Title: Transposition of the EU ETS Directive: Review of the 2005 UK Greenhouse Gas Regulations. IA No: DECC0079 Lead department or agency: Department for Energy and Climate Change Other departments or agencies: Environment Agency	Impact Assessment (IA) **Date:** 11/01/2012 **Stage:** Consultation **Source of intervention:** EU **Type of measure:** Secondary legislation **Contact for enquiries: EU ETS Team, DECC (eu.ets@decc.gsi.gov.uk)**

Summary: Intervention and Options

RPC: RPC Opinion Status

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB in 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
Option ii) £0 Option 4) £55,000	£1.0m £0	-£0.1m £0	No	N/A

What is the problem under consideration? Why is government intervention necessary?

The EU ETS is one of the cornerstones of the UK framework to reduce greenhouse gas emissions and thus help prevent dangerous climate change. The framework for the EU ETS is established in the EU ETS Directive (2003). The Directive was amended in 2009 to make provision for the third phase of the EU ETS starting in 2013. The revised Directive needs to be transposed into national legislation by 31 December 2012 to give full legal effect to the ETS within the UK for phase III. Not transposing the Directive would put the UK in breach of EU law and would also cause significant uncertainty for businesses who have already invested in preparation for the next phase of the ETS. This impact assessment underpins the development of UK legislation in the form of a statutory instrument that will come into effect in January 2013.

What are the policy objectives and the intended effects?

The proposed statutory instrument (SI) will sit alongside a number of pieces of EU tertiary legislation to provide the legal framework for the EU ETS in the UK. In particular, the SI establishes powers needed for the regulators to implement the system, for example, covering operator's permit conditions and the permit application process, information requirements including how and when operators need to submit to the regulator, and the duties of the regulator. The SI also establishes the powers to impose penalties for non-compliance and the rights for operators to appeal against decisions of the regulator. The objectives are to have in place the necessary legal framework for the effective operation of the EU ETS in the UK, delivering high levels of compliance and overall environmental benefits, while ensuring that the administrative burdens on business of the system are minimised. In respect of penalties, this means a system which is dissuasive, proportional and operated at low cost. Our objectives for the appeals system are that it is relatively low cost both to government and operators, efficient and proportionate to the nature of what is being appealed, and is considered, independent, transparent and accessible to operators.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

For the penalty system, Government has considered (i) retaining the current system, and (ii) moving to a system of civil sanctions only. Option (ii) is preferred as it estimated to have lower administrative costs and it also provides the regulator with the discretion to ensure the penalties applied are more proportionate to the offences committed. Furthermore, moving away from criminal sanctions is in alignment with the recommendations of the Macrory report, which government has accepted.

For the appeals system, Government has considered (1) retaining the current system, (2) retaining the current system but with a presumption of written appeals, (3) an approach where appeals are heard by the Planning Inspectorate (PIN), and (4) an approach where appeals are heard by the First Tier Tribunal (FTT). Option (4) is the preferred option as it aligns with the approach for appeals against government decisions under other environmental and climate policy regulations. Policy alignment will improve FTT capacity and consistency of judgements. The FTT is also more independent of government than the other options, likely to be more efficient in processing appeals, while having lower costs compared to the alternative options.

In terms of other general regulatory requirements, Government has undertaken a limited qualitative assessment of a number of relatively minor regulatory changes which aim to simplify the way the regulations are drafted and the procedures for implementing the ETS in the UK. These are likely to offer benefits in the form of small administrative savings for operators and regulators. Views from industry are sought as to whether this is the case and the level of savings during public consultation.

Will the policy be reviewed? It will be reviewed 5 years following date of entry into force (01/2013), consistent with government regulatory guidelines. **If applicable, set review date:** 01 / 2018					
Does implementation go beyond minimum EU requirements? The ETS Directive gives member states the discretion to establish penalties and appeals systems. Whilst there are some instances where general UK regulatory provisions go beyond copy out of the Directive text, this is simply to give effect to Directive requirements.			**No**		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro No**	**< 20 Yes**	**Small Yes**	**Medium Yes**	**Large Yes**
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded: -**	**Non-traded: -**	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ..... Date: .....

Summary: Analysis & Evidence — Policy Option – Penalties (ii)

Description: Penalties Option ii: Move to a civil only system.

All costs and benefits presented are relative to Option (i) (status quo).

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2012	Time Period Years 9	Net Benefit (Present Value (PV)) (£)		
			Low:	High: £34,000	Best Estimate: £0

COSTS (£)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0			
High	0		-£0.145	-£1.03
Best Estimate	0		-£0.14m	**-£1.0m**

Description and scale of key monetised costs by 'main affected groups'

Businesses face a reduction in fines of c. £1.0m (PV) as a result of a more proportionate enforcement system.

Under the high scenario there is also a saving of £5,000 per annum through a reduction in the costs of a custodial sentence under a criminal enforcement regime. This saving is not in the central scenario as it is assumed that compliance rates will continue at current high levels and therefore that even with the retention of criminal offences, operators will not face criminal convictions.

Other key non-monetised costs by 'main affected groups'

There may be some minor cost reductions associated with lower legal costs to operators of defending themselves in civil rather than criminal courts. There may also be a reduction in the costs to government of enforcement through the civil rather than criminal courts, in the event that non-compliance resulted in court procedures.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High			-£0.14m	-£1.0m
Best Estimate	-		-£0.14m	**-£1.0m**

Description and scale of key monetised benefits by 'main affected groups'

There is a £1.0m (PV) reduction in the revenues to government as a result of lower fines with a more proportionate enforcement system. This is a transfer from government to business and thus does not affect the overall NPV.

Other key non-monetised benefits by 'main affected groups'

Businesses will benefit from a more proportionate enforcement system. This is partly a result of a move away from a criminal system (where a criminal record is considered disproportionate to many of the offences) and partly because under the proposed civil system, the application of enhanced regulator discretion will allow regulators to take a more proportionate approach to applying penalties. Improving proportionality is likely to provide an incentive for operators to identify mistakes and make them known to the regulator, thereby reducing instances of underreporting in the future.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

The central estimate assumes full compliance with the EU ETS.
The high scenario assumes 1 case per year will result in a criminal penalty being issued.

BUSINESS ASSESSMENT (Option ii)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: -£0.1m	Benefits: -	Net: £0.1m (benefit)	No	N/A

Summary: Analysis & Evidence — Policy Option Appeals (2)

Description: Appeals Option 2 - Retain the current system but move to a system with a presumption to have written appeals. <u>All costs and benefits presented are relative to Option 1 (the status quo).</u>

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2012	Time Period Years 9	Net Benefit (Present Value (PV)) (£)		
			Low: £0	High: +£51,000	Best Estimate: -£21,000

COSTS (£)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			0	**0**
High			-£7,000	**-£51,000**
Best Estimate	0		-£3,000	**-£21,000**

Description and scale of key monetised costs by 'main affected groups'

The central scenario saves £3,000 per annum for Government. This is driven by a reduction in the financial cost to government associated with having more written than oral appeals.

Other key non-monetised costs by 'main affected groups'

There may be a reduction in the cost to operators of the appeals process associated with having more written than oral appeals. At this stage there is not sufficient information to estimate this saving.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

The cost savings are a result of a reduction in the proportion of oral appeals from 63% to 50%. If there was no reduction in the proportion of oral appeals as a result of this policy, then there would be no cost savings. The central scenario assumes 2.1 appeals per year. If (as under the high scenario) there were 5 appeals per year, the cost savings would increase in proportion (to £51,000).

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	No	N/A

Summary: Analysis & Evidence — Policy Option Appeals (3)

Description: Appeals Option 3: Move to an appeals system using the Planning Inspectorate.

All costs and benefits presented are relative to Option 1 (the status quo).

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2012	Time Period Years 9	Net Benefit (Present Value (PV)) (£)		
			Low: -£43,000	High: +£90,000	Best Estimate: +£38,000

COSTS (£)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low			+£6, 000	**+£43,000**
High			-£13, 000	**-£90, 000**
Best Estimate			-£6,000	**-£38,000**

Description and scale of key monetised costs by 'main affected groups'

The central scenario delivers a reduction in the financial cost (of £38,000 PV) to Government of having appeals heard by the Planning Inspectorate rather than the Secretary of State. This cost saving is driven by the greater number of written rather than oral appeals.

Other key non-monetised costs by 'main affected groups'

There may be some cost associated with reduced accessibility of the system, where operators feel less willing to appeal because of the risk of having an award of costs against them or where a written appeals process is chosen by the inspectorate but the operator feels less comfortable with such an appeals process. There may also be a reduction in the cost to operators of the appeals process as a result of more written than oral appeals. At this stage there is not sufficient information to estimate this saving.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

The main benefit is that the system will be considered more independent and transparent. The system is also likely to be more efficient in terms of the time taken to deal with appeals.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

The cost savings are a result of a reduction in the proportion of oral appeals from 63% to 13%. If there was no reduction in the proportion of oral appeals as a result of this policy, then the costs to Government would increase (by £43,000 PV), rather than fall.

The central scenario assumes 2.1 appeals per year. If (as under the high scenario) there were 5 appeals per year, the cost savings would increase in proportion (to £90,000).

BUSINESS ASSESSMENT (Option 3)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	No	N/A

Summary: Analysis & Evidence — Policy Option - Appeals (4)

Description: Appeals Option 4: Move to an appeals system using the First Tier Tribunal.

All costs and benefits presented are relative to Option 1 (the status quo).

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2012	Time Period Years 9	Net Benefit (Present Value (PV)) (£)		
			Low: +£3,000	High: +£207, 000	Best Estimate: +£85, 000

COSTS (£)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£2,500	1	-£1,000	**-£3, 000**
High	£2,500		+£30, 000	**-£207, 000**
Best Estimate	£2,500		-£13, 000	**-£85, 000**

Description and scale of key monetised costs by 'main affected groups'

In the central scenario there is a reduction in the financial cost (of £85, 000 PV) to Government of having appeals heard by the First Tier Tribunal rather than the Secretary of State. Most of this cost saving is because of a greater number of written rather than oral appeals.

