

**EXPLANATORY MEMORANDUM TO THE
GREENHOUSE GAS EMISSIONS TRADING SCHEME REGULATIONS
2005**

2005 No. 925

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.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

- 2.1 This instrument revokes and replaces the following instruments:

- ❖ The Greenhouse Gas Emissions Trading Scheme Regulations 2003 (S.I. 2003/3311) (the “2003 Regulations”);
- ❖ The Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations 2004 (S.I. 2004/3390) (the “Subsistence Charge Regulations”).

- 2.2 The Regulations (the “Consolidated Regulations”) consolidate the 2003 Regulations and update its provisions, in particular, to:

- ❖ take account of the adoption of the Commission Decision establishing guidelines for the monitoring and reporting of greenhouse gas emissions (Commission Decision 2004/156/EC) and the Commission Regulation for a standardised and secured system of registries (Commission Regulation 2216/2004/EC);
- ❖ give effect to policy developments on the treatment of installations which start operation, are extended or close after the initial allocation of allowances has been made; and
- ❖ include additional charges associated with the above and to introduce an ongoing subsistence charge.

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

Use of terms in the Registries Regulation

- 3.1 Regulation 2 defines the term “Registries Regulation” and provides “unless the context otherwise requires, expressions which are also used in the Registries Regulation have the same meaning as they have in the Registries Regulation”.

3.2 The Department considers that the use of the expression “unless the context otherwise requires” is justified in this context because of the difference in the use of the terms “allocation” and “issue” in the Registries Regulation and the Directive and the Regulations.

3.3 The Directive envisages a two stage process for providing allowances to operators. First the allowances are allocated in respect of an installation in the decision under Article 11(1) or (2) of the Directive. In each year, allowances are issued to the operator of the installation in respect of which they are allocated. The use of the terms in the Consolidated Regulations is consistent with their use in the Directive.

3.4 However the Registries Regulation uses the terms in a different way by providing for the issue of the total quantity of allowances into the Member State’s account (Articles 39 and 45) and then labelling the transfer of those allowances to the operator’s account in the registry as the “allocation of allowances to operators” (Articles 40 and 46). Therefore in this context it is considered that the expressions in the Consolidated Regulations do not have the same meaning as the expression in the Registries Regulation.

4. Legislative Background

4.1 The 2003 Regulations transposed into UK law the requirements of the Emissions Trading Directive (Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the European Community).

New Community legislation

4.2 Since the Regulations were made the Community has adopted additional secondary legislation in accordance with the requirements of the Directive: namely the Monitoring and Reporting Decision and the Registries Regulation. Consequential amendments to the 2003 Regulations are necessary to ensure the Regulations are consistent with the Community legislation.

New entrants and closure

4.3 Under the Emissions Trading Directive Member States are required to state in their National Allocation Plan the manner in which new entrants will be able to begin participating in the scheme. The National Allocation Plan for the UK provides for the creation of a reserve of allowances (“the new entrant reserve”) to be set aside for new entrants. Amendments to the 2003 Regulations are necessary to set out the procedures for applying for allowances from the new entrant reserve.

4.4 The National Allocation Plan also provides that installations which cease operation will not be issued with allowances for the years after cessation has occurred save except in specific circumstances. Amendments to the 2003 Regulations are necessary to ensure that allowances are not issued to closed installations except where the conditions specified in the national allocation plan are met.

Temporary Exclusion

4.5 The EU ETS Directive allows for Governments to apply for certain installations to be excluded from the scheme for all or part of the first phase. Regulation 11 of the 2003 Regulations set out the procedures for applying for a temporary exclusion certificate following a Commission decision on temporary exclusion. Since the Commission decision on the UK's application for the temporary exclusion of installations covered by Climate Change Agreements has yet to be made, an amendment to the 2003 Regulations is required to set out the details of the provisions of temporary exclusion certificates, time limits for operators to apply and details of how allowances will be allocated to temporarily excluded installations.

Fees

4.6 Regulation 17 of the Consolidated Regulations provides for fees to be paid by the operator on application for a permit and in relation to the variation, transfer and surrender of permits. The Subsistence Charge Regulations amended the 2003 Regulations to provide for a charge in relation to the subsistence of the permit for the financial year 2004/5 by persons holding a greenhouse gas emissions permit to cover the costs of administering the scheme which relate to the subsistence of the permit in that year.

4.7 The Consolidated Regulations provide for a charge to be paid by persons holding a greenhouse gas emissions permit to cover the cost of administering the scheme which relate to the subsistence of the permit. The fee will incorporate an element to cover the costs of operating operator holding accounts in the registry.

4.8 The regulations also provide for fees to be paid in relation to an application for an allocation from the new entrant reserve, an application to retain an allocation of allowances and in relation to registry accounts held other than by operators.

4.9 The regulations introduce a charge for the revocation of the permit by the regulator where the operator has failed to comply with an obligation to surrender the permit.

4.10 In the longer term, it is proposed that the fees in the regulations will be superseded by charging schemes developed by the regulators. Regulation 18 of the Consolidated Regulations provide for this possibility. To ensure that it is possible it has been necessary to extend the charging provisions in the Environment Act 1995 and the Pollution Prevention and Control Act 1999 to enable a charging scheme to cover charges of this nature.

5. Extent

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Minister of State (Department of Environment, Food and Rural Affairs) has made the following statement regarding Human Rights:

In my view the provisions of the Greenhouse Gas Emissions Trading Scheme Regulations 2005 are compatible with the Convention rights.

Amendments to the Environment Act 1995 and the Pollution Prevention and Control Act 1995

Schedule 5 to the Regulations sets out the fees and charges which are prescribed under the Regulations. These include:

- ❖ Charges in relation to the grant, variation, transfer, surrender, and revocation of a greenhouse gas emissions permit;
- ❖ Fees in respect of the allocation of allowances;
- ❖ Registry fees, and
- ❖ Charges for the subsistence of a greenhouse gas emissions permit.

Regulation 18(3) provides that the charges in Schedule 5 will apply until such time as they are superseded by the provisions of a charging scheme made under section 41 of the Environment Act 1995 or regulation 19.

Schedule 6 to the Regulations provides for amendments to the Environment Act 1995 (the “1995 Act”) and the Pollution Prevention and Control Act 1999 (the “1999 Act”).

The amendments to the 1995 Act are intended to enable the Environment Agency and the Scottish Environment Protection Agency to make a charging scheme superseding the charges prescribed in Schedule 5 of the Regulations by extending the powers in section 41 of the 1995 Act. It extends the definition of “environmental licence” in section 56 of the Act to include a greenhouse gas emissions permit. A new section 41A extends the types of charges which can be prescribed

in a charging scheme under section 41 of the 1995 Act to include all charges provided for in Schedule 5 of the Regulations.

The amendments to the 1999 Act are intended to enable the Secretary of State to make regulations enabling her to make a charging scheme in relation to offshore installations superseding the charges set out in the Schedule 5 to the Regulations. The amendment extends the purposes for which the Secretary of State can make regulations under section 2 of that Act by inserting a new paragraph 9A into Schedule 1.

