

**EXPLANATORY MEMORANDUM TO**

**THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (NITROUS OXIDE) REGULATIONS 2011**

**2011 No. [XXXX]**

1. This explanatory memorandum has been prepared by the Department of Energy and Climate Change and is laid before Parliament by Command of Her Majesty.

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

2. **Purpose of the instrument**

2.1 Directive 2003/87/EC of the European Parliament and of the Council (“the Directive”) establishes a European Union Emissions Trading Scheme (“EU ETS”) that applies to the greenhouse gases and activities specified in Annex I to the Directive. The purpose of this instrument is to enable the UK to take advantage of the option, accorded by Article 24 of the Directive, to apply the EU ETS to other greenhouse gases and activities, in this case nitrous oxide (N<sub>2</sub>O) emissions from nitric acid production (“the N<sub>2</sub>O opt-in”). For that purpose, an amended plan for the allocation of allowances is specified for the purposes of the Greenhouse Gas Emissions Trading Scheme Regulations 2005 (“the 2005 Regulations”), and a number of amendments are made to those Regulations.

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

3.1 This instrument is made under section 2 of the Pollution Prevention and Control Act 1999 (“the 1999 Act”) and, as regards its application to Northern Ireland, section 2(2) of the European Communities Act 1972. The exercise of those powers can be subject to either negative or draft affirmative Parliamentary procedure. However, under the 1999 Act the draft affirmative procedure is required for the creation of an offence. It is considered that these Regulations do indeed give rise to a new criminal offence. This is because, by virtue of the amendment made by regulation 3(6), read with the existing regulation 7 of the 2005 Regulations, a greenhouse gas emissions permit will for the first time be required for a production of nitric acid resulting in the emission of nitrous oxide. By virtue of regulation 38(1)(a) of the 2005 Regulations, the contravention of that requirement will therefore be a new criminal offence.

3.2 The procedure adopted for this instrument is unusual in one respect, in that the draft instrument has been laid before Parliament before it is known for certain whether the instrument can be made. This is because the powers to make the instrument can be exercised consistently with EU law only if the European Commission’s approval of the N<sub>2</sub>O opt-in has first been obtained under Article 24 of the Directive. That in turn depends upon the outcome of a three-month scrutiny period

during which the draft approval decision is being considered by the EU Council and the European Parliament. In order that the instrument can be made without undue delay, the domestic and European scrutiny processes are proceeding in parallel. In the unlikely event that the Commission's draft approval decision fails to pass European scrutiny, this draft instrument will be withdrawn.

3.3 That scrutiny of the Commission's draft approval decision also gives rise to a transitional problem. In brief, the UK's application, and the Commission's draft approval decision, both assume that the N<sub>2</sub>O opt-in takes effect from 1st April 2011. However, this instrument will not be able to be made or come into force until several weeks after that date. It is accordingly necessary to make provision for the period from 1st April to the commencement date (but without of course imposing any retrospective obligation on operators). The transitional provisions in regulation 4(6) to (8) address that issue, by allowing an operator to take advantage of a period of voluntary monitoring of its N<sub>2</sub>O emissions. Thus if a producer of nitric acid has already begun monitoring emissions before the commencement date, it will be able to notify the regulator that it wishes a period of pre-commencement monitoring to be taken into account in the allocation of N<sub>2</sub>O emissions allowances. The operator's allocation will, however, be reduced pro rata for each day of non-monitoring between 1st April 2011 and the commencement date. Alternatively, the operator can choose not to monitor its N<sub>2</sub>O emissions all until the commencement date. In that case, the allocation of allowances will be reduced to take into account the entire period from 1st April 2011 to commencement.

#### **4. Legislative Context**

4.1 The EU ETS at present applies only to emissions of carbon dioxide from the activities specified in Annex I to the Directive. From 1st January 2013, Annex I will be replaced by a new version of that Annex which includes, in particular, the emission of nitrous oxide from the production of nitric acid. Under Article 24 of the Directive, a Member State may already apply emission allowance trading in accordance with the Directive to greenhouse gases and activities that are not yet listed in Annex I, provided that it obtains the approval of the European Commission. Where both the activity and the gas concerned are not yet listed in Annex I, the Commission's approval is subject to the comitology procedure laid down by Article 5a of Decision 1999/468/EC. That procedure (known as the "regulatory procedure with scrutiny") requires both the agreement of the relevant Committee (in this case the Climate Change Committee) and a three-month scrutiny period during which the EU Council or the European Parliament may oppose the adoption of the Commission's decision.