Other key non-monetised costs by 'main affected groups'

There may be some cost associated with reduced accessibility of the system, where operators feel less willing to appeal because of the risk of having award of costs against them or where a written appeals process is chosen by the tribunal but the operator feels less comfortable with such an appeals process. There may also be a reduction in the cost to operators of the appeals process as a result of more written than oral appeals. At this stage there is not sufficient information to estimate this saving.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low				
High				
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Other key non-monetised benefits by 'main affected groups'

The main benefit is that the ETS appeals system will be better aligned with appeals against decisions under other environmental and climate regulations, improving the capacity and judgement of the FTT, and increasing operators understanding of the process (helping to avoid unnecessary appeals). It is also considered more independent and transparent. The system is also likely to be more efficient in terms of the time taken to deal with appeals.

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

The main cost savings are a result of a reduction in the proportion of oral appeals from 63% to 13%. If there was no reduction in the proportion of oral appeals as a result of this policy, then the costs to government would only marginally fall (by c.£2,000 PV).

The central scenario assumes 2.1 appeals per year. If (as under the high scenario) there were 5 appeals per year, the cost savings would increase in proportion (to £207,000).

BUSINESS ASSESSMENT (Option 4)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: 0	Benefits: 0	Net: 0	No	N/A

Contents

A - Background

The EU ETS

1. The Emissions Trading System ETS was launched in 2005 as one of the key policies introduced by the EU to help meet its greenhouse gas (GHG) emissions reduction target of 8% below 1990 levels under the Kyoto Protocol. It works on a "cap and trade" basis, where there is a cap on all the emissions in the installations covered by the EU ETS, and installations within the scheme have tradable allowances to cover their GHG emissions.

2. The framework for the ETS is established in the EU ETS Directive (2003) and the ETS is now in its second phase running between 2008-2012. In December 2008, a 2020 Climate and Energy package was agreed by the European Council and the European Parliament which included revisions to the EU ETS Directive that made provision for a third phase starting in 2013. Phase III (2013-2020) of the EU ETS will see the introduction of a centralised, EU-wide cap on emissions, which will decline over time, delivering an overall reduction of 21% below 2005 verified emissions by 2020. The new Directive also introduces a number of new rules to ensure a more environmentally ambitious and consistent approach to implementing the EU ETS across the EU. This includes the introduction of new sectors and gases, and harmonised rules on free allocation with a move towards greater auctioning of allowances.

3. The legal powers for regulating the EU ETS in the UK are currently set out in the Greenhouse Gas emissions regulations 2005, which provides implementation measures to enable the UK Government to meet the requirements of the EU ETS Directive 2003.

Transposition

4. Transposition is the process by which the EU's member states give force to a directive by passing appropriate implementation measures, typically by either primary or secondary legislation. This delegated legislation is law made by an executive authority under powers given to them by primary legislation in order to implement and administer the requirements of that primary legislation. Most delegated or secondary legislation in the UK is made in the form of a Statutory Instrument (SI).

5. This impact assessment (IA) considers proposed changes to the 2005 Greenhouse Gas Emissions Trading Scheme Regulations (GHG regulations)[1], needed to fully implement the revised ETS Directive. These proposals represent the outcome of a review of the GHG regulations that was undertaken by Government to inform preparation of the legislative framework for implementation in the UK of Phase III of the EU ETS Directive from 2013.

6. This process was undertaken to ensure that UK legislation accommodates the new provisions for Phase III that are set out in the amended 2009 EU ETS Directive[2]. Hence the scope of the review encompassed EU decisions on allocation rules and the introduction of aviation, as well as EU regulations relating to registries and monitoring, reporting and verification. As such, the UK is now preparing and will lay before parliament ahead of 2013, a revised SI that will replace the 2005 GHG regulations.

Scope of the review of the 2005 GHG regulations

7. Consistent with the Government's better regulation agenda and in the context of public scrutiny of UK regulations as part of Defra's 'Red Tape Challenge', a key objective of the Government review of the 2005 GHG regulations was to identify opportunities for simplifying the existing regulation and reducing the regulatory burdens of the ETS on UK industry. The review sought to ensure that the revised SI contains the measures necessary to facilitate the effective implementation in the UK of Phase III of the EU ETS, but in particular, that those measures are targeted, proportionate and effective. In undertaking the review DECC sought the informal views of other Government Departments, the Devolved Administrations, UK regulators and industry.

8. As many of the key policy decisions relating to the design and functioning of the EU ETS in Phase III have been taken in Europe, the scope of the review was limited to only those areas where the EU ETS Directive gives interpretive discretion to member states, or where in order to make EU ETS Directive requirements implementable, UK regulations have elaborated on the relevant provisions contained within them. The review considers the options for improving the way Government regulates the EU ETS in the UK in three areas:

   i. <u>The penalties regime for the UK</u> – The EU ETS Directive requires member states to put in place a system of penalties for non-compliance with the provisions of the Directive, which is effective, proportionate and dissuasive. The form of the penalties and level of fines are left to member state discretion, with the exception of the civil penalties for failure to surrender sufficient allowances and under reporting of emissions[3]. Current UK penalties, for Phases I and II of the EU ETS, are set out in Part 7 of the 2005 GHG regulations.

   ii. <u>The appeals process for England only</u> - The EU ETS Directive does not set out specific requirements relating to appeals, but is based on the right to a fair hearing which is a general principle of EU law set out at Article 6 of the European Convention on Human Rights (ECHR). Member states must provide the right of appeal against decisions of a competent authority but appeal procedures are at their discretion, subject to the requirements of the ECHR.

   For decisions relating to the EU ETS in England, the appeals procedure is set out in the GHG regulations Part 5, Schedule 2 and Schedule 4. This establishes that an operator may appeal to the Secretary of State (SoS) as the appropriate authority in England or, where an appeal relates to an offshore installation, to the regulator.

[1] http://www.decc.gov.uk/assets/decc/what%20we%20do/global%20climate%20change%20and%20energy/tackling%20climate%20change/emissions%20trading/eu_ets/legislation/1_20091023140706_e_@@_greenhousegasetsregs2005.pdf

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2003L0087:20090625:EN:PDF

[3] Under the EU ETS Directive, operators are required to surrender sufficient allowances to cover their verified emissions from the previous year, by 30 April each year. Any operator who fails to comply with this requirement is liable to a civil penalty which is specified in the Directive at €100/tCO_2 not surrendered. This will be imposed by the regulator upon infraction.

iii. General regulatory measures providing powers for regulation of the system – The regulations establish a number of provisions governing the operations of the regulator, and in some cases their powers to act. These are largely technical in nature, for example establishing the process by which or the format in which the regulator can obtain the information needed to enforce the system. In some cases these elaborate further the original provisions of the EU ETS Directive. This is often necessary because the provisions in the Directive do not contain the level of detail required for implementation. The review analysed all of these instances to ensure that such elaboration was indeed necessary. This process was intended to make the regulations more accessible to incumbent operators by moving non-essential elements to either a schedule or guidance, deleting them completely or where possible, simplifying the approach.

Scope of the impact assessment

9. This impact assessment focuses on options for policy changes to the current ETS penalties and appeals system. In addition, Government has undertaken a limited assessment of the potential benefits associated with possible ways in which general regulatory measures (as under 8 (iii)) could be simplified. For example, Government is proposing to speed up the application process by requesting applications from operators electronically on a form provided by the regulator and by establishing that the regulator will respond within two months. This is significantly quicker than the 13 week benchmark proposed by Cabinet Office for permitting regimes. Using an electronic form will reduce the risk of the operator failing to provide necessary information, and therefore holding up the process of them being issued with a permit (which could delay them starting operations). Government also wants to align the timings for when operators are required to submit information to the regulators and how long they have to do so.

10. These changes aim to make the regulations more accessible and largely involve changes to the way the regulations are drafted, or relate to points of process. They should help to improve the clarity and predictability of the system, which will confer benefits on to operators in the form of small administrative savings or reductions in the amount of time it might take operators to understand the regulatory requirements. In assessing the benefits of such changes, Government has undertaken a proportionate approach at this stage, providing a qualitative description at Annex A. **Government intends to use the public consultation to ask industry whether administrative/time savings will result from the changes and what the scale of those savings is.**

11. The scope of the analysis relating to penalties (section C) applies to the UK. However, for appeals (section D), the appeals processes of Wales, Northern Ireland and Scotland are not be covered by this IA and consultation. The current appeals process in the Devolved Administrations is different. In Wales the system is similar to that of England, in that Welsh Ministers may either refer any matter or question involved in an appeal to an appointed person, and then the Welsh Ministers take a final decision, or alternatively they may appoint a person to determine the appeal (or any matter or question involved in the appeal). Scotland uses their own version of the Planning Inspectorate: the Directorate for Planning and Environmental Appeals (DPEA) is an internal unit which uses salaried or self-employed reporters to hear appeals on behalf of Ministers. In Northern Ireland appeals are heard and determined by the Planning Appeals Commission (PAC). *The fact that the scope of the analysis on appeals in this IA covers England only does not preclude Devolved Administrations from changing their appeals systems in light of the findings of this IA, or on other grounds.*

12. Consistent with our policy objectives for the review, options in this IA will be considered against a range of criteria to ensure that updated regulations are simple, proportionate and effective.

B - Options considered

The Penalties regime in the UK (see section C)

13. Below are two options for the way in which Government might enforce implementation of the ETS from 2013 in the UK. In practice, within the review, Government has analysed all of the existing offences/sanctions to determine what action is most effective in each situation. The review suggested that for effective enforcement of the system Government should continue to recognise all of the offences currently recognised in the sanctions regime.

    Option i: Business as usual. Retain the current system

    The current system includes a mixture of both criminal sanctions alongside the two civil penalties (failure to surrender allowances and under-reporting) that are set out in the ETS Directive.

    Options ii. Move to a system of civil sanctions only

    Criminal sanctions would be replaced with civil ones. Existing civil penalties (as set out in the Directive) would be retained. Penalties could include variable block fines and the introduction of an accumulating daily rate.

The appeals process in England (see section D)

14. Three options for the appeals system looking beyond 2013 have been considered.

    Option 1: Business as usual. Retain the current system

    There are currently two options for conducting appeals in England:

    a) The Secretary of State (SoS) for Energy and Climate Change may appoint a person to hear the appeal and take the decision on his behalf or

    b) The SoS may appoint a person to hear the appeal on his behalf, but still make the final decision himself following receipt of a report from the appointed person.

