide with the first Kyoto Commitment Period. Further five-year periods are expected subsequently.

7.3 The scheme will work on a "Cap and Trade" basis. EU Member State governments are required to set an emission cap for all installations covered by the Scheme. Each installation will then be 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 will be set down in a document called the National Allocation Plan. The list of the number of allowances that each individual installation is then subsequently set out in subsequent allocation decision.

7.4 Over 1000 installations in the UK were permitted and included in that list. Government, regulators, sector associations and others made a considerable effort to contact and permit all UK installations covered by the

EU Emissions Trading Scheme Directive by 1 January 2005 and include them in the allocation decision. However, despite this were still some operators who were at that time unaware of the EU Emissions Trading Scheme, or had incorrectly assessed that their activities are not covered by the Scheme.

7.5 The UK Government decided to set aside a small number of allowances for Phase 1 (1.5MtCO<sub>2</sub> over 3 years) that will be issued to late installations on a first-come first-serve basis. However, the quantity of allowances issued to each installation will be less than the quantity that they would have received had they been included in the final allocation decision. The Commission has accepted this approach as part of our national allocation plan.

7.6 With regard to the other amendments the regulations will provide arrangements for surrender of permits, power to delay issue of allowances, provisions for registry charges, offshore charging scheme and power to collect information for Phase II of the EU Emissions Trading Scheme.

7.7 A minor amendment is made to the wording of the provisions relating to the surrender of permits to make it clear that from the date the surrender or revocation notice takes effect, the monitoring requirements under the permit cease.

7.8 With respect to the power to delay the annual issue of allowances, these amendments allow new and late entrants to be dealt with in the same way as incumbent installations in regards to allowing the registry administrator to delay the issue of allowances.

7.9 The Regulations make amendments to the registry fees by requiring verifiers and organisations appointed by account holders as additional authorised representatives to pay a £175 fee when applying to be included in the registry. This fee will cover the cost of the registry administrator approving the application and checking the identities of two individuals who will access the registry on behalf of that verifier or organisation. Thereafter, a further fee of £50 will be payable each time the verifier or organisation wishes to change their individual representatives or to appoint "new users" in the registry.

7.10 This amendment's objective is ensure that a fee is payable on the appointment rather than nomination of an individual as a new user of the registry. The Regulations simplify and standardise the cost of applying for a Person Holding Account, an External Additional Authorised Representative account or to be a Verifier within the Registry to £175. They also simplify and standardise the cost of applying for a replacement or an extra Authorised Representative for a Person Holding Account, an External Additional Authorised Representative account or a Verifier within the Registry to £50.

7.11 The amendments provides clarification so that for Person Holding Accounts the £50 fee is payable on the appointment as an individual as a "new

user" in the registry rather than on the actual nomination of these individuals as authorised representatives. This removes a loophole which incurred additional costs when making an application.

7.12 The 2005 regulations already provide that the fees specified in the regulations may be superseded by a charging scheme made by the regulator which must be approved by the Secretary of State and laid before Parliament. However, this power did not extend to the regulator of offshore installations. These regulations now extend that power so the power to make a charging scheme for offshore installations is consistent with the power for onshore installations.

7.13 The amendments are also designed to make available information underlying the EU Emissions Trading Scheme to other government bodies for the purpose of preparing and publishing national energy and emissions statistics, including the preparation and publication of a national greenhouse gas inventory as required by the Kyoto protocol. Verified fuel use and characterisation data at installation level will help to improve the accuracy of sector estimates of greenhouse gas emissions reported at an aggregated level within the national inventory. Verified fuel analysis data will ensure default carbon emission factors used in the inventory are current and representative of UK fuels. This in turn will ensure that the allowances that installations are required to surrender each year under the EU Emissions Trading Scheme are accurately calculated.

7.14 The consultation sought views on a second set of proposed amendments to the Greenhouse Gas Trading Regulations 2005 with regard to, among other things, missing and late installations. The consultation process started on Monday 24 October 2005. The consultation closed on Monday 16 January 2006. There were 8 responses to the consultation and the suggestions have been considered in the final drafting of the regulations.

7.15 Three consultation responses concerned the regulations that amend the registry charges. Two of these responses were in favour of the amendment, while the other reaffirmed their long standing opposition to any levy for Registry fees.

7.16 The provision on access to EU Emissions Trading Scheme data is different to that which was consulted upon. Originally, the provision only permitted the use of data for the development of the National Emissions Inventory, however the final version permits their use by Defra and other departments for the purpose of developing and publishing other energy and emissions statistics. Although not specifically consulted upon, in advance of the submission of this year's Inventory to the European Commission a letter was sent out to all EU Emissions Trading Scheme operators asking them if they objected to the use of their data. We only received four outright objections.

7.17 A change has been made to the regulations following a request from the registry administrator. The request was made after the close of the consultation. The amendment will increase the fees payable to people wishing to open registry accounts with the sole intention of trading on the carbon market. The changes, if applied to the current position, would mean a total of £4,700 of additional cost being recovered by the Environment Agency from the 77 accounts of this type.

## **8. Impact**

8.1 A Regulatory Impact Assessment is attached to this memorandum.

8.2 The impact on the public sector is to enable the Secretary of State and the regulators to ensure that the UK is in compliance with requirements of the approved national allocation plan. It is expected that many of the missing and late installation will be hospitals, universities and other public sector organisations. These regulations will enable these installations to gain free allowances to comply with their obligations under the scheme. We set the reserve as mentioned in paragraph 7.5 at 1.5 million allowances. We estimated that there would be between 50 and 100 installations that may apply. To date we have had approximately 20 installations asking for allowances from the reserve, many of these have been hospitals.

## **9. Contact**

Adam Kidson at the Department for Environment, Food and Rural Affairs Tel: 020 7238 4729 or e-mail: [adam.kidson@defra.gsi.gov.uk](mailto:adam.kidson@defra.gsi.gov.uk) can answer any queries regarding the instrument.