4.2 On 9th November 2010 the United Kingdom applied to the Commission to include the emission of nitrous oxide from the production of nitric oxide in the EU ETS, and the Commission's draft approval decision received the agreement of the Climate Change Committee on 15th December 2010. However, the Commission was not able to submit its draft decision for scrutiny by the EU Council and the European Parliament until 7 January 2011, and the three-month scrutiny period will accordingly not have ended until 9 April 2011. If by the end of that period no objection has been raised by the EU Council or the European Parliament, the Commission will be required to adopt its approval decision. The decision will also entail the Commission's approval of a consequential amendment of the UK's approved national

allocation plan for the second phase of the EU ETS. This is the plan that lays down the amounts of greenhouse gas allowances that are allocated to different installations within the United Kingdom for the period 2008-2012, and is based on an opt-in date of 1st April 2011. To the extent that an operator has not monitored its N<sub>2</sub>O emissions from 1st April 2011, or for any reason does not wish its emissions to be treated as included in the EU ETS until this instrument has come into force, its allocation of emission allowances under the amended allocation plan will be reduced (see paragraph 3.3 above).

4.3 A transposition note is annexed to this Memorandum.

## **5. Territorial Extent and Application**

5.1 This instrument applies to England, Wales, Scotland and Northern Ireland.

## **6. European Convention on Human Rights**

The Minister of State Gregory Barker MP has made the following statement regarding Human Rights:

In my view the provisions of the Greenhouse Gas Emissions Trading Scheme (Nitrous Oxide) Regulations 2011 are compatible with the Convention rights.

## **7. Policy background**

- *What is being done and why*

7.1 The Directive established a system for greenhouse gas emission allowance trading within the European Community. The establishment of the EU ETS in 2005 was one of the key policies introduced by the European Union to help meet the EU's greenhouse gas emissions reduction target of 8% below 1990 levels under the Kyoto Protocol. It works on a 'Cap and Trade' basis, with Member States required to set an emissions cap for sectors covered by the EU ETS. The rationale behind emissions trading is that it enables emission reductions to take place where the cost of the reduction is lowest, thus lowering the overall costs of combating climate change. More abatement will be undertaken by operators with lower abatement costs, therefore reducing the overall costs of meeting the emissions target (cap) set by any trading scheme.

7.2 N<sub>2</sub>O is a highly potent greenhouse gas with a global warming potential of 310 times that of carbon dioxide (CO<sub>2</sub>). There is a significant N<sub>2</sub>O emissions reduction potential in the nitric acid sector, this means that companies can dramatically bring their emissions down once they see a carbon price incentive.

7.3 Nitric acid producers will not be allowed to use international project credits generated under the Kyoto Project Mechanisms (e.g. Clean Development Mechanism and Joint Implementation) for compliance in 2011 and 2012 for their N<sub>2</sub>O emissions. The reasoning for this is that the nitric acid producing sector has significant N<sub>2</sub>O abatement potential. It therefore does not require the additional flexibility provided by the use of international project credits to reduce the cost of EU ETS compliance.

From 2013, when N<sub>2</sub>O emissions are included across the EU this limit will come to an end.

7.4 An opt-in from April 2011 will encourage early abatement and contribute to building a low carbon manufacturing sector in the UK. It is anticipated that the N<sub>2</sub>O opt-in will save around 1.6MtCO<sub>2</sub>e (carbon dioxide equivalent) compared to average annual emissions over 2011 and 2012. This will assist the UK in reducing emissions under the Kyoto Protocol 1st commitment period and in meeting our national carbon budgets.