Application with modifications of the Local Government Act 1972 and the Local Government (Scotland) Act 1973

Schedule 3 provides for section 250 of the Local Government Act 1972 and section 210 of the Local Government (Scotland) Act 1973 to apply with modifications. These allow for costs orders to be made where a local inquiry or hearing is held as part of an appeal under the Regulations.

ECHR issues:

There are no ECHR issues raised by these amendments

7. Policy background

7.1 The EU Emissions Trading Scheme aims to promote reduction of greenhouse gas emissions in order to combat the serious threat of climate change. Operators of installations covered by the EU Emissions Trading Scheme must hold a greenhouse gas emissions permit and are allocated emission allowances (which they are able to trade). The conditions of the permit require operators to monitor and report the emissions of CO₂ from their installation and to surrender allowances by 30 April 2006 and in each subsequent year to cover those emissions in the previous calendar year.

7.2 Amendments to the 2003 Regulations are required to enable the implementation of policy decisions that have already been made public as part of the preparation of the National Allocation Plan following previous work and consultation with respect to the UK implementation of the EU ETS. Amendments are also necessary to enable regulators to recover the costs of their responsibilities under the Scheme.

New Community Legislation

7.3 Operators of installations covered by the EU ETS must monitor and report their emissions in accordance with the EC Monitoring and Reporting Decision which was negotiated and adopted since the ETS Regulations came into force. The amendments include a reference to the Decision and other minor amendments associated with the Decision.

7.4 Under the EU Registries Regulation, Member States are required to establish a system of registries in the form of an electronic database for monitoring the issue, holding, transfer and cancellation of allowances. The Regulation is directly applicable and therefore applies directly as UK law. However, it is necessary to make some consequential and supplementary amendments to the 2003 Regulations in order to incorporate the EU Registries Regulation.

7.5 The amendments address issues which were left to the discretion of Member States under the EU Registries Regulation, in that they:

- ❖ appoint the Environment Agency as the registry administrator;
- ❖ provide for the possibility of allowing account holders to nominate a person (“an additional authorised representative”) whose agreement is required to carry out one or more transactions in the registry;
- ❖ provide for an additional penalty where an operator fails to surrender sufficient allowances in accordance with the requirements of its permit, namely by blocking the account so no transfers can be made out of the account;
- ❖ provide that the issue of allowances may be delayed in specific circumstances identified in the National Allocation Plan (e.g. pending resolution of appeals on allocation decisions);
- ❖ provide for a fee to be charged for opening registry trading accounts for entities which do not operate an installation (see further below).

New entrants and closures

7.6 The decision to have a new entrants reserve (NER) was made following previous work and consultation on the National Allocation Plan. Since the 2003 Regulations came into force, Government has been preparing and consulting upon detailed rules on the methodology and procedure for allocating allowances to new entrants. Further details of these can be found in the Regulatory Impact Assessment accompanying the Consolidated Regulations. In November 2004, Government published details of its policy decisions on the types of new entrants that are eligible to apply for allowances from the new entrant reserve and the process for applying for allowances.¹ These detailed rules have been notified to the European Commission as part of the development of the National Allocation Plan.

7.7 The amendments to the 2003 Regulations set out in the Consolidated Regulations set out the procedures for applying for an allocation from the NER and the related functions of the regulators, including the charging of application fees. The regulator will make a

¹ www.defra.gov.uk/environment/climatechange/trading/eu/newentrant.htm

final determination on the allowance allocation to be made to a new entrant, following the rules and procedures set out in the National Allocation Plan. The Consolidated Regulations provide for instructions to be made to the registry administrator to issue the allowances. They also allow for appeals to be made against the regulator's final determination of an application. Appeals are made to the appropriate authority depending on where the installation is located. The amendments also make it an offence to provide false or misleading information for the purposes of obtaining an allocation from the NER.

7.8 Alongside the development of the policy on new entrants, the National Allocation Plan sets out the treatment of installations which cease operation after the scheme has started and provides that they will not be issued with allowances for the years after cessation has occurred. Because it is not possible to revoke allowances which have already been issued, installations that cease operation will retain their allocated allowances for the year in which cessation occurs. The amendments to the 2003 Regulations set out in the Consolidated Regulations therefore provide that steps shall be taken to ensure that no further allowances are issued after cessation and impose an obligation on operators to notify regulators where cessation takes place.

7.9 The National Allocation Plan provides that the only circumstances in which an installation may retain its allocation is in the case where a Schedule 1 activity has ceased to be carried out but production has been transferred to another plant in common ownership. The amendments set out the procedures for applying to retain allocation upon closure, while the details of the conditions which must be satisfied are set out in the National Allocation Plan.

Temporary Exclusion

7.10 The EU ETS Directive allows for Governments to apply for certain installations to be excluded from the scheme for all or part of the first phase. This is conditional on those installations being subject to national climate change policies that result in equivalent emissions reductions (the "environmental equivalence" test), equivalent penalties and equivalent monitoring, reporting and verification arrangements to that which they would have been subject had they moved into the EU ETS.

7.11 The European Commission has already approved the temporary exclusion of installations covered by the UK Emissions Trading Scheme. These installations will not be subject to the full requirements of the EU ETS until 2007 and will not be issued with allowances until that date. However, the Commission decision on the UK's application for the temporary exclusion of installations covered by Climate Change Agreements has yet to be made. Therefore, an amendment to the

2003 Regulations is required to set out the details of the provisions of temporary exclusion certificates, time limits for operators to apply and details of the circumstances in which allowances will be allocated to installations which apply for temporary exclusion.

Fees

7.12 The charging arrangements relating to the EU ETS have been developed in accordance with the principles of cost recovery and cost reflectivity – that is to say that they provide for charges to allow regulators to recover the costs they will incur in carrying out their functions in relation to the EU ETS in the relevant financial year.

7.13 The ETS Regulations set out the fees for permit applications, variations, transfers and surrenders. In addition, the Consolidated Regulations provide for subsistence charging for financial years 2005/6 onwards, fees for new entrants and closures and fees for registry administration for non-permit holders. They also revise the permit application fees to incorporate the costs of assessing monitoring and reporting plans and introduce powers for regulators to develop charging schemes to supersede the fees and subsistence charges in the regulations in the future.

(a) Subsistence charges

7.13 At the time of consulting on the 2003 Regulations, subsistence charges were not provided for because there was insufficient information on the likely level of the costs to be incurred by the regulators and therefore the level of charge required to cover the regulator costs. However, the consultation document made it clear that such a charge would be imposed to cover at a later date.

7.14 The Subsistence Charging Regulations provided for charges for the financial year 2004/5 which related principally to:

- ❖ Set-up costs relating to preparations for carrying out regulator functions under the scheme; and
- ❖ Reviewing and approving monitoring and reporting plans submitted to the regulator by operators in accordance with a condition of their permits.

7.15 Amendments in these Consolidated Regulations require operators to pay a subsistence charge for subsequent financial years (that is, 2005/6 and onwards). The principal activities which these charges cover are inspection, compliance and enforcement costs and the administration of the registry. Full details of the costs incurred and the activities covered by the subsistence charges are set out in the Regulatory Impact Assessment accompanying these Regulations.

