

## APPENDIX D NEW ENTRANTS AND CLOSURES

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*How will new entrants be able to begin participating in the EU emissions trading scheme?*

*In the case that there will be a reserve for new entrants, how has the total quantity of allowances to set aside been determined and on what basis will the quantity of allowances be determined for each new entrant? How does the formula to be applied to new entrants compare to the formula applied to incumbents of the relevant activity? Please also explain what will happen to any allowances remaining in the reserve at the end of the trading period. What will apply in case the demand for allowances from the reserve exceeds the available quantity of allowances?*

*Is information already available on the number of new entrants to expect (through applications for purchase of land, construction permits, other environmental permits etc.)? Have new or updated greenhouse gas emission permits been granted to operators whose installations are still under construction, but whose intention it is to start a relevant activity during the period 2007 to 2012?*

## **A Introduction**

1. The UK has decided to set aside a number of allowances to be allocated for free to installations that commence or extend the operation of an Annex I activity, after 31 December 2007 but before the end of 2012. Further detailed rules on new entrant and closure eligibility and treatment are set out in this Appendix.
2. The total quantity of allowances to be set aside for new entrants has been determined by looking at the probability of new entrants and investment lead times for individual sectors. This has led to the identification of three groups of sectors: the first will be subjected to a sector specific cut based on the expected level of new entry in that sector and the second and third groups will have a different flat reduction rate applied in order to make up the New Entrant Reserve (NER). The allowances will be taken from sector caps that have been calculated to include growth.
3. The NER will contain additional allowances to provide Phase II allocations for new entrants that start towards the end of Phase I, and part of the NER will be earmarked for use by Good Quality Combined Heat and Power (GQ CHP) new entrants.
4. New entrants will be asked to provide input data when making a new entrant application so regulators can run a standardised spreadsheet derived from best practice benchmarks. These spreadsheets are attached at Annex D1. They have been subject to a separate consultation and further detail can be found on the DTI website<sup>1</sup>.
5. As a general principle, Phase II new entrants will be allocated 95% of the amount of allowances as calculated by the spreadsheets at Annex D1. However, GQ CHP new entrants will be allocated at 100% of the amount of allowances as calculated by the spreadsheet to act as an incentive to install CHP. In addition, new entrant boilers and small generators will be allocated at 90% of the amount of allowances as calculated by the spreadsheet. Large Electricity Producers (LEP) new entrants will be subject to the same cut in allocation as LEP incumbents (30.3%).
6. The allowances available from the NER will decrease as new entrant applications are processed and allowances are issued. A queuing system is considered a fair way to manage operators' access to the NER as it changes in size. Should the NER be exhausted, those new entrants that do not receive an allocation will have to buy allowances from the market.

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<sup>1</sup> See: <http://www.dti.gov.uk/energy/environment/euets/phase2/new-entrants/benchmarks-review/page29366.html>

## **B Quantifying the NER**

7. The Phase II NER will comprise 81,601,251 allowances, representing 6.6% of the total allowances<sup>2</sup>. The total quantity of allowances to be set-aside for new entrants has been determined on the basis of the methodology set out below.

### *The NER*

8. In deciding the appropriate approach for calculating the size of the NER for Phase II new entrants, each sector has been assessed against whether it has, or is expected to have, high rates of new entry.
9. Three distinct groups of sectors have been identified:
- “Group 1” sectors, whose trend figures of new entry in Phase I is greater than 4% of the sector’s Phase II BAU emissions and whose expected Phase II new entry is greater than 4% of the sector’s Phase II BAU emissions. Group 1 comprises the following sectors: Large Electricity Producers, Offshore Oil and Gas, Downstream Gas, Combined Heat and Power, and Services;
  - “Group 2A” sectors, whose trend figures of new entry in Phase I is greater than 4% of the sector’s Phase II BAU emissions but whose expected Phase II new entry is less than 4% of the sector’s Phase II BAU emissions. Group 2A comprises the following sectors: Cement, Iron and Steel, Glass, Chemicals and Other B; and
  - “Group 2B” sectors, whose trend figures of new entry in Phase I is less than 4% of the sector’s BAU emissions and whose expected Phase II new entry is less than 4% of the sector’s Phase II BAU emissions. Group 2B comprises the following sectors: Lime, Ceramics, Pulp & Paper, Food & Drink, Aluminium, Other Electricity Producers, Other A, Other C, and Refineries.
10. The estimate of the NER requirements for Group 1 sectors is based on sector expert opinion, taking into account “bottom-up” data (information provided to the Government by installations detailing expected future investments), Phase I trend analysis for new entry, responses to the Government’s consultation on the draft NAP, emission projections and policy changes since the information was provided that may have an effect on proposed new entry.
11. The estimate of the NER requirements for Group 2A sectors is based on sector expert opinion, taking into account trend analysis in Phase I, responses to the Government’s consultation on the draft NAP, emission projections, ‘bottom up’ data and changes in policy between Phase I and

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<sup>2</sup> The NER represents 6.6% of the total number of allowances prior to the deduction of allowances to be auctioned and 7.1% of the allowances to be allocated for free.

Phase II that may have an effect on proposed new entry. The estimate for the NER requirements for Group 2B sectors is based on Phase I trend analysis.

### *CHP NER*

12. Part of the NER will be ring-fenced for use by Good Quality Combined Heat and Power (GQ CHP) new entrants. Good Quality certification is determined under the CHPQA programme<sup>3</sup>.
13. Where a new entrant applicant is partially qualified under the CHPQA programme, only the GQ CHP part of their application will come from the ring-fence, with the rest coming from the general NER. Further details about allocation to GQ CHP new entrants are contained in section E4 below.
14. If there are insufficient allowances remaining in the CHP ring-fence, allowances for successful GQ CHP applicants will be drawn from the main NER. The ring-fence will be reviewed each year from 2010 onwards and in the light of emerging trends in CHP and general new entry, allowances from the ring-fence may be transferred to the main NER.
15. The size of the CHP ring-fence is based on “bottom-up” data, using information provided to the Government by CHP installations detailing expected future investments and those that are already underway, combined with the Government’s assessment of the likely new GQ CHP capacity coming on line during Phase II using the Cambridge Econometric’s projection of GQ CHP that is used in the UK’s Updated Energy Projections (for consistency)<sup>4</sup>.