15. The process of hearing appeals is set out in Schedule 2 of the GHG regulations, which includes the timeframes for responses under an appeal. An appellant should make clear their preference for an oral or written hearing, meaning that a written hearing will only take place if both parties consent to it. There is no clear process for determining whether appeals are conducted via written or oral procedure. Generally, it is assumed that the more complex the case and the greater the implications of the appeal determination, the more likely an oral hearing is.

    Option 2: Option 1 with the presumption of a written appeal procedure

16. The current system involves the appellant making clear their preference for an oral or written hearing, meaning that a written hearing will only take place if both parties consent to it. Option 2, would be identical to Option 1 with the exception that there would be a presumption of a written hearing unless all Parties agree that there is justification for an oral hearing, for example because of the complexity of the case. All other aspects of the appeals system would remain the same.

    Option 3: Appeals are heard by the Planning Inspectorate

17. All appeals would be heard by the Planning Inspectorate (PIN) for England, which is an executive agency of the Department for Communities and Local Government[4]. Nearly all appeals would be

[4] In Wales, the Planning Inspectorate (PIN) is an executive agency in the Welsh Government.

decided by inspectors acting on behalf of the SoS. In a limited number of cases, the inspector will write a report for the SoS to take a decision but this is only in very contentious cases.

18. The majority of all enforcement appeals are decided by written representations otherwise they are heard orally. Appellants and local planning authorities are invited to identify which appeal procedure they consider to be the most appropriate for each appeal, by reference to published criteria. Costs may be awarded if either side has behaved unreasonably and causing unnecessary or wasted expense.

Option 4: Appeals are heard by the First Tier Tribunal

19. All appeals would be heard by the First Tier Tribunal (FTT)[5] which is part of Her Majesty's Courts Service covering a range of environmental regulations and has its own procedures. The FTT system is already in place in England for the Regulatory Enforcement and Sanctions (RES) Act and is being considered as an option for the CRC Energy Efficiency Scheme; it is also being increasingly used by Defra[6]. Appeals are heard by trained experts in the field. Parties may request either a written or oral appeal but the Tribunal must hold an oral hearing unless each party consents to a written procedure.

20. As with the PIN, the Tribunal may make a costs order if a party has acted unreasonably in bringing, defending or conducting proceedings. This includes any costs incurred by a party as a result of any improper, unreasonable or negligent act or omission. Hence there is a risk of costs to the regulator but this is likely to be minimal.

C - Costs and benefits analysis: the penalties regime for the UK

21. Environmental law requires effective enforcement if it is to protect the environment. As such, it needs to deter agents from carrying out the illegal activity. Some corporations may have a disincentive to comply with environmental laws or regulations as compliance generally raises their operational costs. Most theories that look at the effectiveness of penalty systems, are based on compliance with environmental law being a function of the expected penalty which, in turn, depends on the probability of punishment and the severity of the punishment if caught. The 2005 UK Select Committee on Environmental Audit[7] highlights the importance of the threat of detection as a deterrent.

22. The importance of the severity of the penalty becomes even more apparent when applied to a corporate body if, as suggested by economic theory, businesses are likely to view the payment of fines as a cheaper option in comparison to full environmental compliance, and might even set aside funds for this purpose. In order to avoid this practice, the penalty must be sufficiently dissuasive.

23. Whilst the intention is to design a system that provides a sufficient deterrent against non-compliant activity, this must be balanced with ensuring that the stringency of the penalty is proportionate to the offence. It is important to ensure that operators are not unfairly penalised where non-intentional errors occur and to encourage operators that are unintentionally out of compliance to approach the regulator.

Policy objectives

24. This section examines the costs and benefits of Options i and ii for the UK ETS penalties regime post 2013 in terms of a number of policy objectives that aim to balance the need for dissuasiveness with proportionality:

[5] Further details of the First Tier Tribunal procedure can be found at http://www.justice.gov.uk/guidance/courts-and-tribunals/tribunals/environment/index.htm

[6] For example, for regulations on Ecodesign for Energy-Using Products, Flood and Coastal Erosion Risk Management and Waste.

[7] http://www.publications.parliament.uk/pa/cm200405/cmselect/cmenvaud/136/13606.htm

- to encourage operators who are non-compliant to become compliant as soon as possible
- to provide sufficient incentive to dissuade operators from being non-compliant
- for fines to be proportionate to the offences committed, for example to accommodate the range of circumstances set out in paragraph 45 below.
- for the administrative cost of enforcement to be low
- to ensure fairness and equitability for operators that are compliant

The business as usual scenario (Option i) under which we retain the current penalties system is considered first. Option ii will then be considered relative to Option i.

Option (i): Business as usual. Retain the current system including both criminal and civil sanctions

25. To provide a sufficient deterrent against non-compliance with the EU ETS, in the UK regulators enforce a system of both criminal and civil penalties. This deterrent is enhanced by a programme of monitoring which reduces the chances of operators evading the system. Non-compliance could mean installations contravening legislation through operating without a permit, not purchasing allowances which equal verified emissions (or even selling the ones allocated for free) and not surrendering the required volume of allowances to equal their verified emissions.

26. Aside from the civil penalty for non-surrendering of allowances or under-reporting of emissions, the UK applies criminal penalties for the following offences:

    - operating a Schedule I activity without a permit
    - failure to comply with the permit (except where this is because of under reporting or failure to surrender allowances which incur a civil penalty)
    - failure to comply with an enforcement notice
    - failure to provide further information to enable the regulator to process a permit application or to discharge its functions
    - supplying false or misleading information for the processing of a permit application, an application for free allowances or to retain allowances or in response to a request by the regulator for information to enable it to discharge its functions under the GHG Regulations 2005
    - failure to comply with the Registries Regulation – provision of information, notifying changes to that information.

27. The criminal penalties set out in the UK legislation are as follows:

    - on summary conviction, a fine not exceeding statutory maximum or imprisonment not exceeding 3 months.
    - on conviction on indictment, a fine or imprisonment not exceeding two years.

28. Criminal penalties impose costs for non-compliance (in the form of a maximum fine of £5,000 on summary conviction; and at the discretion of the Crown Court on conviction on indictment (therefore unlimited) and/or imprisonment) and other costs such as legal and administrative costs to the firm infracting. Non-compliance costs under the ETS framework could go as far as imprisonment for up to 2 years. The court has full discretion[8] in reaching its decision.

29. In terms of the probability of detection, in England and Wales, the Environment Agency monitors a proportion of installations both directly (i.e. conducting site visits) and through desk based reviews of annual emissions reports (i.e. where the report relates to a large installation or where the verifier has commented). This is based on a risk-based approach. The sample they review is based on size of

[8] Insofar as the offence is not covered by the sentencing guidelines.

emissions, complexity and compliance history which means they undertake relatively more auditing on bigger polluters than on installations with low emissions. Bigger or more complex installations might be more inclined to evade the system because of the higher costs of compliance (admin and compliance costs). In addition, all data submitted by operators is subject to third party verification to ensure accuracy and that good monitoring standards are employed. In Scotland, SEPA also undertakes site visits and all annual emissions reports undergo a desk based review.

Regulator discretion

30. Regulators have their own policy on enforcement. For example, the Environment Agency in England and Wales has an approach to enforcement driven by the objective of preventing and securing compliance in the context of outcome-focused regulation. This is set out in their Enforcement and Prosecution Policy (EPP) and enforcement and sanctions guidance. The latter states that when considering the appropriate course of action to address offending and to ensure compliance, regulators should aim to follow the penalty principles set out in the Macrory Report[9] and included in the Regulators' Compliance Code:

    - aim to change the behaviour of the offender;
    - aim to eliminate any financial gain or benefit from non-compliance;
    - be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
    - be proportionate to the nature of the offence and the harm caused;
    - aim to restore the harm caused by regulatory non-compliance, where appropriate; and aim to deter future non-compliance.

31. As such they generally seek to employ discretion in enforcement, providing advice and guidance to assist an operator or individual to come back into compliance before considering sanctions. This advice will normally be provided after an offence is committed or where the Agency considers that an offence is likely to be committed. This compliance assistance may be either verbal or written, but will be recorded. In the event of continued or further non-compliance(s) this may influence the subsequent choice of response. Other factors such as intent, environmental impact, foreseeability and whether it is a repeat offence will also taken into account.

Dissuading non-compliance/encouraging quick compliance

32. Formal compliance rates in the UK are high, with only twelve operators having been found underreporting emissions in their verified reports (across Phases I and II). No criminal prosecutions have been undertaken so far in the UK either. The extent of sanctions based enforcement in England and Wales has been the issue by the Environment Agency of 67 warning letters, 26 enforcement notices and 1 formal caution (the preliminary stages in the criminal penalty process) in 2010-2011 (see table 1). In addition twelve civil penalties have been issued. The actions set out in table 1 have so far been sufficient to prevent further non-compliance by operators. In other words the threat of action has been sufficiently effective in encouraging compliance.

[9] Regulatory Justice : Making Sanctions Effective (Final Report) November 2006 http://www.bis.gov.uk/files/file44593.pdf

Table 1. The distribution of penalties over the last two years

	Warning letters	Enforcement Notices	Formal Caution
2010	22	17	1
2011	43	9	-

33. However, while formal compliance rates are high, this is not the same as saying there has been 100% compliance. It is possible that there have been instances of non-compliance that have perhaps not been identified by either the verifier or through regulator auditing. This proportion is likely to be very small, as is the extent of their impact on the system. For example, it is likely that any undetected errors are minor ones, such as small volumes of unreported emissions. The provision of templates and issuance of clear guidance (cited as best practice[10]) means the chances of under reporting from human error are low and likely to decline over time as the appropriate individuals become more familiar with best practice on monitoring, reporting and verification.

34. There are also reputational costs of non-compliance and installations might be risk averse, which would strengthen the incentive for compliance even under a low penalty framework. For all of these reasons, we are assuming that UK ETS installations are highly compliant. This is further supported by independent assessment[11].

Proportionality of the penalties

35. The use of criminal sanctions needs to be carefully considered. According to HMG guidance[12] there is a need to consider carefully which type of behaviour warrants the intervention of criminal law at all, and what alternatives there may be to criminal offences. According to Professor Macrory, whose recommendations were accepted in full by Government, criminal law is used too readily in regulatory situations. He envisaged that criminal prosecution should be reserved for the breaches of legislation which have serious consequences and that where existing criminal offences exist, consideration should be given as to how often these offences are used.