7.16 As the overall level of regulatory efforts varies in part with the level of emissions, the installations are grouped into 3 bands (Band A

installations discharging < 50KtCO₂/yr; Band B 50-500KtCO₂/yr; Band C >500KtCO₂/yr) so costs and charges can be apportioned fairly. Annual costs of compliance and inspection will vary depending on the number of installations in the Scheme. Because there are fixed costs which will be incurred regardless of the number of installations covered, the charge must increase as the number of installations decreases. Because the application for temporary exclusion of installations covered by Climate Change Agreements has yet to be considered by the European Commission, it is therefore necessary to set out a range of possible charges. The charges will be fixed once the number of installations remaining within the scheme is confirmed.

7.17 The charge will be pro-rated for the part of the year that the permit is in place. If an operator applies part way through the year, the operator will pay a full application charge with a reduced subsistence charge proportionate to the number of days remaining. Similarly, where a permit is surrendered or revoked, the regulator will refund the relevant proportion of the subsistence charge.

(b) New entrant and closure fees

7.18 The 2003 Regulations do not prescribe charges to cover the additional administrative costs associated with the calculation of allowance allocations for new entrants, ensuring that closed installations are not issued with further allowances and dealing with applications for retention on entitlement to allowances as a result of site rationalisation. The Consolidated Regulations specify the various new fees and increases to existing fees and reflect the time and effort involved in checking applications, calculating provisional allocations of allowances from the reserve and confirming locations once all conditions for issuing allowances are met.

(c) Registry fees for non-permit holders

7.19 The Consolidated Regulations provide for a registries fee to be charged in respect of persons other than operators wishing to open and hold a personal account in the registry. The fee for account creation is £175. Up to three authorised representatives will be allowed per account. If there are any subsequent requests for a change to the named authorised representative(s) of the account, a fee of £50 will be charged. This is to cover the costs of checking and processing the information necessary to change the named authorised representative(s) of the account.

(d) Revised application fees

7.20 The costs of assessing and approving plans developed by operators for monitoring and reporting emissions is currently included in the subsistence charge for 2004/5 rather than the permit application fee. However, for future applications, fees relating to assessing and

approving monitoring and reporting plans will be included as part of the permit application fee, as this information will be provided as part of the application. The Consolidated Regulations set out the levels of the revised fees.

(e) *Charging schemes*

7.21 The regulations introduce a power for regulators to develop charging schemes to supersede the fees and subsistence charges in the regulations. This avoids the need to amend the regulations each time the level of fees and subsistence charges is adjusted and enable a more streamlined and responsive approach to establishing these charges. Regulator charging schemes will still require public consultation and approval by the Secretary of State and regulations permitting the Secretary of State to make a charging scheme for offshore installations would be required to be laid before each House of Parliament.

Consultation

7.22 Government consulted on the proposed regulation amendments for 6 weeks. The reduction from the usual consultation period of 12 weeks was made because (a) the timeframes set out in the Directive for implementing the EU ETS were very tight; and (b) participants in the EU ETS had previously been consulted on most of the issues to which the amended regulations referred, including subsistence charging.

7.23 In relation to the non-charging elements of the regulations, consultation responses were mixed. Many of the comments repeated positions on policy issues which had already been addressed in consultations on the development of the National Allocation Plan and as such did not relate directly to the amendments themselves. In particular, the proposals regarding registries and temporary exclusion were supported by consultees. Detailed technical comments were made on the provisions regarding new entrants and closures and, in finalising the amendments, account has been taken of these comments.

7.24 The consultation draft of the amendments contained provisions addressing the treatment of operators which become insolvent after the scheme has begun. Although some consultees expressed support for the proposal, others have voiced concern and have pointed out technical problems with the proposed approach. Government has therefore decided to take time to consider in more detail the treatment of insolvent operators and amend the regulations at a later date, if it is considered that special treatment is required.

7.25 The provisions relating to subsistence charges formed part of the earlier consultation on the Subsistence Charging Regulations. Consultees expressed dissatisfaction with the level of fees and sought

further details of regulator costs. Following a review of relevant regulator costs and the proposed charges during the consultation period, the charges were revised downwards by approximately 5% but any further reduction would be inconsistent with cost recovery and reflectivity policies.

7.26 In relation to the other fees introduced in the Consolidated Regulations, similar concerns were raised about the level of fees and the transparency of the regulator costs, as well as the complexity of the charging regime. In light of these comments, Government has considered the fee structure and level of fees and discussed these further with the regulators and as a result is satisfied that the proposed approach and level of fees is appropriate and reflects the costs likely to be incurred by regulators.

7.27 Further information on the details of the regulator costs can be found in the attached Regulatory Impact Assessment.

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 the ETS Directive and to give effect to policy decisions on the implementation of the EU ETS in the UK. In addition, the Consolidated Regulations allow the regulators to recover their costs and therefore to carry out their duties under the Regulations effectively.

9. Contact

Chris Dodwell at the Department for Environment, Food and Rural Affairs Tel: 020 7082 8091 or e-mail: chris.dodwell@defra.gsi.gov.uk can answer any queries regarding the instrument.

Regulatory Impact Assessment for Consolidated Greenhouse Gas Emissions Trading Scheme Regulations 2005

1. Title of proposal

1.1 This Regulatory Impact Assessment (RIA) concerns the implementation of the consolidated Greenhouse Gas Emissions Trading Scheme Regulations 2005. This set of regulations will consolidate and replace the Greenhouse Gas Emissions Trading Scheme Regulations 2003 (the 2003 Regulations) and the Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations 2004 (the 2004 Regulations). The amendments that have been made to the 2003 and 2004 Regulations (referred to in this RIA as the ETS Regulations) are in respect of the following issues:

- New Entrants
- Closures
- The EU Registries Regulation
- The EC Monitoring and Reporting Decision
- Temporary Exclusion
- Regulator fees and subsistence charges for 2005/6 onwards
- The ability of the regulators to develop a charging scheme

1.2 The overall impact of the EU Emissions Trading Scheme is addressed in a separate full regulatory impact assessment which is being prepared in conjunction with the development of the National Allocation Plan. Partial regulatory impact assessments were published alongside the draft National Allocation Plan in January 2004², the National Allocation Plan in May 2004³ and the proposed amendments to the National Allocation Plan in November 2004⁴. A final regulatory impact assessment will be published alongside the final allocation decision in late April or early May.

1.3 The regulations apply to England, Scotland, Wales and Northern Ireland.

2. Purpose and intended effect of measure

(i) Objective

2.1 The purpose of the amendments to the regulations is to enable the implementation of the EU Emissions Trading Scheme (EU ETS). A number of policy decisions concerning the operation of the EU ETS have already been made following previous work and consultation. The proposed amendments would facilitate the implementation of these decisions as outlined below.

² <http://www.defra.gov.uk/corporate/consult/eu-etsnap/index.htm>

³ <http://www.defra.gov.uk/corporate/consult/euetsnap-stagethree/index.htm>

⁴ <http://www.defra.gov.uk/corporate/consult/euetsnap-amend/index.htm>

2.2 Certain rules were developed to address the treatment of, and allocation to, new entrant installations. Similarly, rules were developed to address the treatment of an installation's allocation when it ceases to carry out a Schedule 1 activity (in full). The existing ETS Regulations need to be amended to allow for these rules to be applied as and when required. For example the amended regulations would allow operators to apply for allowances from the new entrant reserve.