### *Phase II allowances for later Phase I new entrants*

16. The NER will also contain additional allowances to provide Phase II allocations for new entrants that start towards the end of Phase I (i.e. between 1 July 2006 and 31 December 2007). Further details about how this will operate can be found in Section I. The number of additional allowances has been estimated as follows:
  - for 1 July 2006 – 31 December 2006, the known eligible new entrant applications; and
  - for 1 January 2007 – 31 December 2007, the known eligible new entrant applications plus an estimate to cover additional new entry in three sectors that typically have short lead times (offshore oil and gas; services; and food and drink).
17. The estimate of late Phase I new entry in the offshore oil and gas sector is based on the Government’s best analysis of future trends. For the other

<sup>3</sup> For details of the CHPQA programme, please see the CHP page on the Defra website at: <http://www.defra.gov.uk/environment/energy/chp/index.htm>

<sup>4</sup> The latest Updated Energy Projections can be found at: <http://www.dti.gov.uk/files/file31861.pdf>

sectors with typically short lead times, the Government has estimated late Phase I new entry based on average new entry in the period 2003 - 2006.

**Table D1: NER in the EU ETS sectors, 2008 – 2012**

<b>SECTOR</b>	<b>Total contribution to the Phase II NER (No. of Allowances)</b>	<b>Total contribution to the Phase II NER (As a % of sector cap)</b>
<b>Large Electricity Producers<sup>5</sup></b>	39,436,758	7.3
<b>Offshore</b>	11,554,534	11.4
<b>Downstream</b>	3,792,912	35.2
<b>CHP</b>	16,414,764	13.3
<b>Services</b>	624,498	8.1
<b>Iron and Steel</b>	3,265,315	2.7
<b>Cement</b>	1,495,427	2.7
<b>Glass</b>	304,700	2.7
<b>Chemicals</b>	1,092,331	3.9
<b>Others B</b>	144,692	2.7
<b>Lime</b>	286,001	2.1
<b>Ceramics</b>	277,316	2.9
<b>Pulp and Paper</b>	109,231	2.1
<b>Food and Drink</b>	264,420	3.0
<b>Aluminium</b>	295,745	2.1
<b>Other Electricity Producers</b>	136,423	2.1
<b>Others A</b>	478,531	10.1
<b>Others C</b>	30,065	2.1
<b>Refineries</b>	1,597,588	2.1
<b>TOTAL</b>	<b>81,601,251</b>	

18. The estimates of eligible new entrants have been refined in response to feedback received during consultations on emissions projections and the draft NAP, relating to new entrants under Phase II eligibility criteria, sector and growth rates, as well as the benchmark methodology for allocation to Phase II new entrants.

**Table D2: Components of the NER**

	<b>Total NER during Phase II (million allowances, rounded)</b>
New Entrants (non CHP)	44.9
GQ CHP ring-fence	27.5
Later Phase I new entrants (non CHP)	6.8
Contingency Fund	2.4
<b>Total components</b>	<b>81.6</b>

<sup>5</sup> LEP sector has had reduction factor applied.

## **C Contributing to the NER**

### *Contributing to the NER*

19. Sectors will contribute to the Phase II NER as follows:

- Group 1 sectors (see paragraph 9 above), except LEP and CHP sectors, will make a sector specific contribution to the NER and a flat rate contribution to the CHP ring-fence;
- Group 1 sectors (LEP and CHP) will make sector specific contributions to the NER and to the CHP ring-fence; and
- Group 2A and Group 2B sectors will make a separate standard flat rate contribution to the NER, based on the average amount of new entry in the period 2003-2006. For Group 2A the flat rate is 1.69%. For Group 2B the flat rate is 1.10%.

20. The CHP sector will provide the majority of the CHP ring fence in line with bottom-up information on growth within the sector and the CHP BAU projection. In line with the Phase I approach, EU ETS sectors will be contributing an additional percentage to the CHP ring fence to provide for the projected growth of CHP to 2012, taking into account the incentives provided by EU ETS. Since CHP capacity typically expands when an installation's "host" industry replaces steam and power generation with new CHP, or invests in new CHP capacity rather than in stand-alone boilers, the corresponding emissions are transferred from the "host" sector to the CHP sector. Therefore the CHP sector is exempt from the requirement to contribute further to the CHP ring-fence.

21. Consequently, with the exception of CHP and LEP sectors, all incumbents and new entrants will make an equal contribution of 0.98% to the CHP ring-fence. In order to provide the required number of allowances in the CHP NER, LEP incumbents will contribute an amount equivalent to the 0.98% contribution that the CHP sector incumbents would have made (equal to 1 million allowances). This is in addition to the standing 0.98% contribution, resulting in an effective contribution of 1.19% from the LEP sector incumbents. The LEP sector new entrants will contribute the same flat rate as all other non-CHP new entrants.

22. Table D1 shows the contributions that each sector will make to the NER.

23. In considering options for contributing to the NER, the Government has balanced the objectives of simplicity with equity. The Government has concluded that the Phase II approach would align contributions closely to expected need, so reducing the possibility of cross subsidisation across sectors.

24. It has been estimated that Group 1 sectors will account for around 91% of allocations to Phase II new entrants. The Government considers that

having the same flat rate contribution for all other sectors than those in Group 1 would lead to possible cross-subsidisation, and has concluded that this should be addressed by providing for two flat rates.

*Contributing to the allowances for later Phase I new entrants*

25. The number of allowances in Phase II required for known later Phase I new entrants (i.e. those determined by 30 June 2006) will come from the Phase II allocation for the sector concerned. The estimated allowances required in Phase II for later Phase I new entrants that are not known or not determined by 30 June 2006 will be taken from the relevant short lead time sectors.

**D Definition of Phase II new entrants**

26. In order to be a new entrant in Phase II, an installation must have:

- commenced or extended, or have plans to commence or extend, an Annex I activity between 1 January 2008 and 31 December 2012; and
- obtained a variation in their permit (or, in the case of commencement of operations, a new permit) after 21 August 2006.

*Permitting issues for new entrants*

27. In order to ensure that installations which start or extend operations in Phase II fall within the definition of Phase II new entrants, the Government has issued Directions to the regulators stating that:

- the regulator shall refuse an application for a permit or variation that is received before 21 August 2006 where the application relates to a new installation or extension which only comes into operation on or after 1 January 2008; and
- where a permit has already been granted or varied prior to 21 August 2006 on the basis that the start date of the installation or extension is before 1 January 2008, the regulator shall use its power to vary and revoke permits contained in the Greenhouse Gas Emissions Trading Scheme Regulations 2005 to revoke that permit or variation (in the latter case, by way of a further variation back to the original conditions) if the new installation or extension will only come into operation on or after 1 January 2008.