36. A key consideration when assessing whether to retain the current penalties regime is therefore whether it balances dissuasiveness with proportionality. The threat of imprisonment for example, may well have played a part in ensuring the current high rates of compliance, but it is likely that the Environment Agency's reputation for enforcement and therefore the risk of discovery will have also played a significant role. It can also be argued that criminal sanctions are not necessarily needed when the environmental impact can be rectified by requiring the operator to purchase additional emissions allowances, which in itself would represent a significant cost to an operator and hence be dissuasive.

37. Separately, there is scope to improve the proportionality of the penalty applied for under reporting where operators identify and correct genuine errors in verified emission reports. The €100/tCO_2 penalty for under reporting is set out in the Directive and cannot be amended by Government. Arguably, application of this penalty is excessive in certain instances where an operator discovers a genuine error in their verified report or where the error identified is the result of factors outside the control of the operator. Adjusting the parameters for applying this penalty so that operators are not over penalised where genuine mistakes occur would offer a more proportionate approach. Enhancing regulator discretion in this manner would remove the disincentive for operators to report errors to the regulator under the current regime (where the €100/tCO_2 penalty must be applied in all

[10] Ecofys September 2010: Support to the Commission for the review of permits, monitoring plans and verification reports in the EU ETS at the level of Member States for the 2008-2009 compliance cycle.
[11] http://www.nber.org/chapters/c12140.pdf
[12] http://www.justice.gov.uk/guidance/docs/guidance-regulatory-penalties-offences-jan09.pdf

cases) and to address them. It will be important to retain a penalty level to ensure an incentive is maintained for inaccurate reporting.

Costs of enforcement

38. The costs under the criminal regime are associated with legal and administrative costs to Government of enforcement through the criminal courts, and the costs to operators of defending themselves. The cost of pursuing a criminal conviction is estimated to be around £3,200 per case[13]. The costs associated with a civil regime involve the administrative costs to Government of enforcing civil penalties, including through the civil courts. However, these costs are not available. While they are expected to be lower than the cost of criminal courts, the lack of accurate estimates means they are not included in the monetised benefits. In addition to legal costs, enforcement through a criminal system could result in a custodial sentence; imposition of the maximum 2 year sentence is likely to cost the Government £40,000[14].

Option ii: Move to a system of civil sanctions only

39. Under Option ii the existing civil penalties (as set out in the Directive) would remain but criminal penalties would be replaced by civil sanctions. For illustrative purposes, draft proposals for civil sanctions are set out in Annex B. In general, the penalties could involve a variable block fine as well as the possibility for a mounting daily penalty. It is assumed that the civil penalties would provide a deterrent sufficient to avoid any reduction in current rates of compliance. As under Option i, regulator monitoring arrangements would continue in order to maintain the additional deterrent created by the threat of detection.

40. It is not expected that any change to a civil regime will increase the number of penalties imposed compared to the current criminal system. The civil penalty would be expected to have the same deterrent effect as a criminal penalty. Furthermore, the regulator's approach to enforcement would continue to be in line with established enforcement policy and principles, and statutory guidance would set out the levels of penalties and the basis for applying them. Statutory guidance would be essential to ensure a consistent approach is taken among UK regulators.

Dissuading non-compliance/encouraging quick compliance

41. Assuming no reduction in the level of discretion applied by the regulator or the deterrent effect imposed by a civil penalty regime compared to the current system, there should be no reduction in the level of compliance under Option ii compared to Option i. Giving more control to the regulator (as opposed to the courts) may enhance the capacity for the regulator to exercise discretion over the financial penalty applied to an offence that has already occurred.

42. Replacing criminal sanctions with an effective system of civil sanctions would have the benefit of achieving a consistent approach with ETS aviation and other emerging civil sanction schemes under the Regulatory Enforcement and Sanctions (RES) Act. It is in line with the Government's broader agenda on better regulation and challenging the use of criminal sanctions as set out in the Macrory report. Policy alignment on penalties will help operators to understand better the regulatory requirements on them, the implications of non-compliance, and the powers of the regulator which in turn should help reduce instances of non-compliance.

Use of a daily fine

[13] Estimates from the Ministry of Justice. Estimate assumes 50% of the cases are heard in the crown courts, while 50% are heard in Magistrate courts.
[14] Estimate from the Ministry Of Justice. Estimate assumes 1 year of the sentence is served in prison, and 1 year on probation.

43. Where it is necessary to apply a penalty, for example, where an operator continues to be non compliant, regulators' experience on aviation indicates that the use of a daily fine in addition to block fines can provide a greater incentive for the operator to move quickly into compliance. With the introduction of a daily accumulating fine it may be possible to reduce the scale of the block fine without reducing the level of dissuasiveness. This would mean the stringency of the penalty would in effect start at a lower rate but ramp up over time, consistent with the severity of the non-compliance.

Proportionality of the penalties

44. Whilst the intention is to design a civil system that provides a sufficient deterrent against non-compliant activity, there is a risk that the size of the penalty needed to deter deliberate non-compliance may be disproportionate to the offence in some instances. It may result in overly punitive fines for those who are in non-compliance for reasons outside their control. It is possible to avoid this by preserving regulator discretion and designing a civil regime that incorporates flexibility in fine levels to be matched to the severity of the offence.

45. Where appropriate, introducing variable block fines – up to a maximum level – would give the regulator the capacity to adjust the stringency of the penalty according to the specific circumstances of the case, such as the actions of the individual (e.g. whether the operator has voluntarily come forward) and the impacts of the non-compliant activity on the integrity of the scheme. This will allow the regulator to adjust the penalty to differentiate between, for example:

    - cases where the operator has consciously or wilfully been non-compliant as opposed to unconsciously
    - cases where the operator's non-compliant actions have been detected by the regulator as opposed to cases where the operator has come forward
    - actions with very different material impact on the credibility of the system, such as those causing large or relatively significant sources of emissions to go unreported, compared to failure to submit an improvement report. This includes emissions that are not in themselves large but that are significant compared with other emissions from the site
    - cases where misreporting is out of the control of the operator, compared to instances where the operator wilfully provides misleading information or is negligent

46. If operators understand that they are less likely to be severely punished or may even avoid punishment for a genuine mistake or where steps were taken to avoid non-compliance, they are more likely to come forward, potentially improving compliance or avoiding non-compliance.

47. Transferring the responsibility (and the discretion) for determining the appropriate penalty from the courts to the regulator is likely to lead to more consistent decision making, but could also mean more room for operator challenge (but this may be reduced as decision-making becomes more consistent). To mitigate against these issues, statutory guidance for regulators would set out penalty rates and guidance on their application.

Costs of enforcement

Assumptions

48. For the purpose of this analysis, we have made the following assumptions:

    - Central estimates - assume high levels of compliance and thus no use of the criminal courts or custodial sentences.
    - High scenario – for a criminal regime assumes one court case per year, and one 2-year custodial sentence (or multiple sentences totalling 2 years) over the period 2013-20.

Costs analysis

49. The key change in costs as a result of removing the criminal elements of the system is the possible reduction in legal and administrative costs to government of enforcement through criminal courts and the reduced costs to operators from defending themselves in such a system. As noted above (paragraphs 38), it has not been possible to accurately estimate the savings to Government and operators associated with a switch to civil courts.

50. Whilst there will still be costs to Government associated with administrating civil penalties, switching to a wholly civil penalty system will eliminate the costs arising from custodial sentences. While perpetrators may be indifferent between custodial and financial penalties, the latter results in a transfer of funds from the perpetrator to Government, while both the government and the perpetrator face a significant cost if a custodial sentence is given. As noted above, these savings have not been included in the central estimates, as it is assumed that even under the status quo, compliance rates remain high in line with historic trends and no criminal prosecutions are made. **As a sensitivity, under the status quo it is assumed that, one 2-year sentence (or a combination of sentences totalling 2 years) is applied over Phase III (2013-20). This results in a saving of £34,000 NPV.** See Annex E for a profile of these savings over the appraisal period.

Other costs benefits

51. There are a number of other costs and benefits associated with a civil regime (Option ii) that incorporates the elements outlined above (e.g. regulator discretion retained, improved proportionality, variable fine levels, daily fine/reduced block fine):

- Government policy on penalties will be more aligned across climate/environmental policies, providing consistency across these policies.

- Non-compliant operators may be brought into compliance sooner. A regime with a flexible system of fines and regulator discretion should result in lower penalties to operators who voluntarily come forward, thereby encouraging more operators to do so. This should improve the environmental benefits delivered by the EU ETS as well as improve confidence in the regulatory system.

- Greater levels of compliance as a result of a system that encourages operators to identify and correct any errors in their verified emissions report.

- To date, £2.8m of fines have been imposed for under reporting emissions. All fines (of €100/tCO_2) were imposed in 2010 or 2011. If this level of under reporting was representative of future levels, then there could be around £9.7m (PV) [15] of fines imposed to 2020. By adjusting the parameters for applying this penalty to allow greater regulator discretion in specific cases where genuine mistakes occur, it is assumed that a proportion of these fines would be reduced or waived, such that the total level of fines will fall by 10% (£0.97m).

- There may be a small increase in the administrative cost to regulators as a result of having a marginally more complex enforcement system. The regulator may need to spend more time trying to understand the cause of non-compliance in order to establish the appropriate level of penalty. However this should be standardised through clear statutory guidance.

Summary of penalties regime

[15] Exchange rate of €1 = £0.858 has been used in line with IAG guidance.

52. Following a review of Options i and ii against our policy objectives, DECC is proposing that the UK moves to an enforcement system comprising of just civil sanctions (Option ii). This approach is consistent with broader climate and environment policy and in line with the objectives of better regulation, including the recommendations of the Macrory report to move away from criminal sanctions.

53. DECC analysis suggests that by maintaining the current robust regulator monitoring system and by setting sufficiently dissuasive penalties, this will not lead to increased non-compliance. Enhancing the level of regulator discretion and in turn, the proportionality of the penalties applied, may in fact lead to a reduced risk of non-compliance. This is as a result of the regulator being able to treat more fairly those operators who are generally compliant but non-compliant because of issues outside of their control, and operators feeling more confident about not being penalised unfairly for identifying genuine errors. For those operators who are non-compliant, the introduction of daily fines can encourage compliance more quickly.