**Annex**

## **EU Emissions Trading Scheme**

**Draft amendment to the Greenhouse Gas  
Emissions Trading Scheme Regulations**

**The Greenhouse Gas Emissions Trading  
Scheme (Amendment) Regulations 2006**

**Regulatory Impact Statement**

**October 2005**

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## 1. Amendments to Regulations

- 1.1. This Regulatory Impact Statement is concerned with amendments to the Greenhouse Gas Emissions Trading Scheme Regulations 2005<sup>2</sup>. The amendments are designed to set out how late entrants to the EU Emissions Trading Scheme (EU ETS) will be treated in the UK and how they can apply to receive a proportion of free allowances.
- 1.2. Late entrants include installations that were not included in the National Allocation Plan (NAP)<sup>3</sup>. This is because they failed either to obtain a Greenhouse Gas Permit and/or to submit verified baseline emissions data in time. Those that had more than 3 months in which to submit verified data prior to the release of the NAP, are not considered to be late entrants.
- 1.3. The consequential amendments to the 2005 regulations will also cover the following other matters:
  - surrender of permits:
  - power to delay issue of allowances:
  - registry charges; and
  - offshore charging scheme.

More details on these other matters can be found in section 9.

- 1.4. The amendments are also designed to make available information underlying the EU ETS to other government bodies for the purpose of preparing and publishing national energy and emissions statistics, including the preparation and publication of a national greenhouse gas inventory as required by the Kyoto protocol. Verified fuel use and characterisation data at installation level will help to improve the accuracy of sector estimates of greenhouse gas emissions reported at an aggregated level within the national inventory. Verified fuel analysis data will ensure default carbon emission factors used in the inventory are current and representative of UK fuels. This in turn will ensure that the allowances that installations are required to surrender each year under the EU ETS are accurately calculated.

## 2. Purpose and intended effect

### Objective

- 2.1. The objective of the proposed amendments is to set up the process for dealing with, and issuing allowances to, late entrants to the EU Emissions Trading Scheme. No provision had previously been made in

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<sup>2</sup> See: <http://www.opsi.gov.uk/si/si2005/20050925.htm>

<sup>3</sup> See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/nap/approved.htm>

the Regulations for dealing with eligible installations that were not included in the final National Allocation Plan.

- 2.2. The objective of the proposed amendments relating to the national emissions inventory is to improve the accuracy and consistency of reporting both under the EU ETS and the national inventory, particularly since emissions data now carry significant financial implications.

## **Background**

### *Late and Missing Installations*

- 2.3. The broad objective of the EU ETS is to reduce greenhouse gas emissions from installations covered by the Scheme. It is a key market-based instrument and the EU ETS forms an integral part of the European Union's strategy to tackle the challenges posed by climate change. It aims to reduce, in the most cost effective way, EU emissions of carbon dioxide (CO<sub>2</sub>) that contribute to the problems associated with global warming. Also the Scheme is intended to encourage investments by business to help EU Member States achieve the reductions necessary to meet their Kyoto Protocol targets for 2008-2012.
- 2.4. The UK National Allocation Plan (NAP) was published on 24 May 2005<sup>4</sup>. The NAP outlines how installations in the Scheme were issued free allowances. The NAP is intended to put us on a path to achieving our national climate change goal of moving towards a 20% reduction in CO<sub>2</sub> emissions on 1990 levels by 2010.
- 2.5. Further information about the Scheme and how it operates can be found on Defra's website<sup>5</sup>.
- 2.6. The original Greenhouse Gas Emissions Trading Scheme Regulations did not include provision for the treatment of late entrants. However, the approach has been subsequently agreed to by Ministers and was inserted into the final National Allocation Plan in Appendix C6.

### *National Emissions Inventory*

- 2.7. Previously Defra did not envisage that the data required for preparation of the NAP would be used for any other purpose and this was set out in letters sent to participants in 2003. However, it has become clear that the information held by participants at a detailed level used for monitoring and reporting under the EU ETS is a potentially very useful resource to improve the accuracy of government bodies when preparing and publishing national energy and emissions statistics, including the preparation and publication of a national greenhouse gas inventory as required by the Kyoto protocol. The national inventory is

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4 See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/nap/approved.htm>

5 See: [www.defra.gov.uk/environment/climatechange/trading/eu/index.htm](http://www.defra.gov.uk/environment/climatechange/trading/eu/index.htm)

6 See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/nap/pdf/annexc.pdf>

used to assess progress by the UK in meeting its Kyoto target. It is therefore important that where more accurate data exists these are made available for the purposes of preparing the national inventory.

- 2.8. The benefits will be two-way. Currently Defra requests data for inventory purposes from participants on an individual basis which is a very time-consuming and inefficient means of procuring information. Requests for information are becoming a burden to industry so efforts to streamline will be important. Industry has a clear interest in ensuring that the most accurate information particularly on emission factors is shared and used within the UK context since it will determine the number of allowances that participants must surrender each year under the EU ETS.