28. Where an operator has applied to the Phase I NER on the basis of a start date in Phase I, but where the actual start date slips until after 31 December 2007, the Phase I application will be rejected and the operator will need to make a new application as a Phase II new entrant on the basis of the rules set out in this Appendix.

## **E Eligibility for allowances and calculating the allocation**

29. The allocation to a new entrant will be determined on receipt of an application (which may be in advance of commencing operation) and allowances will be issued shortly after the first emissions. A new entrant will receive a pro-rata allocation of allowances from the NER for the calendar year in which operations commence, and a full annual allocation for subsequent years in Phase II.
30. Phase II new entrants that come within the definition set out in section D will generally be eligible to obtain allowances from the Phase II NER. All new installations will be eligible for allowances; however, not all extensions will be eligible for allowances. Detailed provisions on the eligibility of extensions for allocations are set out in sections E1 – 4 below.

### **E1 Allocations to extensions**

31. An extension at an installation which takes place after 31 December 2007 will be eligible for allowances if it:
- involves the introduction of a new piece of equipment that increases the net output capacity of the Annex I activity; and
  - the increase applies to a technology listed in the new entrant calculation spreadsheet (described in section E6 below).
32. For all sectors, an extension will only be eligible for allowances from the NER in respect of a piece of equipment which directly produces emissions which must be accounted for under the scheme. The allocation will be based on the benchmark associated with the pieces of equipment, which are listed in the new entrants calculation spreadsheet.
33. This is a change from the approach in Phase I, where extensions in the iron and steel and refineries sectors were eligible for allowances if they increased the overall throughput capacity of the Annex I activities at the installation as a whole. The Government has reconsidered the Phase I approach and has concluded that it is more appropriate for a direct emissions approach to be taken for all sectors.
34. This approach would be consistent with the treatment of other incumbent installations that run their equipment harder. It would also reduce the complexity of the NER eligibility rules and reduce the complexity of verification required for some applications, thus reducing the regulatory burden on some operators.
35. The Government recognises that moving to a direct emissions approach could mean lower allocations than otherwise for new entrants in the iron & steel and refineries sectors. However, because the NER is funded from sector caps, a reduction in the expected allocation to new entrants in a sector is mitigated by a corresponding increase in the remaining allowances available to be shared by the sector. It is also considered that this approach would simplify the NER.



36. Extensions to reduce local emissions of sulphur and other non-CO<sub>2</sub> gases and substances will not be eligible for allowances from the NER, as in Phase I. However, the increase in emissions of CO<sub>2</sub> attributable to the installation of such units will be taken into account in the allocation to sectors under the final allocation decision.
37. Operators making an application to the NER must provide a realistic start date. Operators are also obliged to inform the regulators of any change to the nominated start date.

### *Capacity*

38. As part of the application process, operators will be asked to provide information on the installation's capacity before the planned changes, and information on all of the changes to the installation that have had an effect on the relevant capacity of the installation that have taken place since either:
- the time of the installation's last successful application to the NER (or rationalisation application if this involved the extension of capacity without an application to the NER, see section F1 below); or
  - where there has been no previous application to the NER, the end of the baseline period on which the allocation given in the final allocation decision was based. However, in the case where a benchmark has been used for the final allocation, then the appropriate point of time is 30 June 2006.
39. For the purposes of this determination, capacity here refers to the capacity that is comparable to the new entrant application. For example, if the application is referring to a new boiler, the information required is on previous thermal capacity. The notion of comparable capacity should cover all cases where equipment may replace other equipment. The regulator has the discretion to determine what is considered comparable capacity and may ask for further information from the operator if necessary.
40. In the case of Large Electricity Producers that are extending existing installations it will be necessary to provide information on the increase in gross capacity planned at the installation (where capacity is defined as the rated output of the unit/station at the generator). In addition evidence is required that Transmission Entry Capacity (contracted with National Grid Company) will increase in a way that is consistent with the gross capacity increase planned.
41. For the purposes of calculating the net capacity in a way that covers overlap of operation with existing pieces of equipment that are being replaced, installations are required to provide information about replacements taking place within six months of the start date of the new entrant (i.e. expected closures of the equipment that is being replaced).

Regulators will calculate allowances for the new entrant on the basis of the overall net difference in capacity expected when the replacement is complete. It is expected that, in most cases, an overlap period of more than six months would not be necessary. Any period greater than six months is subject to there being a justifiable operational need to keep the equipment that is being replaced in operation.

## **E2 Recommencing operations as a new entrant following closure**

42. Installations or pieces of equipment returning from partial or temporary closure after 30 June 2006 will be eligible for allowances from the NER where emissions from the closed piece of equipment have been explicitly excluded from the installation's baseline emissions (for the period 2000 – 2003) for the calculation of Phase II relevant emissions.
43. The size of the free allocation due to such installations or parts of installations will be calculated on the basis of the benchmark spreadsheet, as for other new entrants. The date of recommencement of emissions, i.e. before 1 January 2008 or after 31 December 2007, will determine whether the returning installation is treated, respectively, as a later Phase I new entrant (see section I below) or as a Phase II new entrant. The rate of allocation for Phase II new entrants is discussed in section E5 below).

## **E3. Changes in offshore**

44. The following types of offshore installations will be eligible for allowances from the NER in Phase II:
- new installations and new combustion capacity at existing installations;
  - tie backs i.e. drilling centres and oil and gas wells serving new fields or new areas of a reservoir that are connected to existing installations; and facility modifications to existing installations directly related to the production, processing and delivery of the offshore oil and gas reserves which meet the following criteria:
    - a) the tiebacks/modifications will result in a quantified enhanced recovery of reserves;
    - b) the tiebacks/modifications will require a variation of the relevant permit; and
    - c) the tiebacks/modifications will result in a quantified increased additional power demand that will generate additional emissions from the existing combustion plant.
45. All of these offshore projects are important for enhancing offshore oil and gas capture and thus ensuring security of supply. Operators face a range of investment opportunities, worldwide, to recover oil and gas. Allocations of allowances from the NER will help to ensure that investment in projects to maximise recovery of Continental Shelf oil and gas remains attractive. If these reserves are not accessed at this present time, there is a strong possibility that they may be impossible to recover in the future.

46. It will not be possible to be allocated allowances from the NER for any drilling programmes related to the enhancement projects, as the historic baseline data is assumed to include a component relating to past drilling activity.
47. Installations that are physically onshore will not be allocated allowances from the NER for this type of extension unless they are host to an offshore modification or tieback.
48. The allocation to the new entrant offshore installation will be calculated using the standardised benchmarking methodology for offshore new entrants. This calculation will need to be certified by the verifier, as part of the verification of the NER application.