- **Consolidation**

7.5 The 2005 Regulations have been amended on a number of occasions,<sup>1</sup> and a consolidated version of the Regulations is available on the Department's website.<sup>2</sup> In addition the Directive was significantly revised by Directive 2009/29/EC of the European Parliament and of the Council ('the 2009 Directive'). Those changes will apply from 1st January 2013 onwards, and Member States must complete transposition of the 2009 Directive into national legislation by the end of 2012. It is intended to take the opportunity of that transposition to undertake a new consolidation of the implementing Regulations, in which the 2005 Regulations will be replaced.

## **8. Consultation outcome**

8.1 The Department of Energy and Climate Change with the agreement of the Economic Affairs Cabinet Committee and the Reducing Regulation sub-committees consulted on the N<sub>2</sub>O opt-in for four weeks between October 2010 and November 2010. The shortened consultation period was due to the specific subject matter of the consultation, which only impacts on one company.

8.2 There were three responses in total to the consultation all generally supportive of the N<sub>2</sub>O opt-in. One respondent raised concerns about a proposal included in the consultation that placed a legal requirement on nitric acid producers to return allowances if they reduced levels of nitric acid production ('the partial closure rule'). In parallel to the consultation period officials in the European Commission also informally contacted officials in the Department of Energy and Climate Change with similar reservations about the partial closure rule. Government have agreed that the partial closure rule is unnecessary and would put at risk EU approval of the N<sub>2</sub>O opt-in. The partial closure rule was not key to the overall N<sub>2</sub>O opt-in policy and there would be a low chance of it coming into effect as the company affected by the N<sub>2</sub>O opt-in has made significant investment in order to benefit from the opt-in and so would be very unlikely to reduce its levels of nitric acid production. This requirement has now been removed from the proposed amendments to the 2005 Regulations. Nitric acid producers will now face the same rules as existing EU ETS operators should they partially or temporarily close.

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<sup>1</sup> See S.I. 2005/2903, 2006/737, 2007/465, 2007/1096, 2007/3433 and 2010/1513.

<sup>2</sup>

[http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/change\\_energy/tackling\\_clima/emissions/eu\\_ets/legislation/legislation.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/change_energy/tackling_clima/emissions/eu_ets/legislation/legislation.aspx)

8.3 The Department of Energy and Climate Change have published a response document to the consultation addressing the points raised by respondents and explaining the changes made following the consultation<sup>3</sup>.

## **9. Guidance**

9.1 There is general guidance on the EU ETS both on DECC's website<sup>4</sup> and also on the Environment Agency website<sup>5</sup>. However specific guidance on the N<sub>2</sub>O opt-in is not considered necessary at present.

## **10. Impact**

10.1 The impact on business is at present limited to a single company. The costs are outlined in the accompanying Impact Assessment. No impact is envisaged on charities or the voluntary sector.

10.2 The impact on the public sector is minimal with only relative small costs to ensure that the correct monitoring and reporting requirements are in place and the cost of ongoing checks to ensure compliance with The Greenhouse Gas Emissions Trading Scheme Regulations 2005.

10.3 An Impact Assessment is published alongside this memorandum.

## **11. Regulating small business**

11.1 The legislation applies to small business.

11.2 The impact of the requirements on firms employing up to 20 people will be minimal. The opt-in is assumed to impact on only one large operator in the UK, hence there will be no disproportionate effect on small businesses in the nitric acid production sector.

11.3 The basis for the final decision on what action to take to assist small business is the current EU ETS regulator charging scheme where regulatory costs are lower for smaller emitters and levels of cost recovery for subsistence are also reduced.

## **12. Monitoring & review**

12.1 No specific review is planned for this policy, as a successful N<sub>2</sub>O opt-in is anticipated to start in May 2011 and run until the end of 2012. From 2013, when Phase III of the EU EST starts, both N<sub>2</sub>O and CO<sub>2</sub> emissions from nitric acid production will be included across the EU on a mandatory basis.

