

To: Environment, Planning and Countryside Committee
EPC(2) 14-06 (p6) Explanatory Memorandum

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Standing Order 29.3(iii) Explanatory Memorandum In Respect Of:

**Environmental Protection, Wales
The Emissions Trading Scheme (Wales) Directions 2006**

Summary

These Directions will close a loophole in the Greenhouse Gas Emissions Trading Scheme Regulations 2005, which transpose the EU Emissions Trading Directive 2003/87/EC. The Directive defines “new entrants” as installations which have obtained a permit, or an update of a permit, subsequent to the notification to the Commission of the National Allocation Plan (NAP) for the relevant phase of the EU Emissions Trading Scheme (EU ETS).

The 2005 Regulations currently allow an operator of an installation to apply for, and obtain, a permit under Phase II of the NAP, even if the operator will not start operating until after the Phase II NAP has been notified. Where such an application is made, the Environment Agency (EA) currently has no grounds to refuse the permit and the operator will then be treated as an incumbent, rather than a new entrant, under Phase II. These Directions will close this loophole, so that the EA do not issue permits to new entrants to Phase II before the NAP is agreed by the Commission.

Enabling Power

1. The power enabling this Instrument to be made is under regulation 42 of the Greenhouse Gas Emissions Trading Scheme Regulations 2005, which confers a power to issue directions to the Environment Agency. This power is exercisable by the Assembly in relation to installations (other than offshore installations) which are, or will be, situated in Wales.

Effect

2. The EU Emissions Trading Scheme (EU ETS) is one of the key policies introduced by the European Union to help meet the EU's greenhouse gas emissions reduction target under the Kyoto Protocol. The scheme operates through the allocation and trading of greenhouse gas emissions allowances throughout the EU: one allowance represents one tonne of carbon dioxide equivalent. An overall cap or limit is set by each member state on the total amount of emissions allowed from all the installations covered by the scheme. The allowances are then distributed to the installations in the scheme. At the end of each year installations must ensure that they have enough allowances to account for their installations' actual emissions. If

they do not have enough allowances to cover their emissions then they can buy more. If they have surplus allowances then they can sell these. The buying and selling of allowances takes place on the EU wide market.

3. The EU ETS was established by Directive 2003/87/EC in October 2003 and was transposed into national legislation via the Greenhouse Gas Emissions Trading Scheme Regulations 2003 and the Greenhouse Gas Emissions Trading Scheme (Amendment) Regulations 2004, consolidated in the Greenhouse Gas Emissions Trading Scheme Regulations 2005.
4. The scheme is divided into periods (phases). Phase I of the scheme started on 1 January 2005 and runs for a 3 year period. Following phases of the EU ETS will each last for five years. Phase II of the EU ETS will commence on 1 January 2008. Member States must develop a National Allocation Plan(NAP) for emissions allowances for each phase of the Scheme. The UK NAP for Phase II is currently with the Commission for approval.
5. The EU Directive defines the activities that are covered by the scheme and any installation carrying out these activities must hold a greenhouse gas emissions permit which in effect is a licence to operate and emit carbon dioxide. Permits are issued to installations in Wales by the Environment Agency Wales. This Direction concerns the issue of permits to new entrants under Phase II of the scheme.
6. The European Trading Scheme Directive defines new entrants as those who have obtained a permit, or an update to a permit, after the date that the NAP for that phase was submitted to the Commission.
7. However, in Phase I the UK defined new entrants by reference to the date that an installation or extension started operating, rather than the date the permit was obtained. Although this approach was appropriate for Phase I, the Department for Trade and Industry received legal advice that there was a substantial legal risk in maintaining this approach in Phase II. The draft Phase II NAP therefore defines new entrants by reference to the date a permit was obtained.
8. Changing the definition creates two circumstances where an operator might obtain a permit or a permit variation before the Phase II NAP is submitted to the Commission:
 - where the operator applies for, and obtains, a permit before the Phase II NAP is submitted to the Commission, even though they will not start operation before Phase II has started; and
 - where a permit has already been issued on the basis that the new entrant will start operating in Phase I, but the start date slips to Phase II.
9. In these circumstances, operators would be able to argue that they should be treated as a Phase II incumbent, not a new entrant. They would have an incentive to challenge their treatment, as non-CHP new entrants will be allocated at less than 100% in Phase II. DTI consider that the best way of minimising the risk of legal challenge by operators is to issue directions to the regulators (under the Greenhouse Gas Emissions Trading Scheme Regulations 2005) stating that:

- the regulator should refuse applications for a permit or variation before the Phase II NAP is submitted where the application relates to a new installation or extension which will not start operating until Phase II; and
 - where a permit has already been granted prior to the submission of the Phase II NAP, or has been varied prior to submission of the Phase II NAP on the basis that the new entrant will start in Phase I, the regulator should use its general powers to revoke or to vary permits in order to revoke the permit or to reverse the variation previously made (by way of a further variation back to the original conditions) if the new installation or extension will not in fact start operating until Phase II.
10. This will ensure that an operator will not be able to obtain a permit - and thus claim that they should be treated as a Phase II incumbent - where they will not actually start operations until after 1 January 2008. The policy intention for Phase I was that requirements for permits were only in respect of Phase I. If, having been permitted, an operator did not start in Phase I then the intention was that they would surrender their permit or their permit would be revoked (and they would have to subsequently apply for a permit/variation). It should also be noted that where the start date of an operator slips from Phase I to Phase II, any Phase I allowances already reserved will go back into the new entrant reserve. The operator would have to make a new application to the Phase II reserve, under the rules contained in the Phase II NAP.
11. The intended effect of these Directions is to close a loophole in the Regulations. An operator of an installation could apply for a permit under Phase II and the EA would have no grounds to refuse the permit. There is an incentive for operators to try and claim they should be treated as an incumbent rather than a new entrant because new entrants will be allocated less allowances in Phase II than incumbents. The worst scenario is that we are sued by an operator for treating them wrongly and end up losing a court case with substantial costs. We need to close this loophole as soon as possible so that the EA do not issue permits to new entrants to Phase II before the NAP is agreed by the Commission.

Target Implementation

12. It is intended that the proposed Directions will be made on 20 November 2006 and come into force on 21 November 2006. If the target dates are not met operators in Wales could try and claim they should be treated as an incumbent rather than a new entrant: they may wish to do so because new entrants will be allocated less allowances in Phase II than incumbents.
13. Similar legislation was made in England and Scotland in July.

Financial Implications

14. There are no additional costs to the Assembly or the EA. These Directions direct the EA regarding the issue of certain permits to installations in the EU Emissions Trading Scheme.

Consultation

With Stakeholders

15. The Instrument is a Direction to the EA Wales as such there is no requirement to consult with Stakeholders.

With Subject Committee

16. The Directions were notified to the Environment, Planning and Countryside Committee, via the list of forthcoming legislation, on 28 September 2006 (EPC(2)-12-06(p.3) Annex 2, item no: 20) and were identified for detailed scrutiny. This scrutiny is scheduled to take place at the Committee's meeting on 25 October 2006.