#### **E4. Increase in Good Quality CHP capacity**

49. New GQ CHP installations, which fall within the EU ETS and begin operation after 31 December 2007 will be eligible for allowances from the NER as new installations. In addition, extensions to the existing power capacity of fully GQ CHP installations will also be eligible for allowances from the NER on the same basis as other extensions (see section E1 above). A proportion of the NER will be set aside for GQ CHP schemes.
50. Increases in good quality capacity<sup>6</sup> at an installation after 31 December 2007 which fall outside those changes described above will also be eligible for allowances from the NER in the circumstances set out below.
51. A CHP installation will be eligible for allowances from the NER where its good quality capacity is proposed to increase - by the lower of either a) a minimum of 5% as a proportion of total power capacity "TPC" or b) by 10MW - as compared to the rating of the installation on which the previous allocation was based.
52. Conversion of existing equipment into GQ CHP will also be eligible for allowances from the NER.
53. For a CHP scheme to qualify as GQ CHP, it has to meet the following criteria:
  - the power efficiency (power output divided by fuel input) is greater than or equal to 20%; and
  - the Quality Index (QI) (which combines the power and heat efficiencies, adjusted by factors to take into account the size, technology and fuel of the individual scheme) is greater than or equal to 100.
54. CHP capacity that meets both these criteria is considered to be good quality. Where a scheme's QI is 100 or more, its full power output, and therefore total installed power capacity, is considered to be good quality. In

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<sup>6</sup> The boundaries of a CHP scheme under the CHPQA certification programme do not necessarily fit the boundaries of the EU ETS installation. The allocation of allowances will only relate to that part of the CHP scheme that fits within the relevant boundary of the EU ETS installation.

other schemes, where the QI is less than 100, only a proportion of its power output, and so only some of its power capacity, is considered to be good quality (partially qualified CHP Schemes). As a consequence, the proportion of a scheme that is considered GQ CHP may vary from year to year.

55. Prior to making its application to the regulator, the operator must obtain new certification from the CHPQA (Combined Heat and Power Quality Assurance<sup>7</sup>) programme to show its expected increase in GQ CHP capacity. In calculating the increase in qualifying capacity the CHPQA Administrator will “map” the boundaries of the CHP Scheme against the relevant boundaries of the EU ETS installation and only include the increase in qualifying capacity that falls within the EU ETS installation boundary.
56. The allocation to the installation will be calculated using the published benchmarks for new entrants. The benchmarked allocation before and after the expected increase (using the certified TPC and qualifying capacity values for each) will be calculated. The allocation from the NER to the installation will be equal to the difference between the two benchmark calculations. The additional allocation will be based on the date from which the installation increases its GQ CHP capacity.
57. The GQ CHP NER reserve will be reviewed in each year from 2010 onwards and, in the light of emerging trends in CHP and general new entry, allowances from the CHP ring-fence may be transferred across into the main NER for general usage. If these allowances were not used, they would be treated in the same way as other surplus NER allowances (see section H below).

## **E5 Rate of allocation**

58. As a general principle new entrants will be allocated 95% of the amount of allowances as calculated by the spreadsheets (see section E6 below). This is because the Government wishes to show some movement towards its long terms goal of moving away from free allocation. In addition, it would require operators to take more account of the cost of carbon when making investment decisions. This general principle is subject to the exceptions set out in the following paragraphs.
59. The Government has a target for 10GW of installed GQ CHP capacity by 2010. In order to help achieve this goal, it is necessary to provide incentives for the installation of GQ CHP. The Phase II NAP provides such incentives through the development of a separate sector for GQ CHP installations and a separate CHP ring-fence in the NER. To further strengthen this incentive, GQ CHP new entrants will be allocated at 100% of the amount of allowances as calculated by the best practice benchmark in the NE spreadsheet.

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<sup>7</sup> See: <http://www.chpqa.com/>

60. The Government considers that a 5% differential between new entrant CHP and new entrant boilers and small generators would not provide sufficient incentive to use CHP, as they are an alternative to CHP. New entrant boilers and small generators will be allocated at 90% of the amount of allowances as calculated by the spreadsheet that incorporates best available technology. New entrants in the LEP sector will be subject to the same cut in allocation as LEP incumbents (30.3% - see section 2 of the NAP). This will ensure similarity of treatment of incumbents and new entrants in the LEP sector. In addition to these reductions adjustments are also made in respect of the CHP NER: these are discussed in paragraphs 19, 20 and 21 above.

## **E6 Allocation methodology**

61. Allocations to new entrants will be calculated by applying standardised allocation methodologies that reflect technology, load and fuel specific factors. These are presented in the accompanying New Entrant calculation spreadsheets (Annex D1). For Phase II, all allocation benchmarks have been reviewed in detail and, where appropriate, revised. The development of revised benchmarks has been guided by the following principles:

- Benchmarks should be feasible, i.e. simple, transparent and legal. Transparency includes the scope for independent verification of inputs into benchmarking formulae;
- The trading scheme should provide incentives to choose lower emissions intensity new entrant technology. The new entrant allocation should not dampen these incentives;
- The benchmark should avoid detrimental impact on the decision whether to locate investment in the UK; and
- Benchmarked allocations should not differ unduly from those of similar incumbents receiving an allocation based on historical emissions data.

62. The rationale for standardised benchmarks is to preserve incentives for investment in clean technology and to increase transparency. New entrant allocations can distort incentives if new entrants with lower-emitting technologies are provided with fewer allowances than those using higher-emitting technologies. The aim therefore has been to provide the same benchmark for all technologies producing the same product, to the extent compatible with the other principles set out in paragraph 61 above. The majority of sectors have fully standardized allocation benchmarks in which only capacity is site-specific and other factors, including factors for load and utilisation, emissions, and energy consumption are the same for all producers of the same product.