2.3 The EU Registries Regulation⁵, which establishes a system of registries in the form of an electronic database for monitoring the issue, holding, transfer and cancellation of allowances, entered into force on 30 December 2004. It is directly effective and applies directly as UK law. It is however necessary to make some consequential and supplementary amendments to the ETS Regulations.

2.4 The amendments will also allow the ETS Regulations to include a reference to the EC Monitoring and Reporting Decision⁶ (which sets out the relevant monitoring and reporting conditions) and to require a review of the requirements of the permit to be undertaken if there is an amendment to the EC Monitoring and Reporting Decision, which was adopted in 2004.

2.5 The amendments include provisions to enable regulators to recover the costs associated with performing certain activities required of them under the draft regulations. These include the costs associated with the checking of allocations to new entrants, the costs of dealing with closures and opening registry trading accounts for entities that do not operate an installation. They also include the costs of subsistence of operators' permits for 2005/06 onwards. In addition, the amendments would enable the regulators to set up a charging scheme.

(ii) Background

2.6 The EU Emissions Trading Directive establishes a scheme for greenhouse gas emission allowance trading within the Community. It aims to promote reductions of greenhouse gas emissions in a cost-effective and economically efficient manner. The Directive was transposed into UK law through the ETS Regulations. Obligations to monitor emissions take effect from 1 January 2005. Member States are required to develop National Allocation Plans (NAPs) setting out the total quantity of allowances to be issued to installations covered by the scheme and how those allowances will be allocated to installations.

⁵ Commission Regulation (EC) No 2216/2004 of 21 December 2004 for a standardised and secured system of registries pursuant to Directive 2003/87/EC of the European Parliament and of the Council and Decision No 280/2004/EC of the European Parliament and of the Council entered into force on 30 December 2004 (http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l_386/l_38620041229en00010077.pdf)

⁶ Commission Decision of 29/01/2004 establishing guidelines for the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council (http://europa.eu.int/comm/environment/climat/pdf/c2004_130_en.pdf)

2.7 Amendments to the existing regulations are required to enable the implementation of policy decisions that have already been made with respect to the development of the UK National Allocation Plan⁷ and to enable regulators to recover the costs of carrying out their functions under the Scheme.

(iii) Risk assessment

2.8 The amendments to the regulations are necessary for the effective implementation of the EU ETS. Without the amendments, it may not be possible for some aspects of the scheme, which have already previously been consulted and decided on, to be implemented. If the implementation of certain parts of the EU ETS is not carried out, or is delayed, there is a risk that the potential benefits of the scheme (resulting from the reduction of CO₂ emissions that contribute to the problems associated with global warming) will not be fully realised. The UK's ability to meet its national climate change goal of moving towards a 20% reduction in CO₂ emissions on 1990 levels by 2010 may also be affected. The amendments aim to ensure that policy decisions about the operation of the scheme can be implemented.

2.9 Given the large amount of CO₂ covered by the EU ETS, the number of installations affected and significant financial implications, it is important for the Scheme to have robust compliance checks and enforcement measures. The Environment Agency also require sufficient resources to effectively manage the registry. These will ensure that the Scheme operates effectively and efficiently, and the public are confident in the Scheme's administration and achievements. The imposition of a subsistence charge is necessary to recover regulator costs of enforcing the requirements of permits and monitoring plans.

2.10 If no statutory provision for a subsistence charge were made:

- Operators may be reluctant to pay a subsistence charge if it is voluntary.
- Regulators would not have the resources required to check that operators are meeting the requirements of the Regulations.
- Regulators would not have resources to undertake enforcement action where monitoring and reporting conditions are not being met.
- Without adequate monitoring and enforcement by the regulators, the scheme is unlikely to operate effectively to promote reductions of carbon dioxide emissions in a cost effective and economically efficient manner. The UK would also not be complying with its obligations under the Emissions Trading Directive.
- There is a risk of financial fraud in estimating emissions and in trading.

⁷ Further background information on the EU Emissions Trading Scheme can be found at:
<http://www.defra.gov.uk/environment/climatechange/trading/eu/index.htm>

- There is a risk of infraction proceedings being brought against the UK if the Directive is not implemented properly.

3. Options

3.1 Sections 3 and 4 of this RIA have been divided into two parts.

3.2 The first part covers non-charging related issues as follows:

- New Entrants
- Closures
- The EU Registries Regulation
- The EC Monitoring and Reporting Decision
- Temporary Exclusion

3.3 The second part covers fees and subsistence charging as follows:

- Fees
- Subsistence charging for 2005/06 onwards
- The ability of the regulators to develop a charging scheme

Non-charging related issues

3.4 Two options have been considered:

1. Do nothing;
2. Amend the ETS Regulations.

3.5 Option 2 is the preferred option since if the ETS Regulations are not amended, there is a risk that the EU ETS will not be properly implemented. This means that the potential benefits that the scheme could bring via the reduction of CO₂ emissions may not be fully realised as mentioned above.

Fees and subsistence charging

3.6 To recover the costs of regulators' responsibilities under the Scheme, government and regulators have discussed several options:

1. To fund regulator costs through public funds such as Grant in Aid (GIA);
2. Amend the Regulations to impose a requirement on operators holding a permit to pay a subsistence charge; also for certain fees to be paid in respect of applications for New Entrant Reserve allocations, closure and opening registry trading accounts;
3. Amend the Regulations to enable the regulators to develop a charging scheme to cover fees and subsistence charges;

4. Amend the Regulations to impose a requirement on operators holding a permit to pay a subsistence charge, for certain fees to be paid in respect of other regulator activities, but with express provision for the fees and charges set out in regulation 17 of the Regulations to be superseded by a charging scheme once this is developed by regulators in the future.

3.7 Option 4 is the preferred approach for the following reasons:

- While considerable Government funding has been used to establish the Scheme in the UK, the Government does not consider that further Government funds should be used to resource the regulators to perform the tasks discussed above.
- Charging operators is in accordance with Government policy on the polluter pays principle. This approach will be further discussed in the Charging Handbook currently under development by Defra and regulators.
- Government now have a clear indication of the potential subsistence costs of the Scheme and these can be written into the regulations;
- It is desirable in the future for regulators to develop their own charging schemes, subject to certain procedural requirements, to amend the level of fees and charges rather than requiring an amendment of the regulations each time the level of the fee or charge needs to change.

3.8 A set of amending regulations imposing an obligation on operators of installations to pay a subsistence charge for 2004/05 entered into force on 13 January 2005⁸. The amendments referred to in this RIA provide for fee charging, subsistence charging for 2005/06 and subsequent years, and for the development of regulator charging schemes.

3.9 In order to determine the level of fees and subsistence charges to include in the Regulations, Government considered the following options:

1. Equivalent fees and charges for all participants, irrespective of size and scale of emissions
2. Tiered fees and charges to reflect the average effort of administering the Scheme for installations falling into particular bands based on their annual CO₂ emissions (Group A less than 50,000t CO₂ per year, Group B between 50,000 and Group C more than 500,000 tCO₂ per year)
3. Tiered fees and charges which cap the costs for smaller emitters. This approach would reflect a polluter pays principle.