In addition, we are already required to publish annual reports for the European Commission on the application of the EU ETS Directive. These reports cover the implementation of Member State unilateral opt-ins of additional gases and activities into the EU ETS, and

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<sup>3</sup> [http://www.decc.gov.uk/en/content/cms/consultations/n2o\\_emissions/n2o\\_emissions.aspx](http://www.decc.gov.uk/en/content/cms/consultations/n2o_emissions/n2o_emissions.aspx)

<sup>4</sup> [http://www.decc.gov.uk/en/content/cms/what\\_we\\_do/change\\_energy/tackling\\_clima/emissions/eu\\_ets/eu\\_ets.aspx](http://www.decc.gov.uk/en/content/cms/what_we_do/change_energy/tackling_clima/emissions/eu_ets/eu_ets.aspx)

<sup>5</sup> <http://www.environment-agency.gov.uk/business/topics/pollution/32232.aspx>

include:

- a description of the rules which govern the unilateral inclusion (e.g. which activities, gases, time periods and installation sizes are covered).
- for each installation included in the EU ETS during the year the activity, greenhouse gas, annual emissions, and allocation for all the years of the trading period.

### **13. Contact**

Adam Kidson at the Department of Energy and Climate Change Tel: 0300 068 5269  
or email: [adam.kidson@decc.gsi.gov.uk](mailto:adam.kidson@decc.gsi.gov.uk) can answer any queries regarding the instrument.

## ANNEX

### **DIRECTIVE 2003/87/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL ESTABLISHING A SCHEME FOR GREENHOUSE GAS EMISSION ALLOWANCE TRADING WITHIN THE COMMUNITY<sup>6</sup>**

#### **TRANSPOSITION NOTE**

#### **FOR THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (NITROUS OXIDE) REGULATIONS 2011**

*Statement on over-implementation:* These Regulations do more than is necessary to implement the Directive, in that they exercise an option to apply emission allowance trading to an activity, and greenhouse gas, not currently listed in Annex I to the Directive.

<b>Article</b>	<b>Result to be achieved</b>	<b>Implementation by this instrument, and by the Greenhouse Gas Emissions Trading Scheme Regulations 2005 (“the 2005 Regs”)</b>	<b>Comments</b>
<b>4 (with Art 24)</b>	Member States to ensure that no installation covered by the Scheme operates without a permit.	Reg. 7 of the 2005 Regs, read with the amendment to Schedule 1 made by <i>reg 3(6)</i> .	
<b>9</b>	Member States to develop a national allocation plan (“NAP”) for each scheme phase, which is subject to the approval of the Commission.	<i>Reg. 2.</i>  Reg 2(1) of the 2005 Regs, as amended by <i>reg. 3(2)</i> .	The existing NAP is amended to make provision for N <sub>2</sub> O emissions, in accordance with the Commission’s approval given under Article 24.
<b>11.2</b>	Allowances for 2008-2012 to be allocated by Member States in accordance with the approved NAP	Reg. 21 of the 2005 Regs, as amended by <i>reg. 3(3)</i> .	
<b>11.3</b>	Allocation of allowances to take account of the need to provide for new entrants to the	Reg. 22 of the 2005 Regs, as amended by <i>reg. 3(4)</i> .	Cut-off date designed to limit to genuine new

<sup>6</sup> OJ No L 275, 25.10.03, p 32; as amended by European Parliament and Council Directives 2004/101/EC (OJ No. L 338, 13.11.2004, p 18) and 2008/101/EC (OJ No L 8, 13.1.2009, p 3), and by Regulation (EC) No 219/2009 of the European Parliament and of the Council (OJ No L 87, 31.3.2009, p 109). Further amendments are made by Directive 2009/29/EC of the European Parliament and of the Council (OJ No L 140, 5.6.2009, p 63) but for the most part are not required to be implemented until 31 December 2012.

	scheme		entrants
<b>11a</b>	Member States may allow the use of project credits under the Kyoto Protocol.	Reg. 27A of the 2005 Regs, as amended by <i>reg. 3(5)</i> .	Has the effect that the option is not exercised in the case of N <sub>2</sub> O emissions.
<b>24</b>	Member States may apply the Scheme to activities and greenhouse gases not listed in Annex I to the Directive.	Schedule 1 to the 2005 Regs , as amended by <i>reg. 3(6)</i> .	