63. Load and utilization factors have been calculated based on available data to arrive at sector- or product-specific factors. In most cases, utilisation factors are based on average utilisation over a recent historic period for which representative data were available. Using standardised load factors and utilisation rates increases transparency and reduces the need for verifiers and government to make difficult assessments about the likely operating levels of individual installations. In some cases the most appropriate parameter available has been a combined assessment of capacity and utilisation, so a measure of throughput has been used instead. For part of the offshore sector, because of the unique criteria applied to tie-backs and facility modifications leading to increased use of existing capacity, utilisation rates are not specified in the benchmarks.
64. The fuel emissions factor has been benchmarked to the level of natural gas in all sectors except where the technical characteristics of an industrial process rules out its use. A decision has been made not to reflect the availability of gas in some areas, because of the principle of ensuring that appropriate incentives are provided to invest in the lowest-emitting technologies.
65. Energy consumption benchmarks have been based on the likely characteristics of a best practice new entrant. Where they exist the benchmarks have been based on definitions of Best Available Technique (or BAT, as defined in the EU Directive on integrated pollution prevention and control and documented in BAT Reference Notes). Where BAT values have not been specified or cannot be applied to UK installations, detailed data have been collected from UK or EU installations, taking into account the likely characteristics of a best practice new entrant.
66. Benchmark values associated with process emissions or with energy-use that depends on raw material characteristics have been calculated to reflect the average characteristics of UK installations. To conform to the principle of encouraging investment in the lowest-emitting alternatives, the same benchmark values are used for all installations, regardless of local characteristics.
67. Accredited experts will verify data used to calculate benchmarked allocations. The appropriate Regulator will carry out the calculation and determination of the allowances to be allocated to the applicant. Once issued, the allocation will not be subject to ex-post adjustment.
68. The allocation will be based on the net increase in the relevant capacity measure at the installation. Capacity for these purposes should be understood according to the explanation in paragraphs 38 and 39, i.e. relating to the change proposed under the new entrant application. Furthermore, in the cases of overlapping pieces of equipment during a replacement net increase relates to increase in capacity after six months (as described in paragraph 41), the regulator may wish to allocate different amount of allowances in the first calendar year, or part of calendar year, in relation to this overlap.

69. The Government has decided to take a standardised approach to commissioning that assumes a commissioning period of 50 days, during which new entrants will receive only 50% of their allocation rather than receiving an allocation based on the full, commercial rate of operation from the start date of the new entrant activity. This standardised commissioning approach will be applied to all sectors and all technologies. The load reduction factors will not be applied to benchmarked incumbents. This approach has been taken following analysis of evidence collected showing that periods that could be characterised as commissioning are varied and often of a period up to two months. It is considered to be a credible measure of typical commissioning across the whole scheme.
70. This commissioning rule provides greater consistency with incumbents who are able to account for commissioning by dropping the lowest year and applying for a First Year of Operation Rule (see section 3 of the NAP).

## **F Closure**

71. An installation is considered to have closed when:
- the Annex I activity at the installation has ceased operating; or
  - the capacity of the Annex I activity at the installation has dropped below the thresholds contained in Annex I.
72. An installation that is closing is required to notify the relevant regulator in order to surrender its permit.
73. An operator must also notify the regulator if an installation temporarily ceases an Annex I activity and this temporary closure is intended to be, or becomes, 50 days or longer. The regulators will use their discretion to distinguish between permanent closure and cases where a temporary period of closure has occurred during the normal course of business. Closures that are outside the “normal course of business” would be treated as having permanently ceased operation.
74. Installations that close in accordance with paragraph 70 will retain allowances for the year in which closure occurs but the allowances will not be issued to such installations for the years after closure. Allowances will not be issued in respect of an installation which has closed in the previous calendar year and, as a consequence, the permit has been (or should have been) revoked or surrendered.
75. The registry administrator is obliged to issue a proportion of allowances to installations by 28 February each year. At the time it does so, it may not always be apparent which installations have closed in the previous year. In order to address this, the registry administrator may delay the issue of allowances to a particular installation until it is clear that it did not close in the previous year. In addition, the issue of allowances may be delayed in the following circumstances:

- a. an application to surrender a permit, or to vary it so that it no longer applies to an installation, is being processed by the regulator;
- b. there is an unresolved appeal on a permit surrender or revocation application;
- c. a decision has been made to revoke a permit or for it to be surrendered, but this decision has not yet taken effect;
- d. a rationalisation application is being processed by the regulator (see F1 below);
- e. there is an outstanding appeal on a rationalisation application; or
- f. the decision on a rationalisation application has been made but has not yet taken effect.

76. The decision of whether or not to delay issuing allowances in the situations outlined above will depend solely on the date of the relevant closure, or the closing installation in relation to the rationalisation where rationalisation applications are concerned. The delay of issuing allowances will take place in circumstances where this closure has taken place up to and including the 31 December in the year preceding the issuance of allowances or when there is doubt as to when the closure has taken place. A delay in issuing allowances will not take place in the circumstances outlined above where the closure has taken place on or after the 1 January in the year of issuing allowances in question.

77. Where, according to the circumstances described above, a delay in issuing allowances will take place, the delay will last until such a time as the regulator has completed the task of assessing the surrender, revocation, variation or rationalisation, and the resulting outcome has taken place (e.g. the revocation of the permit), or, where an appeal is involved, the delay will last until the appeal has been decided.

78. Where a closure has taken place, the Registry Administrator shall not issue allowances to the installation in the years after that in which it closed.

## **F1. Rationalisation**

79. Rationalisation occurs where Annex I activities at one EU ETS installation are closed and moved to another EU ETS installation or installations. Under the closure rules described above the closed installation will lose its right to further annual allocations, potentially leaving the receiving installation(s) short of allowances with respect to the transferred production.

80. The rationalisation rule allows an operator to apply to continue to receive the allowances for the closed installation.

81. If the receiving installation (or, where there is more than one receiving installation, either one or more of the installations) does not have sufficient existing capacity to accept the entire transfer, the capacity of the



installation(s) may need to be extended. In such circumstances, operators have a choice:

- they may apply under the rationalisation rule to retain the allowances from the closed installation - in which case they cannot also apply to the NER for the extension that is required; or
- they may apply to the NER for the required extension - in which case they cannot also apply for allowances from the closed installation under the rationalisation rule.

82. Rationalisation rules will not apply to the electricity generating sectors (that is, the LEP and Other Electricity Producers sectors) because:

- it is important to ensure that rationalisation does not have the effect of encouraging the removal of capacity to a level where security of supply is threatened;
- at times of peak demand, other generating stations are likely to be producing at close to full capacity and so it is unlikely to be possible to transfer production at these times to other stations; and
- it is difficult to present objective evidence to determine whether reduced generation from one station has been compensated for by increased output at another specified station or at some combination of other stations.