3.10 For fees, either Option 1 or Option 2 was chosen depending on whether the costs being recovered varied according to installation emissions

⁸ For further information, please see:
<http://www.defra.gov.uk/environment/climatechange/trading/eu/documents.htm>

levels. Hence for the fees aimed at recovering the costs of assessing and approving operators' Monitoring and Reporting plans, Option 2 was chosen since these costs vary with emissions levels. For all other fees, Option 1 was chosen as the costs being recovered do not vary with emissions levels.

3.11 For subsistence charging, Option 2 was chosen because:

1. An equivalent charge for all participants would not be cost reflective and the smaller installations would be subsidising the costs of the larger installations.
2. The tiered charge which takes into account the differentiated levels of effort required to administer the Scheme for different scales of emitters is deemed to be the most cost reflective approach in line with long established principles of cost reflectivity and cost recovery. These principles have been reaffirmed recently by the joint Defra/Agency Review of Charging, with input from across Government departments⁹.
3. Capping the costs for smaller emitters would not be cost reflective and would mean that larger installations would be subsidising the smaller installations.

4. Costs, benefits and risks

Non-charging related issues

4.1 This RIA should be read in conjunction with the Consultation Paper on the Proposed Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Regulations 2005¹⁰. This provides more detailed explanations of the amendments considered below.

4.2 The proposed amendments discussed below relate to policy decisions that were made following previous consultation, and simply allow for those decisions to be implemented in the most effective manner. Thus there are no foreseen costs to these amendments. The benefits of the proposed amendments outlined below are that they allow for the effective implementation of the EU ETS and hence the associated benefits of reduced CO₂ emissions and movement towards meeting our national climate change goal that come with it.

4.3 For further information on the costs and benefits associated with the policy decisions that have been taken on new entrants, closure and temporary exclusion, please refer to the partial RIA that was prepared for the UK National Allocation Plan (NAP)¹¹.

⁹ The first stage of the review has been completed and approved by Ministers Recommendations have been consulted on as part of the Environment Agency's 2005/2006 charging round and will be implemented from April 2005.

¹⁰ <http://www.defra.gov.uk/corporate/consult/euets-regs2/index.htm>

¹¹ <http://www.defra.gov.uk/corporate/consult/euetsnap-stagethree/index.htm>

New Entrants

4.4 The decision to have a new entrant reserve (NER) was made following previous work and consultation on UK implementation of the EU ETS. Since the ETS Regulations entered into force, Government has been preparing detailed rules on the methodology and procedure for allocating allowances from the NER. Further consultation on the mechanics of the new entrant reserve was undertaken between 6 May and 4 June 2004. An announcement on the progress in developing these rules was made on 28 July 2004¹².

4.5 In November 2004, Government announced details regarding its policy decisions on new entrants, closure and auctioning¹³. This included details on the types of new entrant that are eligible to apply for allowances from the new entrant reserve. Consequently, an amendment to the ETS Regulations is required to make provision for applications to be made for an allocation from the NER and for the accompanying fee to be charged (see below for more details on this fee).

4.6 The regulator will make a final determination on the allowance allocation to be made to a new entrant, following the rules and procedures set out in the NAP. The consolidated regulations would provide for instruction to be made to the registry administrator to issue the allowances. They would also allow for appeals to be made against the regulator's final determination of an application. An appeal would be made to the appropriate authority (that is, the Secretary of State for installations in England and offshore installations, the National Assembly for Wales for installations in Wales, Scottish Ministers for installations in Scotland and the Planning Appeals Commission for installations in Northern Ireland).

4.7 The amended regulations will also make it an offence to provide false or misleading information for the purposes of obtaining an allocation from the NER.

Closures

4.8 Alongside the development of the policy on new entrants, the National Allocation Plan sets out the treatment of installations which cease all of their Schedule 1 activities during a phase. Installations that cease operation will retain the allocated allowances for the year in which cessation occurs, but allowances relating to the cessation which have been allocated for the years after cessation has occurred, will not be issued to the installation. The amendments to the 2003 Regulations set out in the Consolidated Regulations therefore provide that steps shall be taken to ensure that no further allowances are issued after cessation and impose an obligation on operators to notify regulators where cessation takes place.

¹² <http://www.defra.gov.uk/environment/climatechange/trading/eu/pdf/euets-newentrant-02.pdf>

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

4.9 The National Allocation Plan provides that the only circumstances in which an installation may retain its allocation is in the case where a Schedule 1 activity has ceased to be carried out but site rationalisation has occurred i.e. production has been transferred to another plant in common ownership. The amendments set out the procedures for applying to retain allocations upon closures, while the details of the conditions which must be satisfied are out in the National Allocation Plan.

The EU Registries Regulation

4.10 The EU Registries Regulation, which entered into force on 21 December 2004, establishes a system of registries in the form of an electronic database for monitoring the issue, holding, transfer and cancellation of allowances. It is directly applicable and therefore applies directly as UK law. However it is necessary to make some consequential and supplementary amendments to the ETS Regulations in order to incorporate the EU Registries Regulation. The amended regulations also provide for the Environment Agency to be appointed as the registry administrator.

4.11 The amendments provide for the possibility of allowing account holders to nominate a person (“an additional authorised representative”) whose agreement is required to carry out one or more transactions in addition to the permission of the primary or secondary account representative.

4.12 Where an operator fails to surrender sufficient allowances in accordance with the requirements of its permit, their account would be blocked so that no transfers can be made out of the account (other than for the purposes of surrendering allowances or for the purposes of cancelling and replacing allowances at the end of the phase). The account would be unblocked when sufficient allowances are surrendered.

4.12 The regulations also provide that the issue of allowances to operators may be delayed in specific circumstances identified in the National Allocation Plan (e.g. pending resolution of appeals on allocation decisions).

4.13 The amended regulations will allow a fee to be charged in respect of opening registry trading accounts for entities that do not operate an installation (see below for more details on this fee).

The EC Monitoring and Reporting Decision

4.14 The amendments would amend the ETS Regulations to include a reference to the EC Monitoring and Reporting Decision¹⁴ adopted last year and other minor amendments associated with this Decision.

Temporary Exclusion

¹⁴ Commission Decision of 29/01/2004 establishing guidelines for the monitoring and reporting of greenhouse gas emissions pursuant to Directive 2003/87/EC of the European Parliament and of the Council (http://europa.eu.int/comm/environment/climat/pdf/c2004_130_en.pdf)

4.15 The EU ETS Directive allows for Governments to apply for certain installations that are covered by the EU ETS to be excluded from the scheme for all or part of the first phase (2005-2007). This is conditional on those installations being subject to national climate change policies that result in equivalent emissions reductions (the “environmental equivalence” test), equivalent penalties and equivalent monitoring, reporting and verification arrangements to that to which they would have been subject had they moved into the EU ETS.