### **Legislative framework**

- 2.9. The Directive was transposed into UK law on 31 December 2003 by the Greenhouse Gas Emissions Trading Scheme Regulations 2003<sup>7</sup>. These Regulations provided the necessary legal framework and detailed rules for implementing the EU ETS in the UK. Amendments to the 2003 Regulations were then made to implement further policy decisions (such as new entrant and closure policy) and relevant EU implementing legislation, and to enable regulators to recover the costs incurred when exercising their functions under the Scheme. The 2003 Regulations have now been revoked and replaced by the Greenhouse Gas Emissions Trading Scheme Regulations 2005<sup>8</sup>, which entered into force on 21 April 2005. The Regulations now require amendments to include provisions for late entrants to the EU ETS, registry charges, offshore charging scheme, subsistence charging, power to delay issue of allowances, surrender of permits and power to collect information for Phase II of the EU ETS.
- 2.10. As a Party to the UN Framework Convention on Climate Change (UNFCCC), the UK is required to develop and update national inventories of anthropogenic emissions by sources and removals by sinks of all greenhouse gases not controlled by the Montreal Protocol. This obligation is extended by the requirement in Article 5 of the Kyoto Protocol for Annex I countries (countries listed in Annex I to the Kyoto Protocol) to have in place, no later than one year before the start of the first commitment period, a national system for the estimation of anthropogenic emissions by sources and removals by sinks of all greenhouse gases not controlled by the Montreal Protocol. Article 4 of the EC Monitoring Mechanism Decision 280/2004/EC<sup>9</sup> requires the

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7 See: <http://www.opsi.gov.uk/si/si2003/20033311.htm>

8 See: <http://www.opsi.gov.uk/si/si2005/20050925.htm>

9 Commission Decision No 280/2004/EC of the European Parliament and of the Council of 11 February 2004 concerning a mechanism for monitoring Community greenhouse gas emissions and for implementing the Kyoto Protocol.

Community as a whole and Member States to establish inventory systems under the Kyoto Protocol for the estimation of anthropogenic emissions of greenhouse gases by sources and removals of carbon dioxide by sinks. In Article 12 (1) to the implementing provisions<sup>10</sup> for Decision 280/2004/EC, Member States are required to ensure the quality of activity data, emission factors and other parameters used for their national greenhouse gas inventory in accordance with the IPCC good practice guidance. The present draft regulations will also assist the UK in complying with its obligations under the UNFCCC, the Kyoto Protocol and EU legislation.

*Rationale for government intervention*

- 2.11. Without amendments to the Regulations in accordance with the section in the NAP on late entrants, no free allowances can be issued to late entrants. They will be required to purchase all the allowances that they would need to surrender from the date the application is duly made until the end of Phase I in 2007.
- 2.12. These draft regulations will improve the accuracy and consistency of greenhouse gas emissions reporting at a national level and under the EU ETS. They will also clarify the position with regard to use of EU ETS data and streamline data requests from industry.

**Consultation so far on late and missing installations**

*Within Government and the devolved administrations*

- 2.13. Government departments, regulators and devolved administrations have been involved in the development of policy options and the draft regulations and have had input to this RIA and the consultation document.

*Public Consultation*

- 2.14. Government sought views on these amendments to the Greenhouse Gas Trading Regulations 2005 with regard to, among other things, missing and late installations. The consultation process started on Monday 24 October 2005. The consultation closed on Monday 16 January 2006. There were 8 responses to the consultation and the suggestions have been considered in the final drafting of the regulations.
- 2.15. Stakeholders, including businesses and non-governmental organisations, have been regularly consulted on the implementation of the Scheme and their responses have been used to inform policy decisions with regard to the development of the National Allocation

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<sup>10</sup> Commission Decision of 10 February 2005 laying down rules implementing Decision No 280/2004/EC of the European Parliament and of the Council concerning a mechanism for monitoring Community greenhouse gas emissions and for implementing the Kyoto Protocol

Plan and Regulations. A list of all consultations that have been held on the EU ETS is available on the Defra website<sup>11</sup>.

- 2.16. Government Departments, the Environment Agency, SEPA, DOENI, sector associations and others, went to considerable lengths to publicise the requirements of the EUETS and to identify and contact all installations that may have fallen into the Scheme. These installations required permits and were eligible to apply for free allowances from the NAP. Letters, emails and phone calls were made to installations that the Government had identified as possibly being covered. However, Government did not always have the relevant information (e.g. capacity of combustion equipment on a site) to determine exactly which installations in the UK fell into the Scheme. It became clear as the NAP was being finalised, that some installations may not have been aware of requirements or had in the first instance incorrectly calculated that they did not exceed the 20MW threshold for combustion installations, only to recalculate later and find that they did.
- 2.17. Therefore, policies on how to treat such installations were developed and confirmed with Ministers. These were then included in the Provisional NAP published on 14th February 2005<sup>12</sup>. At that time, no submissions of comments were made regarding the proposed treatment of late entrants at that stage. The Commission subsequently approved the final NAP<sup>13</sup>, and consequently we are now seeking to amend the Regulations<sup>14</sup> to implement the policy agreed to in the NAP.

### **3. Benefits, costs and risks**

#### ***Sectors and groups affected***

##### *Late and Missing Installations*

- 3.1. The sectors most likely to be affected by the policy and regulations relating to late installations are smaller manufacturing sites, hospitals, universities and services with on-site combustion equipment that exceeds the 20MW threshold.

##### *National Emissions Inventory*

- 3.2. Making EU ETS information available to other government bodies for the purpose of preparing and publishing national energy and emissions statistics, including the preparation and publication of a national greenhouse gas inventory as required by the Kyoto protocol is not expected to impose additional costs upon participants in the scheme. The benefits will be:

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11 See: [www.defra.gov.uk/environment/climatechange/trading/eu/info/consultations.htm](http://www.defra.gov.uk/environment/climatechange/trading/eu/info/consultations.htm)

12 See: <http://www.defra.gov.uk/corporate/consult/euetsnap-stagethree/index.htm>

13 See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/nap/approved.htm>

14 See: <http://www.opsi.gov.uk/si/si2005/20050925.htm>

- ensuring that all participants are using the most accurate and representative basis for monitoring and reporting their emissions;
- streamlining data requests to industry; and
- enabling the UK as a whole to assess more accurately progress towards its Kyoto target. The risks of confidential information being released are considered no greater than at present.

Confidential information on emissions may at present be released under the Environmental Information Regulations 1992 or the Freedom of Information Act 2000. To overcome concerns related to commercial confidentiality, information is presented at an aggregated level in the national inventory.