54. Specifically, a more proportionate approach offers estimated savings to business of the order of £1.0m PV, through the application of greater regulator discretion. As these savings are effectively a transfer from Government, they do not affect the NPV. More generally, there will be reduced legal and administrative costs to Government of enforcement through criminal courts. There will also be reduced costs to operators from defending themselves in such a system.

Risks, sensitivities and assumptions

Costs of compliance

55. Note that for the issue above, and all the issues in this IA, there should be no change in the business costs of complying with the EU ETS. This is because under all forms of enforcement, in addition to paying any penalty, operators may also ensure they rectify any errors and comply with the regulations. For example, if an operator was given a penalty associated with an information notice for failing to provide sufficient information to the operator, in addition to payment of the penalty, they would also need to ensure the requested information was provided, thus the costs of information provision will occur in all instances, regardless of the enforcement regime.

Rates of compliance

56. This IA also assumes continued high rates of compliance. The costs to business associated with different penalties levels under the civil system would only apply in the unlikely event that operators are non-compliant. Furthermore, non-compliance does not necessarily lead to the imposition of an additional cost (e.g. associated with a fine), given regulator discretion.

Levels of penalties

57. Under a lower compliance scenario it would be very difficult to make a comparison of the penalties levels under the two options as the scale of the fine is dependent on the specific merits of an individual case and the opinion of the courts (Option i) or the regulator (Option ii). Notwithstanding this, we have set out for illustrative purposes, draft proposals for penalties ranges under Option ii in Annex B. These aim to balance the need to provide a sufficient deterrent whilst being proportionate to the severity of the offence (e.g. intent and impact). **We will work with UK regulators, Devolved Administrations and other government departments to develop draft proposals for penalty levels in the coming weeks. In developing these proposals, we will take into account existing penalties regimes, such as for aviation operators under the ETS, as well as the penalties regimes of other member states. We aim to consult publicly on these draft proposals with a view to finalising them post consultation. Hence the proposed levels in Annex B may change. However, we are making the assumption that the final penalties levels once set provide sufficient deterrent to maintain compliance rates at their current levels.**

D - Costs and benefits analysis: the appeals process for England

58. Once the decision has been made to regulate, then some form of enforcement mechanism becomes necessary. As is the case under the ETS, the service of an enforcement notice or the imposition of a civil sanction such as a monetary penalty is almost certainly a determination of an operator's civil rights. Article 6 of the European Convention on Human Rights (ECHR) states that, "…*in the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law."*

59. Hence enforcement of the EU ETS is supported by an appeals system which allows an operator to lodge an appeal when an operator:

- has been refused the grant of a greenhouse gas emissions permit;
- has been refused the variation of the provisions of a greenhouse gas emissions permit;
- is aggrieved by the provisions of his greenhouse gas emissions permit or by a variation notice following an application;
- whose application for a regulator to effect the transfer of a greenhouse gas emissions permit has been refused or who is aggrieved by the provisions of his greenhouse gas emissions permit to take account of such a transfer;
- whose application to surrender a greenhouse gas emissions permit has been refused or who is aggrieved by the terms of the notice of surrender; or
- is aggrieved by the regulator's determination of reportable emissions under regulation 30.

Number of appeals so far

60. There have been eight ETS appeals in England in the last five years: two appeals (on decisions made by the Secretary of State (SoS) on applications to the Phase I missing and late reserve) were determined via oral hearings by inspectors from the Planning Inspectorate, with policy and administrative support from Defra officials (as Defra held policy responsibility for EU ETS at that time).

61. Three appeals on decisions on applications to the New Entrant Reserve (NER) made by the Environment Agency (EA) were determined via written procedure. In these appeals the SoS delegated his power to determine the appeal to an appointed barrister.

62. Three appeals focussed on decisions made by the Agency not to allow rationalisation (transfer of allowances from one site to another). These were determined via oral hearings by an appointed barrister on behalf of the SoS.

Number of appeals post 2013

63. Looking ahead to Phase III, it is difficult to predict in advance the volume of appeals that will arise. The fact that the system will have been up and running for 8 years by the start of Phase III and the harmonisation of rules across Europe, may help to reduce the number of potential appeals. However the allocation rules remain complex with some room for misinterpretation and disagreements between operators and the regulator. In addition, the Phase III cap is tighter than in Phase II and will decline over the phase – as the situation becomes more constrained, this could lead to a greater possibility of appeals. More significantly, the scope of the system will expand significantly in Phase III, with the addition of new gases and sectors in the core ETS and with the addition of the aviation

sector. The total number of operators to be regulated by the UK will increase from c. 960 in Phase II (excluding aviation) to c. 1,260[16] in Phase III (including aviation).

64. For the purpose of this exercise it has been assumed that the number of appeals increases in line with the increase in the number of operators that are regulated. Thus the number of appeals per year increases to 2.1, relative to an average of 1.6 per year since 2005. As a sensitivity, it has been assumed that the number of appeals is as high as 5 appeals per year. This sensitivity is to reflect the possibility that aviation operators may have a higher number of appeals than expected, given that a number of cases involving aviation operators are already beginning enforcement procedures, which could lead to the issuance of civil penalties. Thus there is potential for the number of appeals to increase.

Comparison of Options 1-4 relative to policy objectives

65. This section examines the relative costs and benefits of Options 1-4 for the UK ETS appeals regime post 2013, in terms of a number of policy objectives. These include that that appeals system is (not in order of importance):

- Relatively low cost, both to government and operators
- Efficient, avoiding overly burdensome and complex procedures
- Proportionate to the nature of what is being appealed
- Considered transparent and accessible to operators (requirements are clear)
- Independent

Costs of appeals

Financial costs to government

66. The estimated cost of an appeal under the different options is shown in Table 2. This is based on experience of appeals to date, and on information provided by the body being considered in each option. These are broken down further in Annex C.

Table 2. The estimated cost of an appeal for both written and oral procedures for Options 1-4.

£2011	Written appeals			Oral appeals			
Option	Env. Agency	DECC	Total	Env. Agency	DECC	Total	Start up costs
1	19,600	1,200	20,800	29,600	3,000	32,600	-
2	19,600	1,200	20,800	29,600	3,000	32,600	-
3	19,600	4,500	24,100	29,600	5,650	35,250	-
4	19,600	1,000	20,600	29,600	2,500	32,100	2,500*

*There is a set up cost of £2,500 associated with the First Tier Tribunal in Option 4

Assumptions

[16] Note this assumes that the UK will regulate c. 250 aircraft operators in line with the number of operators who have been identified as being entitled to some free allocation (i.e. they have submitted verified production data). This figure is different to the c. 1,000 aircraft operators who were included in the Commission's list of those who may be eligible to be regulated by the UK. The latter list is longer as there are a number of operators who are unlikely to be within the scope of the EU ETS as they are unlikely to fly into or out of the EU, while others may have chosen not to apply for free allocation.

67. A number of scenarios considering different ratios of hearings that are conducted in writing rather than orally and different number of potential appeals has been constructed to estimate the potential range of impacts for Government of each option.

Table 3. The assumptions for the proportion of oral to written appeals for Options 1-4

Option	% Written appeals	% Oral appeals
1	**37%**	**63%**
2	**50%**	**50%**
3	**87%**	**13%**
4	**87%**	**13%**

68. The assumption that 63% of hearings in Option 1 are heard orally, is in line with historic trends[17]. This is assumed to fall to 50% under Option 2, where appellants have to actively decide that they wish to have an oral hearing. The assumption that 87% of hearings in Option 3 and 4 are written, is in line with the historic proportions seen in the current Planning Inspectorate[18]. The estimated annual and NPV costs of the different Options for different numbers of appeals per year are presented in Tables 4 and 5. Note the NPV values reflect the start up costs of Option 4. See Annex E for a profile of the savings of the preferred option (4) over the appraisal period.

Table 4. Estimated annual and NPV costs of Options 1-4 (2.1 appeals per year)

£2011	**Annual costs**	**NPV**	**Net change in NPV relative to BAU**
Option 1 BAU	**59,200**	**407,000**	-
Option 2	56,100	385,000	- 21,000
Option 3	53,700	369,000	- 38,000
Option 4	46,400 (plus 2500 in Year 1)	321,000	- 85,000

Table 5. Estimated annual and NPV costs of Options 1-4 (5 appeals per year)

£2011	**Annual costs**	**NPV (2013-2020)**	**Net change in NPV relative to BAU**
Option 1 BAU	140,900	968,000	-
Option 2	133,500	918,000	- 51,000
Option 3	127,700	878,000	- 90,000
Option 4	110,500 (plus 2500 in Year 1)	762,000	- 207,000

69. All options (2-4) deliver savings relative to the Business as Usual. In the case of a greater number of appeals, these savings simply increase in proportion (an increase of 138%[19]). The estimates of

[17] To date, 5 out of 8 (63%) EU ETS hearings have been heard orally.
[18] Covering the period 2009/10 – 2010-11
[19] The percentage increase in savings are slightly greater (142%) for option 4, due to the start up costs.

savings under a scenario of 5 appeals per year has been used as the "high" estimate on the summary sheets.

70. Given the relative cost of oral to written appeals, the assumption on the proportion of appeals that are held in writing is crucial to determining the relative costs of the options. As the above proportions are based on historic rates, they are considered reasonable estimates. However there is a risk that the proportions vary significantly in the future, particularly for options 3 and 4, where the appeals that have previously been heard may have been very different in nature to appeals related to the EU ETS.

71. To ensure the preferred options are robust, table 6 looks at the likely costs of the different options in the event that for all options there is an equal proportion (50:50) of written and oral appeals.

Table 6. Estimated NPV costs of Options 1-4 with an equal proportion of written and oral appeals (2.1 appeals per year).

£2011	**Annual costs**	**NPV (2013-2020)**	**net change in NPV relative to BAU**
Option 1 BAU	56,100	385,000	-
Option 2	56,100	385,000	-
Option 3	62,300	428,000	+43,000
Option 4	55,300 (plus 2500 in year 1)	383,000	-3,000

72. Table 6 shows that with the sensitivity analysis, there may be no savings from Option 2 (relative to BAU), and Option 3 may actually be more expensive than the status quo, as the costs to Government of running the different appeals are higher (the savings in the central scenario are only driven by the lower proportion of oral hearings). Option 4 remains lower cost to government than the status quo even when the proportion of oral to written appeals is the same, although the cost savings under this scenario are substantially reduced. The figures in the above table have been used as the low estimates in the summary sheets.