4.16 The European Commission has already approved the temporary exclusion of installations covered by the UK Emissions Trading Scheme. These installations will not be subject to the full requirements of the EU ETS until 2007 and will not be issued with allowances until that date. However, the Commission decision on the UK’s application for the temporary exclusion of installations covered by Climate Change Agreements has yet to be made. Therefore, an amendment to the 2003 Regulations is required to set out the details of the provisions of temporary exclusion certificates, time limits for operators to apply and details of the circumstances in which allowances will be allocated to installations which apply for temporary exclusion.

Fees and subsistence charging

Fees

4.17 Amendments are required to provide for additional fees in relation to the administration of the registry for persons other than operators and the application of new entrants and closure rules. It is also proposed to revise the permit application fees to include the cost of assessing monitoring and reporting plans.

4.18 Under the ETS Regulations, regulators are required to carry out certain functions. Provision for the payment of fees is necessary to enable regulators and the Environment Agency as registry administrator to recover the additional costs required to carry out the duties assigned to them under the draft regulations.

4.19 Section 17 of the ETS Regulations currently allows for regulators to charge: in respect of an application for a permit (£530), to vary a permit (£240), to transfer a permit (£240) and to surrender or revoke a permit (£280). Other costs to the regulators that need to be covered but which are not currently covered by the regulations are described in turn below.

4.20 The ETS Regulations do not prescribe a charge to cover additional administrative costs associated with the calculation of allowance allocations and making adjustments to allocations. These costs range from £340 in the case where an installation closes to £1030 where an application is made for an allocation from the NER. This latter fee of £1030 reflects the time and effort involved in checking applications, calculating provisional allocations of

allowance from the reserve and confirming allocations once conditions are met.

4.21 The cost of assessing and approving the plans developed by operators for monitoring and reporting emissions of carbon dioxide is currently included in the first year's subsistence charge rather than the permit fee. This is because this information was provided separately from the permit application. However, for future applications, fees relating to assessing and approving monitoring and reporting plans will be included as part of the total permit fee, as this information will be provided as part of the permit application. The resulting permit application fees are as follows:- for new entrant installations emitting less than 50ktCO₂ a year: £1230; for new entrant installations emitting 50 to 500ktCO₂ and a year: £2300; for new entrant installations emitting more than 500ktCO₂ a year: £5490.

4.22 Operators of these new entrant installations would also need to pay an annual subsistence charge (as is the case with incumbent operators) to cover the costs of on-going inspection and compliance activities and registry administration. In October 2004 Defra consulted on proposed amendments to the ETS Regulations that would enable regulators in the UK to recover costs through annual subsistence charges for 2004/5 and subsequent years of the EU ETS scheme¹⁵. The amendments that came into force on 13 January 2005 provide for a subsistence charge for the financial year 2004/5. The amendments discussed in this RIA will allow for subsistence charging for 2005/06 and onwards.

4.23 The regulations will allow for an increased fee to be charged where an installation fully and permanently ceases to carry out a Schedule 1 activity. So where an installation completely closes, the permit surrender and revocation fee will be £620 (compared to the existing fee of £280). The increase reflects the additional costs associated with ensuring that the operator no longer receives its allocation.

¹⁵ <http://www.defra.gov.uk/corporate/consult/euets-charging/index.htm>

4.24 Table 1 summaries the total fees that will be charged to operators as a result of the amended regulations.

Table 1

Type of application	Total fee (shown in bold)
Pure new entry	
• Installations – emissions < 50 kt a year	£1230 + £1030 = £2260 ¹
• Installations – emissions 50 to 500kt a year	£2300 + £1030 = £3330 ¹
• Installations – emissions > 500 kt a year	£5490 + £1030 = £6520 ¹
Extension of capacity	£240 + £1030 = £1270 ²
Closure	£280 + £340 = £620 ³

¹ The total fee covers the permit application fee and additional administrative costs associated with the application for an allocation from the NER respectively.

² The total fee covers permit variation and additional administrative costs associated with the application for an allocation from the NER respectively.

³ The total fee covers the surrendering of a permit and additional administrative costs associated with allocation adjustment respectively.

4.25 The amended regulations will allow a registries fee to be charged in respect of persons other than operators holding a personal account in the registry. The fee will cover the costs of establishing and maintaining these trading accounts in the registry. The fee for account creation is **£175**. Up to three authorised representatives will be allowed per account. If there are any subsequent requests for a change to the named authorised representative(s) of the account, a fee of **£50** will be charged. This is to cover the cost of checking and processing the information necessary to change the named authorised representative(s) of the account.

4.26 In November 2004, Government announced details of its policy decisions on new entrants, closure and auctioning¹⁶. This included policy on how to deal with site rationalisation (i.e. where production is transferred from a closed installation to another installation in common ownership). It is proposed that a charge for considering an application to retain allowances on closure would be made on an hourly basis at a rate of **£115**.

4.27 The regulators are required to recover the costs of regulation from the operators that they regulate. The Secretary of State for Environment, Food and Rural Affairs has placed this duty upon them using her statutory powers. It reflects the "polluter pays" principle. The fees have been derived using the principles of cost recovery and reflectivity (i.e. the charge reflects the cost of regulatory effort).

¹⁶ <http://www.defra.gov.uk/environment/climatechange/trading/eu/newentrant.htm>

4.28 There are no net benefits or costs to the imposition of the fee charging described. Overall, the fees impose a zero net cost as they simply represent a redistribution or transfer of money from the participants of the Scheme to the regulators on the principle that the polluter should pay. It means that regulators can recover the costs of implementing the EU ETS that are not already covered by the existing regulations. All installations that are covered by the EU ETS are potentially affected by the amendments.

Subsistence charging for 2005/06 onwards

4.29 Under the ETS Regulations, regulators are required to carry out certain functions in relation to the permitting of installations covered by the Scheme and the enforcement of the requirements of such permits.

4.30 Section 17 of the ETS Regulations currently allows for regulators to charge: in respect of an application for a permit (£530), to vary a permit (£240), to transfer a permit (£240) and to surrender a permit (£280). The Regulations do not prescribe an ongoing subsistence charge. Previous consultation on the implementation of the EU Emissions Trading Directive¹⁷ made it clear that such a charge would be imposed to cover the costs of reviewing monitoring and reporting plans, inspections and enforcement but that this would be introduced at a later date as there was insufficient information at the time of making the ETS Regulations on which to ascertain the level of the charge to be fully cost reflective.

4.31 Amendments to the ETS Regulations imposing an obligation on operators of installations to pay an annual subsistence charge were consulted on in October 2004¹⁸. The subsistence charge for the financial year 2004/2005 was provided for by amendments to the regulations that came into force on 13 January 2005¹⁹. This current RIA considers subsistence charging for 2005/06 and onwards.

4.32 To ensure that the level of charges is based on cost reflectivity, the Environment Agency developed financial models to determine the amount of effort required to administer the Scheme during Phase 1, and hence the level of the annual subsistence charges.