### Options for the treatment of late and missing installations

- 3.3. In order to compare the costs and benefits of different approaches for dealing with late entrants, the following options were considered:
1. do nothing and require installations to purchase all their allowances when they enter the Scheme;
  2. set aside a specific proportion of allowances from the cap from which to issue a proportion of free allowances and amend the NAP and regulations accordingly; or
  3. apply to the Commission to issue ‘additional’ free allowances when these installations enter the Scheme (in the form of a supplementary NAP).
- 3.4. Table 1 lists the options and discusses their potential difficulties/costs and their benefits. The options and the reasons for the chosen approach included in the NAP are then discussed.

Table 1. Benefits and costs of the options for treatment of late entrants to the EU ETS.

	Benefits	Difficulties/Costs
Option 1 – require installations to purchase all allowances	<ul style="list-style-type: none"> <li>• Reasonably straight-forward.</li> <li>• No allowances would need to be set aside from either the sector totals or the NER.</li> <li>• Late comers will be penalised for not complying with the Directive within the timelines that many others met.</li> <li>• May not be a particularly large financial burden in</li> </ul>	<ul style="list-style-type: none"> <li>• Could be a considerable financial burden on smaller installations that emit a small percentage of emissions within the NAP.</li> <li>• Defra will need to demonstrate that all ‘reasonable measures’ were taken to contact these installations and inform them of their obligations under the regulations.</li> </ul>

	<p>context of fuel costs for some installations (e.g. £40,000 on top of a £900,000 fuel bill).</p>	<ul style="list-style-type: none"> <li>• There may be future legal challenges to this approach.</li> </ul>
<p>Option 2 – set aside a portion of allowances from the cap for late installations and ring fence the allowances within the NER</p>	<p>A specific quantity of allowances are set aside for late, undiscovered installations.</p> <p>‘Late comers’ could be penalised by issuing them fewer allowances than they otherwise would have received had they been in the NAP.</p> <p>Set aside would probably be relatively small (approx. 0.2% of total cap)</p> <p>A time limit could be set for use of this set-aside with any unused allowances going back into the NER</p> <p>Allocation methodology could be based on method in NAP with ‘penalty’ for late compliance.</p> <p>Penalty could be staggered to encourage late entrants to come forward sooner rather than later.</p>	<p>It will be difficult to accurately predict how many allowances to set aside for late entrants.</p> <p>It is unclear which sector/s would give up allowances for the set aside.</p> <p>Might be seen as unfair for late comers to receive any allowances.</p> <p>When the set aside runs out, installations will have to purchase their allowances.</p> <p>Would need to set up special process and list for dealing with installations.</p> <p>Any penalty reduction in free allocation may still be significant in some sectors.</p>
<p>Option 3 – Seek EC approval on an annual basis to issue additional allowances to these installations.</p>	<ul style="list-style-type: none"> <li>• Would not have to set aside allowances from the current cap.</li> <li>• Would only need to seek approval for a small number of additional allowances, since undiscovered installations are likely to be small.</li> </ul>	<ul style="list-style-type: none"> <li>• May not be approved by the Commission. Particularly since they have already stated that any allowances issued to late entrants must come from within the approved cap.</li> <li>• Time consuming to make an application, especially if the application was</li> </ul>

		<p>rejected.</p> <ul style="list-style-type: none"> <li>• Timing issues are relevant as an application may need to be made for every allocation or on an annual basis.</li> </ul>
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*Option 1 – Do nothing (require operators to purchase allowances)*

- 3.5. Option 1 would require installations to purchase all allowances to surrender at the end of the year to cover all their emissions.
- 3.6. A typical combustion installation discharging around 5,000-10,000 tonnes CO2 per year. The following table outlines how much it may cost to purchase allowances.

Table 2.

<b>Allowance Price</b>	<b>Cost per year</b>
£5	£25,000 to £50,000
£15	£75,000 to £150,000
£25	£125,000 to £250,000

While this is relatively minor in terms of installation fuel bills, which may be an order of magnitude larger, this would still be an additional burden compared to the installation being included in the NAP and receiving a proportion of allowances for free.

- 3.7. Issuing no free allowances could be a particularly harsh financial penalty for some operators that are likely to have relatively minor emissions, such as hospitals, universities, and small manufacturers. Such operators may have been unaware of the EU ETS's requirements until they were approached by the regulators.
- 3.8. It would also dissuade operators from coming forward if they recognise they have erred in determining whether they are in the Scheme. This would mean that not all installations are covered in accordance with the regulations and Directive.
- 3.9. In addition to this potential financial penalty, the installation also faces enforcement action by regulators for failing to hold a Greenhouse Gas Permit.

*Option 2 - Set aside allowances from the overall cap within the NER and amend the regulations*

- 3.10. This option involves setting aside a small number of allowances from the total cap (around 1.5 MtCO2 over three years, approximately 0.2% of the total) to insert into the New Entrant Reserve. This 'set aside' can



then be used to issue a proportion of free allowances to each installation when it enters the EU ETS.

- 3.11. Such a set aside can be designed to run out, after which time no allowances will be issued for free to late entrants. In addition, the set aside will not be available after February 2007, when any left over allowances can return to the NER. There will also be a strict timetable for these installations to submit applications, information and verification opinions. Failure to meet these timeframes may result in no free allowances.
- 3.12. Option 2 is the preferred option and section 3.2.1 below contains further discussion on how allowances can then be calculated and issued to late entrants.

*Option 3 Apply to the Commission to grant allowances to late installations*

- 3.13. Option 3 would involve grouping all late entrants on a period basis, and applying to the Commission to issue them with additional free allowances.
- 3.14. This is not a preferred option because the Commission has already stated that any allowances granted to existing installations 'discovered' after the final application date would need to be accounted for in the total number of allowances already approved in the Member State's National Allocation Plan. The Commission is unlikely to approve the issue of additional allowances by Member States above the approved cap.
- 3.15. Other Member States have issued allowances from their New Entrant Reserve to installations that have come forward after approval of their NAP.