#### *Eligibility for rationalisation*

83. The rationalisation rule will only be applicable where:

- there is full and permanent closure of the closing installation;
- production is transferred to an installation(s) covered by the EU ETS (“the receiving installation”);
- both the closing and the receiving installation(s) have the same EU ETS permit holder;
- all the installations involved in the rationalisation fall within the same EU ETS sector and are within the UK;
- the transfer must involve at least 50% of production (i.e. final physical output of goods and services) taken as an average of the three previous years; and
- to be considered as a transfer of production, the increased production at the receiving installation(s) must be classified as the same product according to the Standard Industrial Classification code (taken to the three digit level) as the product that was made at the closing site.

#### *Applications for rationalisation*

84. The operator must apply to the relevant regulator for the closure and must make an application for rationalisation at the same time.

85. The operator must provide verified evidence to support an application for rationalisation. The regulator will determine whether the period of time within which the production is being transferred is such that it can be considered as rationalisation. As a general guideline, to be considered as

rationalisation, transfer of production should take place within 6 months of cessation of production at the closing installation.

86. Where a rationalisation application is approved, the operator will retain the permit for the closed installation and the number of allowances shown in the NAP will continue to be allocated to that installation.
87. If the receiving installation used as the basis of a rationalisation application subsequently ceases to carry out an Annex I activity, the rationalised permit for the closed installation will be revoked and the related allowances will no longer be issued in the years following this closure, unless another rationalisation application is made and accepted for the transfer of production to another installation(s). In this case, it may be that the allowances under the retained permit for the original closed installation, as well as the permit itself, will be retained. Where there was more than one receiving installation as part of the rationalisation application, the Annex I activity must cease at all of the receiving installations before the rationalised permit for the closed installation is revoked and the related allowances are not issued.

## **G Allocation process**

### **G1. The Role of the Regulator**

88. The regulators for the EU ETS are the Environment Agency for installations in England and Wales, Scottish Environment Protection Agency for installations in Scotland, the Chief Inspector for installations in Northern Ireland and the Department of Trade and Industry (Energy Resources and Development Unit) for installations situated offshore.
89. The regulators are responsible for issuing and varying permits in respect of the installations covered by the EU ETS and for processing all new entrant, closure and rationalisation applications.
90. The operator of an installation requesting free allowances from the NER, or carrying out a closure (including a rationalisation), needs to apply to the relevant regulator. Application forms are available from the regulator outlining the information that must be provided.
91. The regulator will decide whether the application should receive free allowances from the NER and what the size of this allocation should be in accordance with the rules set out earlier in this Appendix. The regulator will also decide whether correct information has been given about closures.
92. The regulator will reject any application for allocations from the NER which it considers to be speculative, unrealistic or false. The purpose of this approach is to ensure that the allowances from the NER are not committed to developments that are unlikely to take place during Phase II.

*Changes to applications*

93. In some cases an operator may wish to apply for a sequence of changes on one application form. The regulator will process such multiple changes within the same application provided only one start date is used. This start date must be the realistic estimate of the start date for the final change. The operator may choose whether to submit several applications and several fees, or include more than one change in one application.
94. Where an operator's plans change to involve a fundamentally different type of technology or process or to require the use of a different benchmark, the operator must notify the relevant regulator. These are considered major changes and the operator will have to withdraw its current application, losing its place in the queue and submit a new application to the NER with respect to the new plans.
95. Operators must provide a realistic start date for their applications and are obliged to inform the regulators of any changes to the nominated start dates.
96. Operators must provide a realistic estimate of capacity in their application form and must inform the regulators of any changes to the capacity stated in the application. Where changes in planned capacity result in a decrease in benchmarked calculations, the new entry allowances tagged for the installation will be modified accordingly. Where the change results in an increase in the number of allowances that an operator is eligible for, the operator must submit a new application with respect to the increase in order to receive additional allowances.
97. Upwards revisions to capacity will require the submission of a new verification document. This will not result in loss of their place in the queue for any application for allowances up to the original quantity of allowances applied for.
98. Notwithstanding the need to potentially make a further application where a greater number of allowances are requested, changes to capacity and start date are likely to be viewed as minor changes and will not result in the operator losing its place in the queue.
99. However, if the original application provides insufficient evidence to satisfy the regulator that the application is not speculative with respect to start date or capacity, applicants may not secure their place in the queue at the outset.
100. Where an application to the Phase I NER has been made on the basis that the start date is before 31 December 2007 and the start date is postponed until after that date, the Phase I application will be rejected and any determined allowances untagged and returned to the Phase I NER. In order to obtain allowances from the Phase II NER, operators will need to submit a new application using the relevant spreadsheets, with a new fee.

Such applications will be subject to the rules and requirements of Phase II new entrant applications set out in this Appendix.

## **G2. The queuing system and “duly made” requirements**

101. The allowances available from the NER will decrease as new entrant applications are processed and allowances are issued, and may increase in certain circumstances (see, for example paragraph 95 above). A queuing system is considered a fair way to manage operators’ access to the NER as it changes in size.
102. The queue will operate in two stages. First, a provisional place will be awarded in relation to the date on which a completed application has been deemed “duly made” by the relevant regulator. Second, a confirmed place will be given when the relevant regulator has processed the application.
103. The Environment Agency will act as manager of the queue system that determines the priority of receipt of free allowances from the NER, for all of the regulators in the UK.

### *“Duly made” applications*

104. An application will be approved as “duly made” where all of the relevant information needed for the application has been provided, even though at this stage the application has not yet been assessed.
105. The information provided to the regulator as part of the new entrant application must include:
  - a. a completed NER application form;
  - b. the input data used in the new entrant spreadsheet, including the technologies eligible for NER allowances and an indicative allowance figure. A completed NER spreadsheet should be made available should the regulator require it. For a new technology that does not appear on the spreadsheet, the technology should be indicated in the application form, noting that a benchmark for the applicable technology is not included in the NER spreadsheet;
  - c. a description of the installation in its new configuration, with details of the relevant changes made and proposed, including expected changes in relevant emissions;
  - d. the date that operations will start, with a timetable for construction and commissioning. The operator must provide a date that is reasonably certain and supporting evidence for it;
  - e. evidence to satisfy the regulator that the NER application is not speculative, contingent, unrealistic or false. The evidence required for these purposes will vary depending on the size, nature and scale of the new entrant (see paragraph 106 below);
  - f. a verified opinion approving the information submitted. See paragraph 66 for further details;