4.33 The subsistence charges for 2005/06 onwards cover the costs of inspection and enforcement required of regulators under the EU Emissions Trading Directive²⁰ and the proposed consolidated regulations. There are two main activities performed by the regulators that need to be recovered by the proposed subsistence charges:

¹⁷ Consultation Paper on the Draft Implementing Regulations of the EU ETS. Sept 2003. Paragraph 63. Available at: <http://www.defra.gov.uk/corporate/consult/euets-regs/consultdoc.pdf>

¹⁸ <http://www.defra.gov.uk/corporate/consult/euets-charging/index.htm>

¹⁹ For further information, please see:

<http://www.defra.gov.uk/environment/climatechange/trading/eu/documents.htm>

²⁰ Directive 2003/87/EC

(http://europa.eu.int/eur-lex/pri/en/oj/dat/2003/l_275/l_27520031025en00320046.pdf)

- **Inspection and Compliance.** This covers items such as periodic inspection of installations to check compliance with permits and following up issues raised during the verification process and enforcement actions. Compliance effort is linked to standard checks and is broadly the same regardless of the level of emissions. However, inspection frequencies have been allocated on a risk basis with larger installations inspected on a more frequent basis.
- **Registry administration.** The subsistence charge will also cover costs of managing and maintaining the registry for the Scheme. It is proposed that the Environment Agency will perform the role of registry administrator for the UK.

4.34 Other costs which need to be recovered by the regulators include:

- Staff training
- Office accommodation , heating, lighting etc
- Ongoing Emissions Trading Helpdesk
- Consultants' charges
- Internal IT costs
- Ongoing legal advice
- Process design changes
- Future policy development
- Changes to permitting database

4.35 Based on the current numbers of installations with GHG Permits: 829 in England and Wales, 119 in Scotland, 91 offshore installations and 30 in Northern Ireland there are 1066 installations. The annual costs of the compliance and inspection program as set out above will vary depending on the number of installations within the Scheme. These are estimated to be **£2.0M per year** based on a total of 1066 installations. This includes an estimate of £150k associated with costs for hosting the EU ETS Registry. These registry hosting costs will be paid for by Defra in 2005/06 but will be included in subsistence charges for 2006/07 and onwards. There are therefore different subsistence charges for the different years as shown in Tables 2 and 3.

4.36 As the overall level of regulatory effort varies in part with the level of emissions, the installations are grouped into 3 bands so costs and charges can be apportioned fairly. These groupings are:

- Band A installations discharging less than 50ktCO₂/yr,
- Band B between 50 to 500 ktCO₂/yr and
- Band C discharging more than 500 ktCO₂/yr.

4.37 These bands are the same as those in the EC Monitoring and Reporting Decision. Charge levels are then derived by apportioning them between the number of installations in each band.

4.38 Annual costs of the compliance and inspection programme will vary depending on the number of installations within the Scheme. This is because there are fixed costs which will need to be apportioned to the number of installations in the Scheme. As the number of installations decreases (e.g. through opt-out), the charge must increase in order to recover the same amount of fixed costs.

4.39 Currently 63 installations (6% of total installations) involved in the UK ETS will be temporarily excluded for 2005 and 2006. In addition, just over 300 installations covered by Climate Change Agreements have also applied to be considered for temporary exclusion. Consequently, the charge will be within the range shown in Tables 2 and 3 below, and fixed once the number of installations remaining within the Scheme is confirmed.

4.40 The charge will be pro rated for the part of the year that the permit is in place. So if an operator applies part way through the year or a temporary exclusion certificate is revoked, the operator will pay a full application charge with a reduced subsistence charge proportionate to the number of days remaining in that financial year. If a permit is surrendered or revoked, the regulator will refund the relevant proportion of the annual subsistence charge.

4.41 The subsistence charge for the financial year 2005/06 is shown in Table 2 below. The subsistence charge for the financial year 2006/07 and for each subsequent financial year is shown in Table 3 below. The increase in subsistence charges from 2006/07 onwards is to cover registry hosting costs.

4.42 The proposed charges in the two tables have been derived using the principle of cost reflectivity (i.e. the charge reflects the cost of regulatory effort). As regulatory effort is linked to the scale of emissions from the installation and therefore band into which it falls, charges are in turn linked to this. The charges also include consideration of the impact of retail price index.

Table 2: Charge for the financial year 2005/2006

		<i>Estimated 2005 emissions or the estimated annual specified emissions from the installation to which the greenhouse gas emissions permit relates-</i>		
		<i>less than 50 kilotonnes per year</i>	<i>at least 50 and no more than 500 kilotonnes per year</i>	<i>greater than 500 kilotonnes per year</i>
Charge if on 1 st April of the financial year to which the charge relates, the total number of installations published by the Secretary of State in accordance with paragraph 7(b) of Schedule 5 of the Regulations is-	less than 500	£2,540	£3,390	£4,230
	500 to 599	£2,280	£3,050	£3,810
	600 to 699	£2,110	£2,820	£3,520
	700 to 799	£1,990	£2,650	£3,320
	800 to 899	£1,900	£2,530	£3,170
	900 to 999	£1,830	£2,440	£3,050
	1000 to 1099	£1,750	£2,350	£2,900
	1100 to 1199	£1,720	£2,300	£2,870
	1200 or more	£1,690	£2,250	£2,810

Table 3: Charge for the financial year 2006/2007 and subsequent financial years

		<i>Amount of annual specified emissions or estimated annual specified emissions from the installation to which the greenhouse gas emissions permit relates-</i>		
		<i>less than 50 kilotonnes per year</i>	<i>at least 50 and no more than 500 kilotonnes per year</i>	<i>greater than 500 kilotonnes per year</i>
Charge if on 1 st April of the financial year to which the charge relates, the total number of installations published by the Secretary of State in accordance with paragraph 7(b) of Schedule 5 of the Regulations is-	less than 500	£2,915	£3,765	£4,605
	500 to 599	£2,553	£3,323	£4,083
	600 to 699	£2,341	£3,051	£3,751
	700 to 799	£2,190	£2,850	£3,520
	800 to 899	£2,076	£2,706	£3,346
	900 to 999	£1,988	£2,598	£3,208
	1000 to 1099	£1,893	£2,493	£3,043
	1100 to 1199	£1,850	£2,430	£3,000
	1200 or more	£1,815	£2,375	£2,935

4.43 There are no net economic benefits of this amendment. It simply means that regulators can recover the costs of administering and enforcing the Scheme not already covered by the charges provided for in the Regulations (in relation to applications for permits, variation, transfer and surrender of permits). The resources required to do this are estimated to be £2.0M per annum. It should be noted that of this, £1.85m will be raised through subsistence charges in the 2005/06 financial year and £2.0M for financial years 2006/07 onwards. The lower figure for 2005/06 is because Defra are supplying the cost of hosting the Registry for this year. The proposed option allows this resource required to be paid for by the participants of the Scheme.

4.44 The environmental benefits the Scheme is expected to achieve in the UK in Phase 1 were set out in the UK NAP published in May 2004.²¹ It is difficult to quantify what proportion of these emissions reductions will be encouraged through adequate compliance and enforcement by the regulators. However, it is important that there is adequate enforcement of the scheme to ensure it delivers cost effective emissions reductions, and for operators and other market participants to have confidence in the robustness of the enforcement. To carry out proper checks on compliance and enforcement the regulators need to be sufficiently funded.