*Options for calculating allowances*

- 3.16. As discussed above, Government wanted to strike a careful balance. On the one hand penalising late comers for failing to comply with well-publicised requirements (in addition to potential enforcement action by regulators). And on the other hand making any penalties so onerous that they would have a significant financial impact, or deter operators from coming forward to join the Scheme.
- 3.17. If installations that should be in the Scheme do not come forward, because they perceive the costs of compliance to be too high, the UK Government risks infraction for non-implementation of the Directive.
- 3.18. Bearing these issues in mind, the UK Government has determined that late entrant allowances can be calculated using as far as practicable the methodology in the NAP, with a reduction factor applied.
- 3.19. Any reduction factor will result in operators having to purchase allowances, or not having as many allowances to sell at the end of

each reporting year (compared to them being in the NAP). Between 10% to 25% of free allowances will be withheld as a penalty for late entry.

- 3.20. As an example, the potential financial impacts on a small combustion site in the services sector with relevant emissions of 10,360 tCO<sub>2</sub> of a range of different reduction factors are given in Table 2. Such an installation would have been granted an annual allocation of around 8,745 tCO<sub>2</sub> and 26,234tCO<sub>2</sub> total allowances for Phase I in the NAP.

**Table 2. Potential impact of reduction penalties**

	Allocation annual average tCO <sub>2</sub>	Total Allocation tCO <sub>2</sub>	Annual financial penalty at £5/tCO <sub>2</sub>	Total financial cost of penalty at £5/tCO <sub>2</sub>	Annual financial penalty at £15/t	Total financial penalty at £15/t
Full allocation <sup>1</sup>	8,745	26,234	0	0	0	0
<b>10% penalty</b>	<b>7,871</b>	<b>23,610</b>	<b>£4,373</b>	<b>£13,119</b>	<b>£13,118</b>	<b>£39,354</b>
<b>25% penalty</b>	<b>6,559</b>	<b>19,675</b>	<b>£10,931</b>	<b>£32,790</b>	<b>£32,794</b>	<b>£98,382</b>
50% penalty	4,373	13,117	£21,863	£65,589	£65,588	£196,764

<sup>1</sup> 'Full allocation' does not mean they will not have to buy some allowances, rather that the allocation would be the same as if the installation had been included in the NAP.

- 3.21. Having considered the figures above, Government determined that the allocations should be reduced by 10% for those applying for their GHG Permit up to 31 August 2005, increasing to a 25% reduction after 6 months from this date (from 1 September 2005).
- 3.22. In reality, these penalties will not be as high for the first year since the installation will only receive allowances for the first year prorated to the date the application is duly made.

### **Economic Impact**

- 3.23. The proposed option strikes a balance between ensuring that late installations, who possibly knew nothing about the Scheme's requirements, receive a fair allocation, but at the same time acknowledging that many installations have met the legal requirements of the Scheme and fully complied with it and all timeframes.
- 3.24. The economic impact of the proposed amendments on late entrants could still be reasonably substantial depending on the quantity of emissions from the site (and reduction factor applied). However, the impact would have been far greater if the Regulations are not amended as proposed.

- 3.25. As required by the NAP and proposed regulations, late entrants will also be required to obtain verification of their baseline emissions data by an accredited verification body. If an installation has only one year's non zero data using the baseline, its allocation will be based on the bench marking methodology.
- 3.26. The proposed regulations also state that if late entrants apply for their GHG Permit after the late entrant set aside runs out, or after the end of February 2007 when the set aside expires, they will need to purchase all their allowances. It is difficult to say how many installations may be affected as a consequence of the late entrant reserve expiring. By 2007, all installations should have had plenty of opportunity to apply for relevant permits and seek allowances from the late entrant reserve and comply with the Scheme.

### ***Uncertainties***

#### **The price of carbon**

- 3.27. As indicated in Table 2, the price of allowances will significantly influence the extent to which late installations will be penalised. A high carbon price will mean that the 10% or 25% penalty reduction will be more expensive than a low carbon price.

#### **Number of late installations and potential emissions**

- 3.28. It is difficult to predict how many installations are not yet permitted and should be in the EU ETS that are likely to come forward to enter the Scheme during Phase 1. It is also difficult to predict what their emissions are likely to be. However an estimate was required to determine the quantity of allowances to set aside. Following discussions with regulators about the types and likely scale of missing installations, Government estimated that there could be between 50 to 100 installations coming into the Scheme during Phase 1 that would discharge around 10,000 tonnes of CO<sub>2</sub> each year. This gave rise to a late entrant set aside of 1.5Mt CO<sub>2</sub> in total over three years.
- 3.29. A finite number of allowances have been set aside for late installations. The number of installations and the demand for allowances will affect the ability of the late entrant set aside to meet requirements. If the Government's predication is too low, then some late entrants may not receive and free allowances, if they are too high, new entrants will benefit from allowances being transferred back into the NER in 2007.

## ***Summary of costs and benefits***

### ***Benefits***

#### **Administrative**

- 3.30. All installations within the Scheme are more likely to come forward with the knowledge that they will receive some free allowances. This is compared to the alternative of receiving no free allowances.
- 3.31. The Commission are unlikely to take infraction proceedings if the UK can demonstrate that it is carrying out all reasonable measures to ensure that eligible installations have GHG Permits and are in the Scheme.

#### **Environmental**

- 3.32. More installations in the Scheme means that more installations will be working towards reducing emissions through emissions trading.

#### **Economic**

- 3.33. Late installations will receive some allowances free of charge. When these installations surrender allowances they will only have to purchase the allowances they require above the free allocation.

