



The UK's policy proposal for a small emitter and hospital opt out from the EU ETS according to Article 27, as notified to the European Commission

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This paper sets out the UK's proposed policy measure for excluding or opting out UK small emitters and hospitals from the EU Emission Trading System from 2013, in accordance with Article 27 of Directive 2003/87/EC. This policy proposal has been notified to the European Commission for approval, as required by the EU ETS Directive. Discussions with the European Commission are ongoing and as such the policy set out below remains provisional. The final UK policy will be published once it is approved.

Excluding UK small emitters and hospitals from the EUETS in Phase III

1. The UK actively supported the European Commission's decision to include a provision for excluding small emitters and hospitals from the EU ETS, in recognition of the fact that the administrative costs faced by small emitters under the EU ETS are disproportionately high per tonne of CO₂, compared to the costs for installations with larger emissions.
2. An assessment of the administrative costs faced by UK operators during Phases I (2005-2007) and II (2008-2012) of the ETS,¹ found that smaller emitters accounting for 2% of emissions, incurred approximately 20% of the total administrative burden (across the 60% of all installations covered by the assessment). The largest 8% of emitters were responsible for 60% of emissions and incurred 45% of the administrative burden. Per tonne of CO₂ emitted, the estimated administrative costs for UK small emitters exceeded £1, while costs for UK large emitters were estimated to be £0.04. In the UK, monitoring reporting and verification (MRV) makes up around 50% of the average administration costs for small emitters, with the verification being the largest element (around 1/3 of overall costs or £3,000). Almost all UK hospital installations are also small emitters and therefore face the same disproportionate administration cost burden per tonne of CO₂.
3. The UK Government is actively pursuing a 'better regulation' agenda which aims to reduce regulatory burdens on business, thereby helping to boost economic growth. In climate change policy terms this translates into a commitment to ensuring that regulatory effort is

¹ Aether (2010). Assessing the cost to UK operators of compliance with the EU Emissions Trading System.

focused on those areas of greatest risk to achieving our climate emission reduction goals and that the administrative costs of delivering these goals are minimised.

4. In this context, the UK has designed a simplified policy alternative to the EU ETS which aims to reduce administrative burdens on small emitters and hospitals whilst maintaining incentives for emission reductions. Through this proposal, UK Ministers intend to deliver real savings for small businesses and hospitals in the UK. The Small Emitter and Hospital Agreements Scheme is consistent with the principles and objectives of the Directive as set out in Recital 11, to “reduce unnecessary administrative burdens for smaller emitters” and to “set up simplified procedures and measures”.
5. This proposal been developed in close consultation with affected industrial sectors and hospitals including gaining feedback on draft proposal papers, holding several stakeholder meetings and conducting ongoing discussions with the Department of Health, the Emission Trading Group and sector representatives.
6. In evaluating this proposal, we hope that the European Commission will engage with it in the spirit of Article 27 and in recognition of the disproportionate costs faced by installations constituting less than 1% of all emissions covered by the EU ETS. We encourage the Commission to take a pragmatic approach in recognition that to alleviate regulatory costs Member States must provide simplified measures that, whilst equivalent, are tailored to the Member State context and it further requires that the equivalent measure offered is one that small emitters will choose to take up.
7. We are confident that the UK proposal provides administrative cost savings for eligible installations whilst delivering an equivalent contribution to emission reductions through:
 - Individual installation targets for non-carbon leakage sectors which reduce in line with reduction trajectory of the EU ETS cap
 - Individual installation targets for carbon leakage exposed sectors which maintain a flat trajectory;
 - A legal requirement on operators to meet individual emission reduction targets;
 - A penalty for excess emissions equal to the EUA price;
 - Monitoring and reporting according to EU regulations;
 - Simplified verification measures to guarantee the reliability of reported emissions whilst removing the full costs of third party verification.

Scope of UK exclusion scheme

8. The eligible UK installations that have indicated an interest in exclusion have a total historic (2008) emissions of approximately 2.4Mt. This represents 0.9% of UK emissions under the EU ETS and 0.1% of emissions covered by the ETS across the EU.
9. These estimates are not definitive as we will not be asking UK operators to confirm if they would like to be excluded until the UK proposal is finalised. It is likely that some eligible operators will choose to remain in the core EU ETS.

Legal framework

10. The UK has prepared draft regulations setting out the legal requirements for the Small Emitter and Hospital Agreements Scheme in the UK. This will be finalised following agreement to the scheme from the Commission. UK regulations on the Small Emitter and Hospital Agreements Scheme will be contained in the amended 2005 Greenhouse Gas regulations. The amended regulations are due to be laid in Parliament for approval during 2012 and will not take effect until the start of 2013.