- g. for all GQ CHP applications, a certificate of the Good Quality status of the planned installation or extension, indicating the percentage GQ of the extension or installation. This certification should be obtained in line with the description in paragraph 56 (which relates to cases where the GQ qualifying output capacity is changing in the absence of an extension or new build installation); and
  - h. for extensions, applications should also include details of the capacity before and after the proposed change, where “before” is interpreted according to the description in paragraph 38, and the nature of the change.
106. Evidence that the NER application is not speculative, contingent, unrealistic or false would include:
- a) for all applications -
    - I. recorded management decisions that enable the expenditure to proceed and which indicate that this expenditure has been committed at a senior level;
    - II. applications or permissions under planning laws or Integrated Pollution Prevention and Control legislation (IPPC) where relevant;
    - III. information demonstrating a contractual agreement or purchase in respect of the new entrant equipment and building/installation;
    - IV. sector specific information where relevant; and/or
  - b) for applications for extended use of CHP, information on new connections to CHP.
107. Whether the information provided by the applicant, according to the list above, is sufficient to show that the application is not speculative, contingent, unrealistic or false will be determined by the regulator at their discretion.
108. As well as providing the relevant information, applications by installations in all sectors other than the offshore sector will only be considered if accompanied by the appropriate application fee.
109. For installations in the offshore sector, payment procedures are different and therefore the application can become “duly made” without the application fee having been received. The relevant regulator will send an invoice to the operator within 28 calendar days of receiving an application and payment must be received by the regulator within 28 calendar days of the date of this invoice, otherwise the applicant will immediately lose the place in the queue that had been previously secured by being considered “duly made” without payment.

*Obtaining a provisional place in the queue*

110. The operator’s provisional place in the queue for NER allowances is determined by the date and time at which the Environment Agency receives the new entrant application. The date for taking a provisional

place in the queue as a “duly made” applicant is 21 calendar days from this time. The operator can only take this place in the queue if the relevant regulator approves the application as “duly made”. The relevant regulator will notify the Environment Agency once the determination of “duly made” has been completed.

111. Applicants must send their application forms to both their relevant regulator and the Environment Agency. This is to ensure that such applicants are registered in the queue at the appropriate time, and the regulators have the information that they need to process the application further.
112. In cases where the regulator requests more information for “duly made”, the date of determination for “duly made” will be delayed until the regulator has received the complete set of information requested. In the event that the relevant regulator has neither requested more information, nor confirmed the “duly made” status of the application, the application will automatically be considered “duly made” after 21 calendar days.
113. Following determination of a duly made application the relevant regulator will notify the operator of its likely allocation.
114. Where the application has been rejected, the operator will lose its provisional place in the queue after 21 calendar days (unless the operator lodges an appeal).
115. Applicants that lodge an appeal within the time limit (see Section G5) will have their provisional place in the queue and full allocation in the initial application frozen until the appeal has been determined. However, an operator’s place in the queue will not be frozen in any other circumstances.
116. Where an appeal is approved, the operator will have its place in the queue and allocation confirmed. Where the appeal is rejected, the operator will lose its provisional place in the queue and the frozen allowances will become available for other applicants to the NER. Where the appeal decision is an adjustment of the allocation sought by the operator, the quantity approved will be allocated to the operator and the remainder made available to other applicants to the NER.

### **G3. Issuing allowances**

117. Allowances that have been reserved for a particular applicant to the NER will be tagged. The first year’s tagged allowances will be issued within 14 calendar days of the relevant regulator receiving confirmation from the operator that the new entrant activity has commenced.
118. If the date of the first emissions from the new entrant is later than foreseen in the original application, the operator shall receive a pro-rated amount of allowances for the first year of operation, based on the correct

number of days in the year to be covered. The surplus tagged allowances will be made available to other applicants to the NER.

119. Where the new capacity is lower than in the original application, in accordance with the description of minor changes above, the surplus allowances tagged will be untagged and will be returned to the NER.
120. When the first allowances are issued to the operator, the relevant regulator will also serve a notice on the operator setting out its allocation for each remaining year of the phase. The notice will act as an instruction to the registry administrator to issue allowances.

#### **G4. Penalties**

121. Operators are liable to penalties for providing false or misleading information in their new entrant/closure applications and for failing to notify the regulator of relevant changes.
122. Operators are not allowed to apply for allocations from the NER for the same change more than once. It is an offence to provide false or misleading information in relation to an application for an allocation from the NER or in order to retain an allocation where the installation has ceased carrying out an Annex I activity. Operators convicted of an offence will be liable to a fine or imprisonment.

#### **G5. Appeals**

123. Should the operator disagree with the decision made by the relevant regulator, the operator is entitled to appeal within 15 working days of the decision.
124. Appeals should be made to the appropriate authority depending on the jurisdiction (this being the Secretary of State for England and offshore, the National Assembly for Wales (NAW) for Wales, Scottish Ministers for Scotland and the Planning Appeals Commission for Northern Ireland.)
125. The process for appeals is set out in the Greenhouse Gas Emissions Trading Scheme Regulations 2005<sup>8</sup>.

#### **G6. Availability of Allowances**

126. Operators will retain their place in the queue even if the demand for allowances from the NER exceeds the supply in the NER. However, these operators will only be able to obtain allowances from the NER if the allowances available to installations ahead of them in the queue are untagged (e.g. because they start later than originally planned or the capacity is less than the original application (see paragraph 118 above), as allowances surrendered on closure will not be returned to the NER.

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<sup>8</sup> See: <http://www.opsi.gov.uk/si/si2005/20050925.htm>

Those new entrants that do not receive an allocation by the time allowances need to be surrendered will have to buy allowances from the market.

127. The operator of an installation that ceases to carry out an Annex I activity will retain allowances already issued, but will not be issued with further allowances in the years following cessation. Allowances that are not issued in respect of installations that cease an Annex I activity will be auctioned or sold (see section H below).
128. Applicants for the GQ CHP ring-fence of the NER will be able to access NER allowances in the broader NER should the GQ CHP ring-fence run out, but the reverse is not possible. The GQ CHP NER reserve will be reviewed each year from 2010 onwards and, in the light of emerging trends in CHP and general new entry, elements of the CHP ring-fence could be transferred across for general usage.

## **H Disposal of surplus allowances**

129. Two types of surplus allowances may arise in the NER:
- allowances which have not been issued due to application of the closure rules (see section F); and
  - allowances that have not been allocated from the NER.
130. The Government intends to have an auction or sale of surplus allowances remaining in the NER and from closures. Allowances that have not been issued due to application of the closure rules will not be returned to the NER.
131. The amount of allowances that member states can auction or sell in Phase II cannot exceed 10% of allowances. If the surplus allowances in the NER would take the overall level of auctioning in Phase II to more than 10%, the excess allowances will be cancelled.