### ***Costs***

#### **Economic, implementation, verification and compliance costs**

- 3.34. The costs of being involved in the Scheme have already been discussed in the RIA statement available on Defra's website<sup>15</sup>.
- 3.35. Late entrants risk financial penalties for failing to hold a GHG Permit by 1 January 2005.
- 3.36. As they failed to comply with legal requirements, late installations will receive a reduced allocation compared to others that are included in the NAP.

#### **Verification**

- 3.37. Late installations applying for free allowances must follow the same process of baseline verification as incumbent installations. Operators must:
- calculate their baseline emissions (1998 to 2003);
  - obtain an independent verification to confirm them; and

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<sup>15</sup> See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/pdf/euets-finalria.pdf>

- submit the verification to Defra.
- 3.38. Late entrants will not be able to apply to have the baseline, commissioning and rationalisation rules applied to the calculation of their allocation. This may also result in them receiving a lower allocation than they would have done had then been in the NAP.

#### **4. Monitoring and reporting**

- 4.1. Once late entrants enter the Scheme they will be required to monitor and report their emissions in the same manner as incumbent installations.
- 4.2. Installations must monitor and report annual emissions of CO<sub>2</sub> in accordance with the regulator approved monitoring and reporting plan (M & R Plan). The costs of monitoring will depend on:
- the scale and complexity of the installation;
  - the level of accuracy required by the Commission's M&R Decision; and
  - the requirements of the installation's M&R Plan.

The medium definition of combustion installation adopted for Phase I of the Scheme may reduce the costs of monitoring for some installations.

- 4.3. The M&R Decision<sup>16</sup> generally requires installations to use the highest, most accurate monitoring tiers unless it is not technically or economically feasible to do so. Therefore each year, installations will need to consider how and whether they can improve the accuracy of their monitoring methods. While accuracy requirements for monitoring are generally lower for smaller emitters since improving them could be argued to entail unreasonable costs. The monitoring and reporting costs for smaller emitters will still be relatively high per tonne of CO<sub>2</sub> compared to much larger emitters. Further consideration of the costs facing smaller emitters and how Government can work towards reducing them is being considered through work on Phase II of the EU ETS.<sup>17</sup>
- 4.4. Regulators are currently preparing guidance on their expectations for improvements within certain Schedule 1 activities.<sup>18</sup> Improving accuracy will incur costs, such as installing new gas meters, but will facilitate the purchase or sale of allowances. The regulators will consider cost benefit assessments in determining whether to require

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16 See: [http://europa.eu.int/comm/environment/climat/emission/mrg\\_en.htm](http://europa.eu.int/comm/environment/climat/emission/mrg_en.htm)

17 See <http://www.defra.gov.uk/environment/climatechange/trading/eu/phase2/index.htm>

18 Schedule 1 to the ETS Regulations sets out the activities covered by the Scheme.

See: [www.legislation.hmso.gov.uk/si/si2005/20050925.htm](http://www.legislation.hmso.gov.uk/si/si2005/20050925.htm)

more accurate monitoring through varying Greenhouse Gas permit conditions.

## 5. Risks

### ***Identification, verification and enforcement***

- 5.1. The UK endeavoured to locate and permit all installations covered by the EU ETS by 1 January 2005, with the aim of including them in the NAP. However, despite facing potential enforcement action under the Regulations, the challenging implementation timetable means that there is a risk that not every installation falling within the scope of the scheme has been permitted and included in the NAP. Some operators may still be unaware of the Scheme's requirements, or they may have incorrectly determined that they are not in the Scheme. These installations are expected to include smaller combustion installations, such as small manufacturing plants, universities, hospitals and public services. We have endeavoured to minimise costs as far as possible for small installations involved in Phase I, and further work on minimising the potential costs to small installations is being considered through Phase II consultation.
- 5.2. Operators of installations covered by the EU ETS that do not hold a Greenhouse Gas permit from 1 January 2005 risk potential enforcement action by the regulators.<sup>19</sup> Penalties (on summary conviction) include fines (not exceeding the statutory minimum) or imprisonment not exceeding three months.
- 5.3. Operators also risk penalties for failing to surrender the correct number of allowances by 30 April each year (equal to the verified annual emissions figure). Failure to surrender the correct number of allowances will result in a penalty of €40 per tonne during Phase I of the Scheme.

### **Accuracy of data**

- 5.4. To ensure that the data underlying the allocations were as accurate, complete and consistent as possible, the Government required operators to obtain independent verification of the baseline emissions data reported in the NAP data forms. Verifications had to be performed by verification bodies accredited by the UK Accreditation Service. Independent verification identified and addressed many inconsistencies and errors in the data. There is still a risk of errors or misstatements remaining in some installation's baseline data.
- 5.5. Future verifications will play an important role in potentially identifying any undiscovered errors in baseline emissions data. Where such

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<sup>19</sup> See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/info/directive.htm#regulations>

cases constitute provision of a 'statement that is false or misleading' that lead to an over-allocation of allowances, Government can seek to amend future allowances to an installation under regulation 38<sup>20</sup>. There is a risk that these errors are not picked up and go undetected. The risk of errors resulting in the installation having received a lower allocation than they should have, will not be pursued by the Government.

### **Issues of equity and fairness**

- 5.6. These have been discussed previously and considered as discussed above in developing the reduction factors proposed in the NAP and proposed amendments.

## **6. Consultation with small businesses**

- 6.1. As discussed previously, Government attempted to identify and contact installations falling into the Scheme. Many sector associations were asked to alert their members to the EU ETS requirements. We also contacted many hospitals and universities and these installations were also followed up by their overarching Government departments (such as the Department of Health) through follow up letters and discussions.
- 6.2. Many seminars and workshops were held to discuss EU ETS requirements and the timetable for lodging information and verification opinions.
- 6.3. However, given that Government does not hold records of the operating capacity of sites, operators were responsible for determining whether or not they are included in the scheme. Therefore, it has been difficult to locate and therefore consult with all small businesses and sites potentially affected by these regulations.
- 6.4. The installations on the current late entrants list will be given the opportunity to comment on the consultation document accompanying this RIA and the draft regulations.