73. An award of costs associated with Options 3 and 4 could expose the regulator to the costs of reimbursing the operators' expenses associated with the appeal if they have been deemed to have not properly exercised their responsibilities or followed due process. However, the risk is likely to be low and outweighed by the benefit of having an incentive against unnecessary appeals by operators. An award of costs does not necessarily follow the outcome of the appeal. An unsuccessful appellant is not expected to reimburse the planning authority for the costs incurred in defending the appeal. Similarly, the planning authority is not expected to reimburse successful applicants[20].

Financial costs to operators

74. It has not been possible to estimate precisely how costs to operators are likely to vary across the different appeals systems. Nevertheless it can be expected that an operator faces a similar set of costs to those faced by the regulator, for example the staff costs of preparing appeals, the cost of hiring external representation and the costs of appearances at the hearing. External legal representation at a location which is likely to be away from the installation/company legal offices is a significant cost concern for some operators.

[20] Most appeals do not result in a costs application, let alone a costs award. Statistics are published by the Planning Inspectorate. In recent years, on average, costs applications have been made in about 20 per cent of hearing cases, 25 per cent of inquiry cases and 4 per cent of written cases. Awards have been made in about 40 per cent of these cases overall.

75. DECC considers that the cost of written appeals will be lower than oral appeals owing to lower expected legal fees.

76. With a greater presumption for written procedures under Options 2, 3 and 4, and an award of costs under Options 3 and 4 helping to provide an incentive towards the most proportionate approach, Options 2, 3 and 4 are likely to be lower cost than Option 1. Moreover, oral hearings under Options 3 and 4 are likely to have lower travel costs as appeals are heard locally rather than in London. So on balance, Options 3 and 4 should cost the least amount for operators, although it is not possible to quantify this benefit. **Consultation respondents will be invited to present their views and evidence on how costs will vary across the appeals systems.**

Efficiency of the process

77. The majority of past appeals (Option 1) have relied upon a single qualified barrister who will have developed a good level of knowledge of the EU ETS. Whilst no further training will be required for future appeals, under Options 1 and 2, there are risks to efficiency in relying on one person in terms of availability and capacity to handle the increased caseload. For example, they may need much longer to gather and process the information if acting alone. There may also be a perceived reputational risk associated with relying on the judgement of one person.

78. The PIN and FTT (Options 3 and 4) are likely to be as efficient as Options 1 and 2 in terms of the time needed to build background knowledge of the case but are perhaps more efficient than Options 1 and 2 in terms of case handling given that both systems have the capacity to handle multiple cases. Option 3 employs a number of inspectors, including two inspectors who dealt with two previous EU ETS appeals for Defra. Inspectors are supported by administrative staff. This is also the case with Option 4 where a panel of judges and non-legal experts, experienced in environmental regulations including climate policies, is available to hear appeals. In fact the QC who has handled the majority of previous EU ETS appeals, sits on the FTT, so the existing knowledge that has built up will be transferred. Judges are also supported by a well established system of administrative and I.T. support.

79. The FTT (Option 4) is also thought to be efficient because of its flexibility – it can adapt to hear different types of appeal (with a judge sitting alone or with one or two expert members, allowing quicker resolution) and can cater for long and complex or short and simple hearings. Judges also have the ability to strike out a case if there is no prospect of success. The FTT will also sit in various venues, utilising the existing network of Tribunal venues across the country.

80. There are also efficiency issues surrounding the length of time taken for an appeal. Industry has said they would like to see this reduced, as speeding up the process would in their view, reduce costs. Table 7 sets out the information available on the procedural steps and timings for each appeals process (Options 1/2, 3 and 4). Options 1 and 2 are quite complex compared to Options 3 and 4, with different timings for lodging an appeal depending on the regulation that is subject to appeal, and has more steps to go through. The procedures under Options 3 and 4 are more streamlined with more time being allowed for operators to lodge an appeal (28 days compared to 15 under Option 1). This is consistent with calls from industry to double the current response times.

Table 7. Procedural steps and timings of the appeals processes under Options 1/2, 3 and 4.

Stage in process	Option 1/ 2 (Status Quo/Status Quo+ written)	Option 3 (PIN)	Option 4 (FTT)
Lodging an appeal	Ranges between 15 working days and 6 months after the appealable decision depending on the regulation being appealed. There is	An appeal must be lodged before the effective date of the enforcement notice (which will be a minimum of 28 days after the date of issue of the	Operators are required to lodge an appeal within 28 days of receipt of a notice from the regulator (although this maybe extended) using a

	scope to extend these timings.	enforcement notice). There is no scope for extension. PIN will decide the most appropriate appeal route within 7 days of receipt of a valid appeal.	standard template available on the FTT website.
Respondent timings	The regulator shall give notice of the appeal within 14 days of receipt of the appeal. Within 14 days of issuing the notice above, the regulator shall notify the appeal body of who was sent the notice	14 days after the appeal being lodged the regulator sends the appellant and the PIN a completed questionnaire and supporting documents.	Each respondent must send or deliver to the Tribunal a response to the notice of appeal within 28 days after the date on which the respondent received the notice of the appeal.
Submission of case by appellant	Representations should be made no later than 17 days after representations by the regulator. Representations to the appeal body shall be sent to all Parties who then have a further 14 days to make representations on them	6 weeks from lodging the appeal the respondent and appellant can submit any further statements.	Following the response appellant has another 14 days to submit their case.
Provision of information by appellants and regulators		9 weeks all final comments on submissions by others (appellant may comment on regulator's submissions and vice versa).	The appellant may make a written submission and provide further documents in reply to a response within 14 days after the date on which the respondent or the Tribunal sent the response to the appellant.
Total time taken for submission of info	c. 12-33 weeks (although experience is at the upper end of this range)	20 (written)/28 (hearing) weeks for a decision	c.12 weeks
Total time taken for decision	31 weeks from date of hearing to decision being issued*	32/33 weeks all in Aim for no later than 7 weeks after date of hearing	No published indication of timescale for a decision to be made, other than "as soon as possible"

* Based on average timeframe for the 3 most recent oral hearings

Policy alignment

81. In his report dated January 2011, Professor Richard Macrory investigated the appeal arrangements for over 60 pieces of environmental regulation and found that, where an appeal is provided for at all, "there is little in the way of underlying principle in choice of the appeal body". He asserted that "the existence of the Environment Tribunal[21] now provides an opportunity for consolidating environmental appeals across a wide range of existing laws". As such there is an emerging alignment of Government policy on environment and climate regulations appeals processes towards the FTT.

82. Appeals to FTT are obligatory in certain instances. For example in relation to civil sanctions under regulations made under the Regulatory Enforcement and Sanctions (RES) Act 2008 in England or in relation to certain decisions under the Marine and Coastal Access Act 2009. It is also being used to hear appeals on decisions under the Carbon Reduction Commitment Energy Efficiency Scheme. An increased use of the FTT for a range of environmental appeals will help to foster increased

[21] Used as shorthand for the environment jurisdiction of the general regulatory chamber of the First Tier Tribunal.

experience and knowledge of handling such cases in the FTT, increasing its efficiency over time. This is also likely to improve the consistency of judgement and capacity to handle ETS cases.

Proportionality

83. Ensuring the type of appeal hearing is proportionate to the nature of what is being appealed is important to promote efficiency and reduce costs. All options offer both written and oral procedures for resolving appeals. Oral appeals are more costly for all parties as it requires travel and subsistence of parties and their legal support. The need for an oral hearing should depend on the complexity of the case being heard. Where the issue is complex or if there is significant room for interpretation, an oral hearing may allow for a greater exploration of the subtleties involved in the appeal. However, where a case is more straightforward, it is likely that an oral hearing is not necessary for a fair appeal. Hence, it is likely that the costs of holding an oral hearing will be out of proportion to the benefits derived.

84. As under Option 2, Government could modify the current appeals system so that there is an automatic presumption of a written hearing unless either party requests an oral hearing and there is sufficient justification for one, to keep costs for all parties to a minimum. Government could also seek to replicate this approach under the FTT (Option 4). The model under Option 3, is that the inspector takes the decision subject to the relevant regulation, and is able to override the wishes of the Parties in this respect.

85. Options 3 and 4 also provide for an award of costs for unnecessary or wasted expense resulting from an appeal. The helps to incentivise the use of the most appropriate hearing procedure.

Transparency and accessibility

86. It is important that the appeals procedure, including grounds for appeal, information requirements and timings are clear. The provision of clear procedural information for all parties will reduce the chances of unreasonable appeals, reduce the burden on all parties (such as the learning costs) and improve the efficiency of the process. While the current process for appeals (Options 1/2) is set out in the GHG regulations in Schedule 2, none of the supporting guidance covers the procedure. In general, the current requirements are legalistic and prescriptive and could be simplified. Government could provide guidance for the post 2013 appeals process under the status quo (Options 1/2).

87. Simplification of the text, supported by clear guidance will help to reduce the risk that genuine appeals are deterred by the upfront investment needed to understand the requirements. Options 3 and 4 are well established processes with clear and accessible web-based guidance and experienced staff that are on hand to provide advice. Moreover, as the FTT (Option 4) is familiar to both operators and regulators for handling environmental cases, it is likely to be less burdensome. FTT rules of procedure are clear and flexible, and the tribunal can sit at different locations increasing physical accessibility and reducing travel costs.

88. Furthermore, given the possibility under Options 1 and 2 for the SoS to delegate the appellate function, the process may be unclear to the appellant. Government could make this clearer in supporting guidance. Alternatively, Government could move to a process where there is one procedural path, as is the case under Option 4 and in the majority of cases under Option 3. For Options 1 and 2 this could mean removing the possibility for the SoS to hear or take decisions.

89. As Options 2, 3 and 4, require the appellant to justify why a oral hearing is required, there is a small risk that this could reduce the accessibility of a genuine application to receive an oral hearing. Under both Options 3 and 4, while the possibility of an award of costs for unreasonable action or wasted expense may help to ensure that calls for oral hearings are robust, this could also deter genuine

appeals. DECC considers this risk is limited, given that it is unlikely that appellants would face this cost[22].

90. In general, as noted in paragraphs 74-76, the expected financial cost of appealing to the operator is likely be to slightly lower for Options 3 and 4 relative to Options 1 and 2. This will increase the accessibility of Options 3 and 4. In terms of time to appeal, as noted above, operators will have more time to lodge an appeal under Options 3 and 4, thus further increasing accessibility. In light of all of these factors, on balance accessibility is likely to be similar between the options, with Options 3 and 4 considered slightly more accessible.