Process

11. The UK will notify the Commission of the final list of installations to be excluded once Member State equivalent measures have been agreed and following a period of consultation in the UK to formally ask eligible operators whether they want to be excluded on the basis of the UK's agreed scheme. This will be as early as possible in 2012. We are mindful of the need to avoid any delay to the overall NIMs process or take any actions that will impact on the UK auction pot allocation.

UK Small Emitters and Hospitals Agreement Scheme

12. The UK's proposed equivalent measure allows eligible operators to be excluded from the EU ETS if they agree to a 'Small Emitters and Hospitals Agreement'.
13. This would be a legally binding agreement between the operator and the UK government, backed up by regulation. UK Greenhouse Gas regulations would stipulate that installations may only be excluded if they formally agree to comply with an individual target for reducing emissions. Operators would face a penalty for non-compliance set in line with the EUA price.
14. Excluded installations would not receive any free allocation of EUAs, and would not be required to surrender allowances for their emissions or hold a registry account. Excluded installations will be required to report annually according to EU Monitoring and Reporting regulations. Excluded installations would fall under UK regulations setting out a simplified verification scheme rather than being subject to EU Accreditation and Verification regulations. Operators will be able to bank overachievement against their target and apply for an adjusted target to reflect production capacity extensions.
15. Aside from this, excluded installations would in general be required to comply with the same conditions as EU ETS installations. They would still be required to hold a permit² but this would be amended to reflect the requirements of the Small Emitter and Hospital Agreement Scheme.

Eligibility

16. Small emitter installations will only be eligible for the Small Emitters and Hospitals Agreement Scheme if they meet the criteria set out in Article 27 of the 2009 EU ETS Directive, where:
 - a. reported annual emissions are less than 25,000tCO₂e in 2008, 2009 and 2010 and subsequent years; and,
 - b. where an installation undertakes combustion activity, rated thermal input does not exceed 35MW (net) per year in 2008, 2009 and 2010.
17. Hospital installations will only be eligible for the Scheme if the operator identifies the hospital which the installation is associated with and the association is confirmed by the Department of Health or relevant Devolved Administration.
18. Article 27 of the Directive applies only to static installations, therefore aircraft installations will not be eligible. Installations joining the EU ETS at the beginning of phase III will only be eligible if they either i) obtained a greenhouse gas emission permit before 30th of July 2011, or ii) were in fact operating on or before that date and had obtained all other relevant

² Installations carrying out activities regulated by the Directive, as specified in Schedule 1, will be required to hold a permit in UK regulation

environmental permits. Installations that join the EU ETS during phase III will not be eligible.

Installation target baselines

19. Each installation taking up a Small Emitters and Hospitals Agreement will be required to comply with an individual target to reduce emissions. Targets for the first year of the scheme will be set by regulators according to a fixed formula. Operators will be given a choice of two baselines for setting targets for 2013:

a. Historic emissions: the 2013 target will be set according to the average of an installation's historical emissions over the period 2008-2010 reduced by 5.22%³ (in line with the overall EU ETS cap reductions relevant to the Phase II cap).

2013 target = (average of installation emissions in 2008, 2009, 2010)* (1 – 5.22%)

b. Benchmark: the 2013 target will be set according to 100% of the relevant product benchmark (or heat benchmark, fuel benchmark or process emission sub installation, as appropriate) for the installation, as set out in Annexes I, II and III of the Community Implementation Measures⁴ and used in determining the UK National Implementation Measures (NIMs).

2013 target = sum of sub installation targets

sub installation targets⁵ =

relevant product/heat/fuel benchmark * historical activity level

OR

process related historical activity level * 0.97

Target trajectory

20. For sectors not at significant risk of carbon leakage, targets will decline at -1.74% of the baseline per year over the period 2013-2020 in line with annual reductions in the EU ETS cap. For sectors at significant risk of carbon leakage, targets will not decline over the period 2013-2020. The cross sectoral correction factor will not be applied to the targets.

21. The annual targets for each individual installation that is excluded will be published.

³ The EU ETS Directive states that the Phase III cap will reduce annually by 1.74% of the average Phase II (2008-12) cap. The 2013 cap will therefore be 5.22% (3 * 1.74%) lower than the 2010 cap level.

⁴ <http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2011:130:SOM:EN:HTML>

⁵ Historical activity levels of each installation will be determined from the baseline period from 1 January 2005 to 31 December 2008, or, where they are higher, from the baseline period from 1 January 2009 to 31 December 2010.