## **I Later Phase I new entrants (starting between 1 July 2006 and 31 December 2007)**

132. The NAP does not provide individual Phase II allocations for new entrants starting or extending operations between 1 July 2006 and 31 December 2007. Whilst their Phase I allocations will come from the Phase I NER, their Phase II allocations will come from the Phase II NER.

### *Applications for Phase II allowances*

133. The Government considers that applications by later Phase I new entrants (i.e. new entrants starting or extending operations between 1 July 2006 and 31 December 2007) for Phase II NER allowances should take priority over applications from Phase II new entrants (i.e. new



entrants starting or extending operations on or after 1 January 2008). This is because the financial consequences of the Phase II allowances are more important to later Phase I new entrants as these allowances will be issued for each of the five years in Phase II.

134. Applications to the Phase II NER from later Phase I new entrants and Phase II new entrants may therefore be made as follows:
- **1 May 2007** – first date for applications from later Phase I new entrants
  - **1 August 2007** – first date for applications from Phase II new entrants.

135. Later Phase I new entrants will be given priority access to the Phase II NER if their applications are received between 1 May and 31 July 2007. However, they are not assured of priority access if their applications are received after 31 July 2007, as Phase II new entrants will also be able to apply to the NER after this date.

*Definition of Later Phase I new entrant*

136. In order to be eligible as a later Phase I new entrant, an installation must:
- have commenced or extended, or have plans to commence or extend, an Annex I activity between 1 July 2006 and 31 December 2007; and
  - be eligible for allowances from the Phase I NER.
137. An installation that would have fallen within the definition in paragraph 136 above if it had been within the scope of the EU ETS in Phase I will also be deemed to fall within this definition. This would cover, for example, an installation in a sector that has been included under the expanded scope of the EU ETS for Phase II (see paragraph 2.4 above) or an installation temporarily excluded from the EU ETS in Phase I.

*Eligibility for allowances and calculating the allocation*

138. Later Phase I new entrants that come within the definition set out above will generally be eligible to obtain allowances from the Phase II NER. All new installations will be eligible for allowances; however, not all extensions will be eligible for allowances due to the adoption of a direct emissions approach for all sectors in Phase II, in particular those that obtained allowances from the use of an integrated approach in Phase I in the iron & steel and refineries sectors.
139. Detailed provisions on the eligibility of extensions for allocations are set out in sections E1 – 4 above; for later Phase I new entrants, references to 31 December 2007 in those sections should be read as references to 30 June 2006.
140. Later Phase I new entrants must make a separate application for Phase II allowances. However, an installation that has already made an

application for Phase I allowances will only need to provide the regulator with any new input data that is required in addition to, or in place of, data provided in respect of its Phase I application. If this data has not been previously accepted as part of the Phase I application, it will need to be independently verified. Specific data requirements will be detailed in an application form that will be published in due course.

141. Regulators will contact all known affected new entrants and other potentially eligible installations (see paragraph 136 above) and inform them of further details of the process for obtaining allowances for Phase II.

#### *Calculating individual allowances*

142. Individual Phase II allocations will be calculated by applying a relevant emissions difference factor to Phase II benchmark spreadsheet outputs. This will be the difference between relevant emissions and actual allocation experienced by installations listed in the NAP in the specific sector concerned. This difference includes the effect of projected sectoral growth and contributions to the Phase II NER (including amounts for the GQCHP ring-fence and for later Phase I new entrants). The basic NER spreadsheets for Phase II new entrants will be used, although the rates of reduction set out in section E5 that will be applied to Phase II new entrants will not be applied to late Phase I new entrants.

#### **J Contingency Fund**

143. As discussed in para 1.16, the Government has determined that 2.4 million allowances should be available within the NER to issue to late installations entering the Scheme and to allocate for any allocation mistakes that are uncovered after the final installation level allocation for Phase II.
144. Allocations for all eligible late installations and corrections to allocations will be calculated using the installation's historical emissions data, and so far as possible the allocation methodology in the NAP, with a reduction factor as appropriate. No free allowances will be issued to installations that have not applied for their GHG permit before 1 January 2010. If the Phase II contingency fund runs out before this date, installations that satisfy the eligibility criteria for being a Phase II late entrant, but who apply for the fund before that date will be required to buy allowances, and they will not be eligible for allowances from the NER. The allowances in the fund will also act as a source for correcting mistakes, such as administrative errors in the Phase II allocation. The contingency fund will not be topped up by allowances from closure, and if it still contains some allowances after 31 December 2009, a decision will be taken as to whether they should revert to being part of the main NER.

145. Phase II late entrants will be subject to a separate eligibility regime depending on whether or not an installation is in a Phase II expansion sector.
146. Installations in Phase II expansion sectors (gypsum, mineral wool, carbon black<sup>9</sup>) that apply for, or receive their GHG permit after 30 June 2006, but before the start of Phase II (1 January 2008) will be granted their full allocation for Phase II from the Phase II contingency fund. A reduction factor of 10% will be applied to the allocation of those installations in operation before 1 January 2008 that apply for their GHG permit up to 6 months after the start of Phase II, increasing to a 25% reduction factor after 30 June 2008. The basis for the proposed reduction factors is that they are the same as those applied to late entrants in Phase I, where the scheme was new for participating installations.
147. Installations covered in Phase I that apply for, or receive their GHG permits after 30 June 2006, and before 1 March 2007 will be allocated 100% of their Phase II allocation from the Phase II contingency fund. Installations that apply for their GHG permits after 28 February 2007 and before 1 January 2008 will be given their Phase II allocations from the Phase II contingency fund. Their allocations will be subject to a 40% reduction factor.
148. The 40% reduction has been proposed on the basis that it provides an incentive to installations to enter the scheme sooner rather than later, whilst recognising that they have participated in Phase I and therefore should be treated differently from those installations covered in Phase I that fail to participate in Phase I at all.
149. Installations which are covered in Phase I that are not in a Phase II expansion sector and who only apply for their GHG permit after the start of Phase II (1 January 2008), will be eligible for a Phase II allocation from the Phase II contingency fund, but their allocation will be subject to a 75% reduction.
150. The reduction factor has been proposed on the basis that it encourages installations to enter the scheme in Phase I if they have not already done so, and penalises those installations covered by the Directive which fail to enter the scheme in Phase I and have been emitting for up to 3 years without a permit (this excludes expansion sectors)

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<sup>9</sup> Other expansion activities (glass; flaring; petrochemicals (crackers); and integrated steelworks) affect installations covered by the scheme in Phase I.