## **7. Competition assessment<sup>21</sup>**

### ***Within the UK***

- 7.1. If these installations had been required to enter the Scheme, but received no free allowances there may have been some competitive distortions. They would have had to purchase all of the allowances required to be surrendered at the end of the year. This is compared

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20 See: <http://www.defra.gov.uk/environment/climatechange/trading/eu/info/directive.htm#regulations>

21 Analyses of the competitive impacts of the EU ETS can be found on the Defra website at: <http://www.defra.gov.uk/environment/climatechange/trading/eu/info/impact.htm#compete>

with the installations that entered the NAP and received a proportion of the allowances they require for surrender free of charge because they submitted all relevant data and information as required by the NAP (although they may still have had to purchase some allowances).

- 7.2. While late entrants will be penalised by not receiving a full allocation, the level of the penalty should not cause any significant adverse impacts on competitiveness. Installations need to come forward to enter the Scheme as soon as possible since the set aside may run out. If the late entrant set aside runs out before 28 February 2007, operators of late installations will need to purchase their allowances.
- 7.3. In addition, many of the installations are unlikely to compete directly as they typically include such as hospitals, universities, other public services and small manufacturers.

### ***Other Member States***

- 7.4. Late installations entering the EU ETS in the UK may be better off than their counterparts in other Member States. Few other Member States have provided a specific 'set aside' for late EU ETS installations that were not included in the final National Allocation Plan. Late entrants in countries without a late entrant set aside may need to purchase all their allowances to surrender at the end of the year. Alternatively the Government would need to purchase the allowances on their behalf.
- 7.5. In some Member States late installations (emitting less than 25,000 tonnes of CO<sub>2</sub> year) will be added to their opt out applications and approval sought from the Commission. While others have indicated that they may apply to the Commission to include these installations in their NAPs in due course. Other countries may consider issuing allowances from the New Entrant Reserve.

## **8. Enforcement, sanctions and monitoring**

- 8.1. Late installations are installations that operated an activity listed in Schedule of the Greenhouse Gas Emissions Trading Scheme (EU ETS) Regulations 2005 on the 31 December 2003, but were not included in the final National Allocation Plan (NAP) published on 24 May 2005. They include installations that were granted a Greenhouse Gas permit (GHG permit) after 1 January 2005, but were unable to submit a verification opinion verifying their baseline emissions data to Defra by 28 February in time to be included in the final allocation decision, and also installations that applied for a GHG permit after 24 May 2005 when the final allocation was published.



### ***Enforcement and sanctions***

- 8.2. The European Commission has the power to bring infraction proceedings against any EU Member State which does not meet the deadlines in the Directive for implementation of the Scheme.
- 8.3. The UK is therefore required to ensure that all appropriate installations have GHG Permits and that they participate in the trading Scheme. Failure to include all appropriate installations may result in infraction proceedings by the Commission.
- 8.4. To implement the EU ETS Directive requirements the ETS Regulations<sup>22</sup> contain specific enforcement powers and sanctions. The regulators for the EU ETS in the UK are responsible for ensuring compliance with the Regulations. The regulators and/or the Secretary of State, Scottish Ministers, National Assembly for Wales, and the Chief Inspector (Northern Ireland) have powers to enforce sanctions on installations that fail to comply with their obligations. In particular, it is the duty of the regulators to enforce compliance with the monitoring and reporting conditions that are set out in the operator's permit. The regulator has the power to serve an enforcement notice on the operator if the regulator has reason to believe that an operator has contravened, is contravening or is likely to contravene any monitoring and reporting condition.<sup>23</sup>
- 8.5. The UK Regulations provide both criminal and civil sanctions. The Regulations contain several criminal offences in relation to the Scheme, such as:
  - carrying out an activity covered by the Scheme without a GHG permit;
  - knowingly or recklessly providing misleading statements in order to obtain a greenhouse gas emissions permit; and
  - failing to comply with the requirements of an enforcement notice.
- 8.6. Failure by an operator of an installation to surrender a sufficient number of emission allowances by 30 April each year will result in a financial penalty. In the Phase I this penalty will be set at €40 per excess tonne of CO<sub>2</sub> (allowance) that an operator fails to surrender. In the Phase II of the Scheme the penalty will increase to €100 per allowance. Payment of the penalty does not relieve the operator from the obligation to surrender allowances under the Scheme. The shortfall from the year in which the penalty was paid will be rolled over and added to the number of allowances that must be surrendered the

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<sup>22</sup> <http://www.defra.gov.uk/environment/climatechange/trading/eu/info/directive.htm#regulations>

<sup>23</sup> See Part 4 of the Greenhouse Gas Emissions Trading Scheme Regulations 2005 for further details.

following year. The UK Regulations provide an additional enforcement mechanism where an operator fails to surrender sufficient allowances by blocking transfers out of the account until sufficient allowances have been surrendered<sup>24</sup>.

- 8.7. Failure to submit a verified annual emissions figure will result in the installation's registry account being blocked by the registry administrator. The installation will then be subject to the fines described above if they have not surrendered the correct number of allowances. This emphasises the need for installations to start to arrange for verifications as soon as possible and not to leave it to the last minute. Verified annual emissions reports must be submitted by all operators by 31 March each year. This requirement must also be met by late installations. If annual emissions reports cannot be verified, operators must seek guidance from the regulators. Regulators have the ability to calculate emissions on the behalf of operators.
- 8.8. Late entrants are subject to potential enforcement action for failing to hold a GHG Permit. Once they have obtained their permit and entered the Scheme they will be subject to all the Scheme rules and requirements.
- 8.9. Late applicants must submit the Late Entrant form, NAP data form and verification opinion statement within specific timeframes. If they fail to do so they may not receive any free allowances or could lose their place in the queue.