The ability of the regulators to develop a charging scheme

4.45 The regulations introduce a power for regulators to develop charging schemes to supersede the fees and subsistence charges in the regulations. This avoids the need to amend the regulations each time the level of fees and subsistence charges is adjusted and enable a more streamlined and responsive approach to establishing these charges. Regulator charging schemes will still require public consultation and approval by the Secretary of State and HM Treasury and regulations permitting the Secretary of State to make a charging scheme for offshore installations would be required to be laid before each House of Parliament.

5. Equity and Fairness

5.1 The consolidated regulations apply to all installations that are covered by the EU ETS and in that sense can, on the whole, be deemed to be fair and equitable.

5.2 In particular, the regulations relating to the charging of fees have been calculated on the basis of cost reflectivity i.e. the fees charged reflect the

²¹ Available at: <http://www.defra.gov.uk/corporate/consult/euetsnap-stagethree/index.htm>

approximate effort required to administer the requirements of the EU ETS Regulations.

5.3 The subsistence charges have also been calculated on the basis of cost reflectivity i.e. the charge for each band and each year reflects the approximate effort required to administer the requirements of the EU ETS Regulations.

5.4 Developing fees and charges other than on the basis of cost reflectivity could be considered to be inequitable, because some installations would effectively be subsidising another installation's costs. This moves from cost recovery to environmental taxation which is not permitted by Fees and Charges guidance and is outside the enforcing authority's powers.

6. Consultation with small business: the Small Firms' Impact Test

6.1 There are unlikely to be many 'small' businesses with less than 50 employees in the EU ETS. Therefore a full impact test has not been carried out. However, in developing the proposed charges careful consideration was given to the possible impact on Small and Medium Sized Enterprises (SME's).

6.2 The charges were derived following the application of Treasury guidelines, the polluter pays principle, and the principles of full cost recovery and cost reflectivity, within the framework of Community Law. Cost reflectivity means that the regulator's charges should closely reflect the cost of the service provided.

6.3 In the case of the EU ETS, the degree of time and effort required to assess applications for allocations from the NER and to set up and maintain the registry are the same regardless of the size of the operator. Thus uniform fees are charged in respect of these.

6.4 Government concluded that the level of effort associated with the assessment of monitoring and reporting plans increases for installations with higher emissions because they are required to meet more accurate monitoring requirements in accordance with the Commission's EC Monitoring and Reporting Decision. Hence the fees relating to this have been calculated accordingly.

6.5 In developing the subsistence charges, government took into account the fact that ongoing inspection effort is generally independent of the size or level of emissions. There is generally a fixed level of effort associated with preparation for an inspection, ensuring data submissions have been received and travel time. In addition, the checks required are generally the same regardless of the size of the site or level of emissions. However, because government has decided to follow a risk-based enforcement strategy, this means that larger installations are likely to be inspected more often and therefore this increases the charge for the larger installations.

6.6 Government has taken a number of steps to help minimise the impact on SME's. These include: -

- The charges are flexed according to the regulatory effort, which helps SME's
- Spreading some costs over a three year period helps keep the initial level of charges lower and lessens the initial impact on SME's
- Regulators have proposed a risk-based approach to the compliance activities. Whilst, for example, the time taken for an inspection does not vary with the level of emissions, installations with lower emissions will be inspected less frequently.

7. Competition Assessment

7.1 Provision for the payment of fees and charges is necessary to enable regulators and the Environment Agency as Registry Administrator to recover the additional costs required to carry out the duties assigned to them under the regulations. This proposal simply establishes the legal basis for the fees and charges described and sets out what these are likely to be.

7.2 The partial RIA for the National Allocation Plan contains the full competition assessment for the EU Emissions Trading Scheme.

8. Enforcement and Sanctions

8.1 The proposal will be enforced by regulators throughout the UK – the Environment Agency (England and Wales), Scottish Environment Protection Agency (Scotland), Department of Trade and Industry (off shore installations) and the Chief Inspector (Northern Ireland).

8.2 Operators holding a greenhouse gas emissions permit will be liable to pay the subsistence charges set out in this RIA. The charges will be collected through invoices sent to operators on an annual basis. If the subsistence charge is not paid, the regulator will be able to take action to recover the money as a civil debt or revoke the permit.

9. Monitoring and Review

9.1 Defra will monitor and review the amended regulations to ensure that the intended effects of the amendments are achieved in an effective manner.

9.2 The regulators will keep the level of fees and subsistence charges under review to ensure that they are cost reflective, equitable and fair. Any proposed charging scheme will be consulted on before being implemented.

10. Consultation

i) Within government

10.1 DTI, regulators (the Environment Agency, SEPA, DoENI and DTI Offshore Licensing Unit) and Devolved Administrations have been involved in developing the amended regulations.

ii) Public Consultation

10.3 Government consulted on the proposed regulation amendments for 6 weeks. The reduction from the usual consultation period of 12 weeks was made because (a) the timeframes set out in the Directive for implementing the EU ETS were very tight; and (b) participants in the EU ETS had previously been consulted on most of the issues to which the amended regulations referred, including subsistence charging.

10.4 In relation to the non-charging elements of the regulations, consultation responses were mixed. Many of the comments repeated positions on policy issues which had already been addressed in consultations on the development of the National Allocation Plan and as such did not relate directly to the amendments themselves. In particular, the proposals regarding registries and temporary exclusion were supported by consultees. Detailed technical comments were made on the provisions regarding new entrants and closures and, in finalising the amendments, account has been taken of these comments.

10.5 The consultation draft of the amendments contained provisions addressing the treatment of operators which become insolvent after the scheme has begun. Although some consultees expressed support for the proposal, others have voiced concern and have pointed out technical problems with the proposed approach. Government has therefore decided to take time to consider in more detail the treatment of insolvent operators and amend the regulations at a later date, if it is considered that special treatment is required.

10.6 The provisions relating to subsistence charges formed part of the earlier consultation on the Subsistence Charging Regulations. Consultees expressed dissatisfaction with the level of fees and sought further details of regulator costs. Following a review of relevant regulator costs and the proposed charges during the consultation period, the charges were revised downwards by approximately 5% but any further reduction would be inconsistent with cost recovery and reflectivity policies.

10.7 In relation to the other fees introduced in the Consolidated Regulations, similar concerns were raised about the level of fees and the transparency of the regulator costs, as well as the complexity of the charging regime. In light of these comments, Government has considered the fee structure and level of fees and discussed these further with the regulators and as a result is satisfied that the proposed approach and level of fees is appropriate and reflects the costs likely to be incurred by regulators.

11. Summary and Recommendation

It is recommended that the amendments to the ETS Regulations, as set out in this RIA and accompanying Explanatory Memorandum, be carried out.

The amendments are intended to facilitate the effective implementation of policy decisions that have already been made with respect to the EU ETS.

This includes the enabling of regulators to recover the costs associated with carrying out certain activities required of them under the ETS Regulations. As discussed above, the annual cost to regulators of carrying out their compliance and inspection programme has been estimated to be £2.0M per annum for the financial year 2005/06 and onwards.

Further details on the costs and benefits of the EU ETS can be found in the Partial Regulatory Impact Assessment prepared for the National Allocation Plan. This is available at:

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

12. Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed: *Elliot Morley*

Date: *23^d March 2005*

Elliott Morley
Minister for Environment and Agri-Environment
Department for Environment Food and Rural Affairs