Excess emissions penalties

22. If annual emissions exceed the relevant target for the year then operators will be required to pay a penalty for those emissions. The penalty price will be set in line with the EUA price.
23. The price will be based on the average⁶ end of day settlement price of the December futures contract⁷ of the relevant compliance year. The average will be calculated across a full year of settlement prices. The price will be set in the December of the year before the beginning of the compliance period.
24. For example, the penalty for 2013 will be set in December 2012 and determined by the average price of the December 2013 futures contract over the period November 2011 – November 2012.

Banking and borrowing

25. Operators will be given the ability to bank overachievement in one year and for this to be offset against the target in the following year. This will provide further incentives for cost effective abatement effort.
26. Consideration is also being given to providing a borrowing mechanism in the first two years of the phase that would allow underachievement in years 1 or 2 to be compensated for by overachievement the following year. This is in recognition that operators may require time for investment to meet targets were more stringent targets required.
27. If an installation re-entered the EU ETS, the operator would remain liable for penalties associated with any borrowing that had not been paid back through further reductions in emissions but they would not be entitled to any benefit from banked emission reductions.

Extension or reduction of capacity and closures

28. To allow for business expansion and because many UK small emitters have emissions far below the 25,000tCO₂ threshold, extension of targets will be provided for if an installation increases its production capacity by installing new equipment. Increases in target will be calculated on the basis of product benchmarks multiplied by the 'nameplate' capacity of the extension. No small emitter installation will receive a target of greater than 25,000tCO₂.
29. Operators will be required to notify regulators if they meet conditions of reduction of capacity, part closure or closure to assist with the verification scheme.

Monitoring, Reporting and Verification

30. Operators will be required to report emissions annually to the regulator in accordance with the EU ETS monitoring and reporting regulations.
31. Annual reports will be subject to a simplified verification scheme carried out by regulators rather than requiring operators to have their annual reports verified according to the

⁶ Average will be a simple arithmetic mean of the closing prices across all relevant days of trading.

⁷ The exchange with the most volumes of trading across the whole period will be used to determine the relevant forward price.

Accreditation and Verification regulations. The simplified verification scheme will be cost recovered by regulators.

32. UK regulators will operate a risk based verification scheme. All annual reports will undergo a risk analysis that will determine subsequent regulator activity. Excluded installations will face full verification at least twice during the Phase (2013-2020) but where the installation or reported emissions match predefined risk criteria, it is likely they will undergo full verification more frequently. Small emitter installations with emissions above 20,000tCO₂ per year will undergo full verification, including a site visit, annually.
33. The key steps in the risk based auditing process are:
 - a. Operators undertake self verification and formally certify their reported emissions data.
 - b. All reports undergo a risk analysis by the regulator.
 - c. A proportion of annual reports selected for further verification according to a risk analysis or to meet the requirement that each installation should be audited at least twice during the Phase.
 - d. If an installation is selected for further verification, operators will be requested to submit additional information as required by the regulator.
 - e. Where necessary to establish the reliability, credibility and accuracy of monitoring systems and reported emissions, installations will subject to a site visit as part of the verification process.
34. It is expected that around 30-40% of installations will undergo full verification each year, with the majority of these including a site visit.
35. Operators may choose to undertake third party verification, and in this case will be excluded from the regulator verification programme.
36. Operators would face penalties for misreporting, as they do under the EU ETS.

Compliance year

37. The compliance year will remain the calendar year with monitoring beginning on 1 January and ending on 31 December.
38. Invoices for excess emissions will be issued by end of March with payment required by 30 April.

Table 1: Compliance timeline

January - December (Compliance year)	Monitoring of emissions and begin preparing annual report Notify regulator if emissions likely to exceed small emitter threshold (25000tCO ₂)
31 December	End of Monitoring period
28 February	Complete and submit annual emissions report
31 March	Regulators issue excess emissions penalty invoice
30 April	Deadline for payment of excess emissions penalty invoice

Re-entering the EU ETS

39. There are two conditions under which an installation will re-enter the EU ETS:
- a. Excluded small emitter installations will re-enter the EU ETS if their annual emissions exceed 25,000tCO₂. (Excluded hospitals installations will not re-enter the EU ETS if emissions exceed 25,000tCO₂ per year.)
 - b. Excluded small emitter or hospital installations will re-enter the EU ETS if they fail to pay the penalties associated with not meeting their emissions reduction target. On re-entering the EU ETS operators will remain liable for any unpaid penalties and any further sanctions applied for non-payment.
40. Those installations that re-enter the EU ETS will do so from the beginning of the following year. The installation will be required to comply in full with the requirements of the EU ETS from the year of re-entry onward. They will be awarded a free allocation at the level set out in the Phase III NIMs; the allocation will come from the UK auction pot.

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