### ***Monitoring and review***

- 8.10. The Directive (Article 21) requires Member States to report annually to the Commission on the application of the Directive. The first of these reports is due on 30 June 2005.
- 8.11. Operators of installations covered by the EU ETS are required to prepare and implement monitoring and reporting plans. These plans describe how emissions from the installation are monitored and reported on an annual basis. In mid-2004, regulators in the UK published guidance on how to prepare these plans and ran workshops with EU ETS participants.
- 8.12. Upon approval, the monitoring plan was included as a condition of the Greenhouse Gas Emissions Permit and operators started monitoring in accordance with approved plans on 1 January 2005.
- 8.13. The permit application for late entrant now requires the monitoring and reporting plan to be submitted with the application and approved at the same time as the GHG Permit.

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<sup>24</sup> See Part 7 and Regulation 26(8) of the Greenhouse Gas Emissions Trading Scheme Regulations 2005 for further details.

- 8.14. Annual emissions reports and the monitoring programme must be verified by accredited verifiers before they are submitted to regulators. They must be submitted by 31 March each year for emissions during the preceding year. Allowances must then be surrendered in accordance with the verified Annual Reportable Emissions figure by 30 April each year.

## **9. Other Consequential Matters**

### ***Surrender of Permits***

- 9.1. The objective of this amendment is to cover situations which have recently come to light. The Regulations ensure that a Surrender notice imposes an obligation on the operator to report his emissions up until the date the Surrender Notice takes effect.
- 9.2. In relation to a permit that covers more than one installation on the same site, an operator will be obliged to vary (rather than surrender) his permit if he closes just one of the installations covered by a permit. The allowances relating to the closed installation would not be issued to the operator for the years following the closure. The impact on operators of the amendment is low because there are currently no permits which cover more than one installation. In any event, the requirement does not impose any new costs on operators.
- 9.3. A new surrender provision ensures that closed installations must report emissions up until the date the Surrender Notice takes effect, rather than only up to the date the Notice was served. This ensures that all possible emissions up to the actual closure of the installation are reported but this does not impose any onerous costs or additional burdens on operators.
- 9.4. A minor amendment to the wording of the surrender provisions makes it clear that the monitoring and reporting requirements under the permit cease from the date the Surrender Notice takes effect. This reduces the burden on operators, since the requirement is unnecessary.

### ***Delay of Allowances***

- 9.5. The objective of this amendment is to allow new and late entrants to be dealt with in the same way as incumbent installations.
- 9.6. The impact on business is that in certain circumstances new and late entrant operators may have the allocation of their allowances in a given year delayed until after the 28th February allocation deadline. However, this delay is necessary in order to ascertain whether the installation is still entitled to the allowances in question. After such a decision is made, the allowances will either be allocated or withheld.

### ***Registry Charges***

- 9.7. This amendment's objective is ensure that a fee is payable on the appointment rather than nomination of an individual as a new user of the registry.
- 9.8. The Regulations simplify and standardise the cost of applying for a Person Holding Account, an External Additional Authorised Representative account or to be a Verifier within the Registry to £175. They also simplify and standardise the cost of applying for a replacement or an extra Authorised Representative for a Person Holding Account, an External Additional Authorised Representative account or a Verifier within the Registry to £50.
- 9.9. The regulations will increase the fees payable to people wishing to open registry accounts with the sole intention of trading on the carbon market. The changes, if applied to the current position would mean approximately a total of £4,700 of additional cost being recovered by the Environment Agency from the 77 accounts of this type.

### ***Offshore Charging Scheme***

- 9.10. The objective of this amendment is ensure that offshore charging is consistent with onshore charging.
- 9.11. By virtue of regulation 19(1) of the 2005 Regulations<sup>25</sup> the Secretary of State (DTI) may make a charging scheme to cover fees for permit applications, applications to vary, transfer or surrender such permits and fees for subsistence charges for such permits. The amending Regulations simply add four other categories of fees - for registry, new entrant, rationalisation and closure charges - which could be included in any charging scheme made by the Secretary of State where such charges are necessary. Accordingly, the regulatory impact of these amendments is negligible.

## **10. Post-implementation review**

- 10.1. Once the regulations have been made, Defra and the regulators will monitor the applications coming from late installations. We will regularly review the availability of the allowances in the late entrant reserve and ensure distribution of allowances in a fair manner in accordance with the established procedures in the regulations.
- 10.2. Inclusion of late entrants into the Scheme will then be taken into account in the annual report to the Commission discussed above.

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<sup>25</sup> See: <http://www.opsi.gov.uk/si/si2005/20050925.htm>

## **11. Summary and recommendations**

- 11.1. The amendments to the regulations will ensure that late entrants are not required to purchase all their allowances. Details of applicants and status of application will be public.
- 11.2. The regulation amendment aims to ease the burden of the EU ETS on late entrants. These are likely to be:
- smaller operators who may have overlooked requirements; or
  - operators who incorrectly determined that they were not in the EU ETS, and have subsequently recognised that they are covered.
- 11.3. The regulations amend consequential matters by:
- ensuring that a surrender notice imposes an obligation on the operator to report on his emissions up until the surrender notice takes effect.
  - allow new and late entrants to be dealt with in the same way as incumbent installations with respect to the delay of allowances
  - ensuring that a fee is payable on the appointment rather than nomination of an individual as a new user of the registry
  - making certain that offshore charging is consistent with inshore charging.
- 11.4. The amendments are designed to make available information underlying the EU ETS for the national emissions inventory.

## **12. DECLARATION**

- 12.1. I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs

**Signed**

**Date**

**ELLIOT MORLEY, MINISTER OF STATE**

**DEPARTMENT FOR ENVIRONMENT FOOD AND RURAL AFFAIRS**