Independence

91. The current system does allow for the final decision to be made by the DECC Secretary of State. The decisions being appealed will have been made by the Environment Agency. While this is a separate body, it is clearly still an arm of Government, so some have expressed concern over the independence of the appeal process. DECC does not believe that the independence of the system is in question. However Options 1 and 2, and to some degree Option 3 could all raise similar comments on the grounds of perceived independence (under Option 3 inspectors take a decision on behalf of the SoS). Option 4 is fully independent of Government however, so the risk of any negative perception on the degree of independence will be less. In addition, the FTT has a clear, established internal onward appeal procedure, which none of the other options do.

Summary of appeals process

92. Following a review of the options against set criteria, DECC is proposing that appeals against decisions relating to the GHG regulations in Phase III are handled under the FTT (Option 4). Government believe Option 4 is preferable to the other options on the basis of efficiency, proportionality, transparency and independence. On issues around accessibility there is little to choose between Options 2, 3 or 4. Option 1 is the most costly for government with Option 4 the least costly. A summary of the assessment is provided in table 9 at Annex D.

93. Whilst it is in DECC's gift to improve the proportionality and accessibility of Option 1, proceeding with Option 4 is consistent with a broad Government shift towards the use of the FTT for appeals against decisions under environmental and climate policy, in line with the recommendations of the Macrory Report. This policy alignment will help the FTT to build knowledge and experience over time, promoting consistency of judgement and increased capacity to handle greater numbers of appeals. This is important to improving efficiency and reducing the need for more costly oral appeals. With respect to the latter, Government would work with the FTT to promote the use written procedures wherever possible (as requested by the appellant). The enhancement of capability under the FTT may be particularly important for the EU ETS post 2013, which could see an increase in appeals with the introduction of the aviation sector. The FTT has the additional benefit of being flexible in terms of the type and location of appeals (reducing travel costs), and is independent of Government.

One-in, one-out

94. As this proposal derives from an EU Directive it might be expected to be outside the scope of the One-In One-Out. The Directive does require Member States to lay down the rules on penalties, and ensure they are implemented. Therefore the level at which penalties are set is outside the scope of

[22] In recent years, under the Planning Inspectorate, costs applications have been made in about 20% of hearing cases, 25% of inquiry cases and 4% of written cases. Awards have been made in about 40% of these cases overall. The PIN deals with appeals across the whole planning system and thus is estimated to have a higher number of unreasonable appeals than we would anticipate from the EU ETS.

the One-In, One-Out framework. However, the Directive does not require Member States to establish an appeals process against decisions made by the regulators. The right to a fair hearing is set out in Article 6 of the European Convention on Human Rights (ECHR). As an international treaty, the ECHR should be treated in the same way as EU measures for the purpose of One-In One-Out methodology. Therefore a~~A~~ shift from the current appeals system to the FTT is ~~expected to lower the costs to operators who appeal against decisions made by the regulator, although it has not been possible to quantify this reduction in costs. Therefore a move to option 4 is an Out~~outside the scope of the One-In One-Out framework. **Respondents to the consultation will be asked to provide their views on this proposal, including in terms of the associated reduction in costs.**

E - Conclusions

DECC is proposing that the UK moves to an enforcement system comprising of civil sanctions only (Option ii).

95. This approach is consistent with broader climate and environment policy and in line with the objectives of better regulation, including the recommendations of the Macrory report to move away from criminal sanctions.

96. DECC analysis suggests that by maintaining the current robust regulator monitoring system and by setting sufficiently dissuasive penalties, this will not lead to increased non-compliance. Enhancing the level of regulator discretion and in turn, the proportionality of the penalties applied, may lead to a reduced risk of non-compliance.

97. A more proportionate approach offers savings to business of the order of £1.0m PV from greater regulator discretion in the application of the €100/tCO_2e penalty for under reporting.

DECC is proposing that appeals against decisions relating to the GHG regulations in Phase III are handled under the FTT (Option 4).

98. Option 4 is considered preferable to the other options on the basis of efficiency, proportionality, transparency and the external perception of independence. DECC considers that on issues around accessibility there is little to choose between Options 2, 3 or 4. Overall Option 4 the least costly for Government.

99. Proceeding with Option 4 is consistent with a broad Government shift towards the use of the FTT for appeals against decisions under environmental and climate policy, in line with the recommendations of the Macrory Report. The FTT has the additional benefit of being flexible in terms of the type and location of appeals (reducing travel costs), and is independent of Government.

100. As a result of shifting to Option 4, Government is estimated to save £85,000 (NPV) over the appraisal period.

F - Questions for consultation respondents

Penalties

Q1. Are criminal sanctions disproportionate to the range of offences under the EU ETS?

Q2. Are there any costs that haven't been identified in this consultation, which are associated with a criminal or civil penalties regime?

Q3. Would a move to civil sanction regime (Option ii), with flexibility to match fine levels to the severity of the offence, retain a sufficient deterrent to non-compliance?

Q4. Do you support increased regulator discretion over application of the €100/tCO_2e penalty in specific circumstances, for example, where an operator has identified a genuine error in a verified

emissions report, surrendered the necessary allowances and reported these actions to the regulator? A penalty will still need to apply to retain the incentive for accurate reporting.

Q5. Do you agree the proposed approach to setting penalties as set out in Annex B? What other methods are there or issues that should be taken into account?

Appeals

Q6. How do you think the costs to the operators of appealing will vary across the four options considered?

Q7. What concerns do you have about the appeals process; have the right criteria been identified and assessed?

Q8. Do you agree that the First Tier Tribunal is preferable to the current approach?

Q8. Based on the evidence above, do you think those with a genuine appeal will find a First Tier Tribunal as accessible as the alternative options proposed?

Additional questions will be added ahead of the consultation, including on the methods for setting penalties levels.

Annex A - Qualitative assessment of the benefits of changes to the regulations (drafting or procedural) that are outside the scope of this IA.

There are a number of provisions in the UK 2005 GHG regulations, beyond the penalties and appeals regimes, which elaborate further the original provisions of the EU ETS Directive. This is often necessary because the provisions in the Directive do not contain the level of detail required for implementation in the UK. The review identified areas where it is possible to make the regulations more accessible to incumbent ETS operators by either moving non-essential provisions to a schedule of guidance, simplifying the text, or removing the regulation completely. Hence these are not policy changes but changes that simply aim to clarify the regulatory requirements for operators and regulators, and make it easier for operators to provide information to the regulator – the information and regulatory requirements in the new statutory instrument will remain the same as under the current regulations. The review identified the following options for simplification:

- **Change:** Streamline and make clear the permit application process by introducing a requirement for applications to be made on a form provided by the regulator (at present the regulation does not specify how information should be provided). This will be submitted electronically on a form which is compatible with EA data management software unless otherwise agreed with the regulator.

  Benefit: This will remove a number of the existing regulations in the draft SI regarding the permit application process and provide an opportunity to make the application process clear. By using a standard form available online, the information requirements will be clear for operators – reducing the time spent understanding them. The form can be designed so that it cannot be submitted until all necessary info has been provided, increasing the likelihood of a successful application and reducing permit processing delays associated with inaccurate or incomplete applications. Using a form compatible with EA data management software will bring the permit application process for static operators in line with that for aviation operators, and may lead to administrative savings for the regulator (e.g. through easier information management and reduced paperwork). In the future it is likely that the same information management system will be used for other climate policies (e.g. CRC).

- **Change:** Bring together the timings for operators having to submit information to the regulator. Ensure the timings are practicable.

  Benefit: This will reduce the number of different deadlines throughout the year for operators and provide them with a reasonable timeframe to respond to deadlines. This will in turn reduce the risk of them missing a deadline and being penalised for doing so. It will reduce the time spent by operators understanding the requirements and help both operators and regulators plan for peaks and troughs in work load throughout the year.

- **Change:** Standardise where possible the timeframe in which the regulator responds to operator. At present there is disparity between the response times for static and aviation operators.

  Benefit: This will make it clearer both to both the regulator and the operator the requirements of the regulator and when responses can be expected, aiding business planning for both Parties. This approach is in line with the recommendations of the Penfold review which aims to set clear timescales for determining applications, providing greater certainty and reducing delays to business[23].

[23] http://www.bis.gov.uk/assets/biscore/better-regulation/docs/i/11-1413-implementation-of-penfold-review.pdf

- **Change:** Combine all of the duties of a regulator into one section (this is something that regulators have requested) which can be referred to more quickly. At present the requirements distributed throughout the text.

  Benefit: Whilst this will not change the administrative burden on operators or the regulator, it will make it easier to establish for both regulators and operators the role of the regulator. Potentially, this could reduce the time spent by both Parties in understanding their requirements.

- **Change:** Bring together in one place all the information requirements – both where the regulator requests information from operators, and where the Secretary of State may require the regulator to provide information. Currently, the requirements are distributed throughout the text.

  Benefit: Whilst this will not change the administrative burden on operators or regulators, it will make it easier for them to establish and meet their requirements, potentially reducing the time spent by both Parties understanding the system requirements.

Annex B – Draft proposals for EU ETS civil penalties in phase III

101. Currently, criminal penalties set out in the UK legislation are as follows:

- on summary conviction, a fine not exceeding statutory maximum of £5,000 or a term of imprisonment not exceeding 3 months.
- on conviction on indictment, a fine (unlimited) or a term of imprisonment not exceeding two years.
- other costs such as legal and administrative costs to the firm which is in breach.

102. The civil penalties are as follows:

- installations would need to pay a penalty of €100 per tonne of CO_2 under reported or not surrendered plus the cost of purchasing enough allowances to cover their under-reported or not surrendered emissions at the going carbon price.

103. Under the new regime, levels would be set to ensure that they are as dissuasive as criminal sanctions. The proposals in table 8 below are illustrative examples of the penalty levels. These are based on an assessment of the penalties applied for aviation ETS and considered in the context of the penalties applied elsewhere in the EU. Our intention is to work with the Environment Agency and the regulators in Northern Ireland and Scotland to develop more substantive proposals on which to publicly consult. Final penalty levels will be determined post-consultation, taking into account any responses and further analysis of potential methods for setting penalties.

104. The same level of compliance in phase III as in phase II of the EU ETS is assumed. With the exception of the penalty for under reporting, it is not possible to compare phase III civil sanctions with the criminal sanctions under the current regime; it is not possible to determine with any certainty the court's judgement of a specific case and the resultant penalty. However, with increased flexibility for the regulator to assess the nature of the non-compliance on the basis of factors such as the level of intent and impacts on the integrity of the ETS, a civil system (Option ii) would ensure greater proportionality. The application of the daily rate would help reduce the likelihood of prolonged non-compliance which could lead to additional costs. The draft regulations also provide for discretion to be exercised by the regulator in setting penalties in different circumstances. This should assist in the award of appropriate penalties for different types of non-compliance e.g. the award of a lower penalty for mistaken as opposed to wilful non-compliance.

105. The approach to be taken by the regulator in exercising their discretion would be set out clearly in published guidance. Whilst there should be no change in the way the regulator assesses individual cases between Options i and ii, there should be increased consistency of judgement as a result of them assessing all cases rather than the courts, and on the basis of principles established in the guidance.

Table 8. Illustrative examples of draft methods for establishing penalties levels under a civil regime in phase III.

Offence	Proposed penalty (for illustrative purposes only)
Failing to surrender sufficient allowances	The proposed penalty is the sterling equivalent of €100 for each allowance that the operator fails to surrender. This is based on the penalty specified in the EU ETS Directive for operators and aircraft operators who do not surrender sufficient allowances, by 30 April each year, to cover their emissions during the preceding year.
Exceeding an emissions	The proposed penalty is for the excess emissions amount in tCO2e multiplied by the carbon price for that year

target for an excluded installation	
Failure to pay for excess emissions for excluded installations (the small emitter opt out)	The proposed penalty is for a fixed block fine of 10% of the amount unpaid up to a maximum of £25,000. No block penalty will be applied for unpaid amounts below £100. In addition, a daily rate of £150 for each day that the fine remains unpaid will be applied, up to a maximum of £13,500. If the excess emissions remain unpaid after one month the installation may be returned to the core EU ETS. The daily rate would continue to accrue to a maximum of £13, 500. This proposal is based the need for flexibility given that the cost of excess emissions may vary from as little as £10 to as much as £250 000 or more. The maximum rates are drawn in comparison to maximums for small emitters in the offence of operating without a permit; the fixed block fine is reduced by half to reflect the fact that this offence will only ever relate to one compliance year.
Carrying out a regulated activity without a permit.	The proposed penalty is A + B, where: A is the avoided costs of the operator carrying out a regulated activity without a permit B is the estimated value of the total number of allowances the operator would have had to surrender during the entire trading period. The regulator has discretion to amend B so that operators without permits cannot financially benefit over operators that do hold permits. This is based on the actual costs the operator has avoided by operating without a permit.
Failure to comply with a condition of a permit	The proposed penalty range is up to £3,750, based on: • The penalty for the equivalent offence under the aviation EU ETS regulations from 2012 onwards: failure to comply with emission plan conditions, of £3,750. A daily penalty of £375 up to a maximum of £33,750 would apply if the penalty is not paid by the due date.
Failure to surrender a permit	The proposed penalty is £5000. This is based on the fact that failure to inform the regulator that the installation has ceased operation could result in allocations being received that the operator is not entitled to. These allowances should be recovered, and consideration of further enforcement action may be needed where an operator has sold these allowances e.g. requirement on the operator to surrender the unrecoverable allowances, failure to do so would attract the €100 per tCO_2 civil penalty set out in the Directive.
Failure to return allowances	The proposed penalty level is £20,000. A daily rate of £1,000 up to a maximum of £30,000 will be applied for each day that the allowances are not returned. This is based on the penalty for failure to comply with an enforcement notice. The failure to return allowances that an operator is not entitled to is a similar offence that can be considered a deliberate act of non-compliance with regulator requirements.
Failure to comply with an enforcement	The proposed penalty is a fixed block fine of £20,000. A daily rate of £1,000 up to maximum of £30,000 will be applied where the penalty is not paid by the due date.

notice	This is based on the seriousness of non compliance with the regulator's requirements following other attempts to procure compliance, as well as the requirements of the permit. The regulator could have discretion to take into account any mitigating factors and reduce this penalty.
Failure to comply with an information notice	The proposed penalty is a fixed block fine of £1,500. A daily rate of £150 up to maximum of £13,500 will be applied where the penalty is not paid by the due date. This is based on the equivalent penalty under the aviation EU ETS regulations and the fact that the block fine should be set lower than the fixed block fine for non-compliance with an enforcement notice as the situation is likely to be less critical.
Failure to notify the regulator	The proposed penalty is £5,000. In addition one type of offence under this penalty is failure to inform the regulator that the installation has changed operation. This could result in allocations being received that the operator is not entitled to. These allowances should be recovered, and consideration of further enforcement action may be needed where an operator has sold these allowances e.g. requirement on the operator to surrender the unrecoverable allowances, failure to do so would attract the €100 per tCO_2 civil penalty set out in the Directive.
Failure to comply with a notice	The proposed penalty level is £1,500. A daily rate of £150 up to maximum of £13,500 will be applied where the penalty is not paid by the due date. This is based on the penalty level above for failing to comply with an information notice.
Providing false or misleading information	The proposed penalty is £1,000. This is based on • under the current EU ETS regulations, this offence attracts a maximum penalty of £5,000 or 3 months imprisonment on summary conviction or an unlimited fine or 2 years imprisonment on conviction on indictment • the penalty for the equivalent offence under the aviation EU ETS regulations, making false or misleading statements, of £1,000. The regulator could escalate the penalty through the issuing of an information notice to obtain the correct information, and possibly an enforcement notice. There could be further consequences as a result of this offence: for example incorrect reporting of emissions could require additional surrender of allowances, or an incorrect free allocation could be recovered from the operator's registry account.

Annex C – Costs of an appeal

106. The main cost to government of the appeals process in England is for the Environment Agency in preparing the case. Based on past experience, the cost to the environment agency of a written appeal is £19,600. This rises by £10,000 to £29,600 as a result of paying legal counsel fees for an oral hearing.

107. The Environment Agency is likely to face the same charges and fees for all the options considered.

108. Based on previous experience, under Options 1 and 2 DECC is likely to face a cost of £1,200 per written appeal, rising to £3,000 per oral hearing. This is to cover the cost of the person appointed to hear the appeal on behalf of the Secretary of State and assumes 2 working days per written appeal[24], 5 working days per oral appeal and a daily rate of £600.

109. In Option 3, the estimated cost to DECC of the Planning Inspectorate is £4,500 per written appeal rising to £5,650 per oral hearing. This is to cover the cost of the planning inspectors time (estimated by the Planning Inspectorate), and the cost of room hire and travel and subsistence, in the event of an oral hearing.

110. In Option 4, the estimated cost to DECC of the FTT is £1,000 per written appeal rising to £2,500 per oral hearing, plus a start up cost of £2,500 for the first year associated with judicial training around the EU ETS. This estimate was made following discussions with the FTT.

[24] Made up of ½ day preparation, 1 day per appeal and ½ day preparing a report with the recommendation.

Annex D – Table 9. Summary of options against criteria.

	Option	NPV costs (2013-20), £2011 Central estimate	Proportionality	Independence	Efficiency	Accessibility
1	**SoS hearing and decision/ SoS delegates hearing and decision** **Presumption of oral hearings**	**406,715**	No power to refuse to hold oral hearing if requested No criteria for deciding which procedure	No evidence of any lack of impartiality in any of the existing judgements but the fact that the Secretary of State is ultimately accountable for the working of the ETS in the UK has given rise to challenges about his independence from the process when making judgements.	Dependent on one barrister in terms of availability and judgement Process quite complex with different response times for different issues Some learning time needed for administrative support	Central estimated cost to operators is greater thus on average may deter some appellants. Right for oral hearing will increase accessibility who feel more comfortable through this process
2	**SoS hearing and decision/ SoS delegates hearing and decision** **Presumption of written hearings**	385,423		As Option 1	As Option 1	As Option 1
3	**Planning Inspectorate**	368,815	Inspector takes decision based on criteria Power to refuse oral hearing or to request one if not requested Award of costs for unreasonable cases	Inspector takes decision on behalf of the SoS DECC officials may still be involved in organisational issues.	Legally trained inspectors dealing with waste and water permitting issues. Two inspectors dealt with previous Defra ETS case Experienced support staff Capacity to take on more cases Process clearly set out in guidance and streamlined	Will cost less to appeal but risk of award of costs may deter appellants. More time provided to appeal
4	**First Tier Tribunal**	321,364	No power to refuse to hold oral hearing if requested Award of costs for unreasonable cases, wasted	Third party – would manage the entire process independently of DECC.	In line with other appeal systems for environmental legislation	Will cost less to appeal but risk of award of costs may deter appellants More time provided to

			expense Judges can strike out case if no chance of success			appeal

Annex E – Profile of savings delivered by preferred options

Penalties regime in the UK

Option ii: High Scenario savings relative to business as usual (undiscounted)

£2011 prices	2013	2014	2015	2016	2017	2018	2019	2020	Total
Cost for 2 year sentence (combination)	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-40,000
Total	**-5,000**	**-5,000**	**-5,000**	**-5,000**	**-5,000**	**-5,000**	**-5,000**	**-5,000**	**-40,000**

Option ii: Net Present Value High Scenario savings relative to business as usual

£2011 prices	2013	2014	2015	2016	2017	2018	2019	2020	Total NPV
Cost for 2 year sentence (combination)	4,831	4,668	4,510	4,357	4,210	4,068	3,930	3,797	**34,370**
Total	4,831	4,668	4,510	4,357	4,210	4,068	3,930	3,797	**34,370**

Appeals process for England

Option 4: Appeals system using the First Tier Tribunal relative to business as usual (undiscounted)

£2011	2013	2014	2015	2016	2017	2018	2019	2020	Total
2.1 appeals	-10,268	-12,768	-12,768	-12,768	-12,768	-12,768	-12,768	-12,768	**-99,644**

Option 4: Net Present Value Appeals system using the First Tier Tribunal relative to business as usual

£2011	2013	2014	2015	2016	2017	2018	2019	2020	Total
2.1 appeals	-9,921	-11,919	-11,516	-11,127	-10,750	-10,387	-10,036	-9,696	**-85,351**