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EXPLANATORY MEMORANDUM & REGULATORY IMPACT ASSESSMENT FRAMEWORK

Explanatory Memorandum to the consultation on the European Commission Regulation (EC) No. 1221/2008 and draft Statutory Instrument (The European Community Marketing of Fresh Horticultural Produce (Wales) Regulations 2009 (“the draft Regulations”)).

This Explanatory Memorandum has been prepared by the Department for Rural Affairs and Heritage and is laid before the National Assembly for Wales in accordance with Standing Order 24.1.

- (i) **Description**
EU Marketing Standards for fresh fruit and vegetables impose both quality standards and labelling requirements and were implemented to ensure that buyers had sufficient information and to facilitate trade. The European Commission has revised the marketing standards as they are believed to be too burdensome and to have removed a market for lower grade products. Commission Regulation (EC) No. 1221/2008 reduces the current 36 Specific Marketing Standards (SMS) to 10 and introduces a General Marketing Standard (GMS) for all other fresh produce not covered by a SMS, the Regulation is directly applicable in the UK and comes into force from 1 July 2009.
- (ii) **Matters of special interest to the Subordinate Legislation Committee**
None.
- (iii) **Legislative Background**
The standards are directly applicable in all EU Member States. In England and Wales, the standards are currently implemented by:
- Agriculture & Horticulture Act 1964
 - The Grading of Horticultural Produce (Amendment) Regulations 1973
 - The Grading of Horticultural Produce (Forms and Labels) Regulations 1982
 - The Grading of Horticultural Produce (Amendment) Regulations 1983
 - Horticulture Produce Act 1986

We will be introducing a new set of domestic regulations using section 2(2) of the European Communities Act 1972 (“the EC Act”).

The Welsh Ministers have the legal power to make the draft Regulations under a section 2(2) (EC Act) Common Agricultural Policy (CAP) designation. The EC CAP designation relied on is set out in SI 2005/2766 in favour of the National Assembly for Wales and the power to exercise that designation was transferred to the Welsh Ministers by paragraph 30 of Schedule 11 to the Government of Wales Act 2006. The draft Regulations will follow the negative resolution procedure.

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(iv) **Purpose and intended effect of the legislation**

Council Regulation (EC) No 1234/2007 established a common organisation of agricultural markets which includes specific rules as regards the fruit and vegetable sector, including marketing standards. Commission Regulation (EC) No 1580/2007 lays down the implementing rules in the fruit and vegetable sector, which again covers marketing standards.

EU Marketing Standards for fresh fruit and vegetables exist for a wide range of produce (although not all) i.e. there are currently 36 separate standards. Subject to certain exceptions, they apply to all stages of distribution (import, export, packing, distribution, wholesale, retail). Their objective is to keep products of unsatisfactory quality off the market, as well as ensuring that produce is accurately labelled; guiding production to meet consumer requirements and facilitating trade under fair conditions. However, over recent years retailers, in particular supermarkets often have their own more exacting standards.

Often the full impact of the standards goes largely unseen by the consumer and their benefits are taken for granted, for example defects such as maggots in apples and lettuces full of grit are rarities these days due to the requirements of the standards and the way that they are enforced. In addition, they help determine whether produce is of the right maturity and ensure that produce is not marketed too early. In addition, consumers benefit from labelling requirements at the retail stage where labelling or shelf displays must give details of the nature of produce: quality class (Extra, Class I or II); country of origin and variety.

Commission Regulation (EC) No. 1221/2008 (“the Regulation”) amends Commission Regulation (EC) No 1580/2007 laying down implementing rules of Council Regulations (EC) No. 2200/96, (EC) No 2201/96 and (EC) No 1182/2007 in the fruit and vegetable sector. The aim of the Regulation is to harmonise, consolidate, simplify and deregulate the European Commission marketing standards and their application for all fresh fruit and vegetables. The Regulation has been driven by the Commission’s reform of the sector in 2007, while also ensuring that produce traded is ‘sound, fair and of marketable quality’.

The key features of the Regulation, which enters into force on 1 July 2009, are:

- There should be a strengthening of the role of risk assessment in selecting products for checks.
- A reduction from 36 to 10 Specific Marketing Standards (SMS) which are to be enforced as at present at all stages of

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the marketing chain (i.e. import, grower, wholesale, distribution and retail).

- A General Marketing Standard (GMS) is to be introduced that will apply to all fresh produce not covered by a Specific Marketing Standard (see Annex D of consultation document for a list of products).
- This will be legally binding on all traders in these products. Member States may opt to adjust the frequency of selective checks on low risk products based on risk assessment.
- The database of traders needs to be maintained (RPAI will update and extend to cover all products).
- Data on the conformity of all products is required to ensure conformity checks can be carried out with appropriate frequency based on risk.
- Approved Inspection Services (AIS) for selected approved Third Countries to remain.
- Approved Trader Scheme (ATS) may be extended to allow traders to self certify consignments at import and export.
- Removal of requirement to notify and certify consignments for processing.
- Extension of regulatory powers to distance selling, such as internet.
- Option for derogation from the Specific Marketing Standards for products presented for retail sale to consumers for their personal use and labelled as intended for processing.

The fresh fruit and vegetable industry in the United Kingdom is worth around £1.5bn a year for home produced fruit and vegetables, along with £3.6bn of imports (Basic Horticultural Statistics, see <https://statistics.defra.gov.uk/esg/publications/bhs/2008/default.asp>).

(v) **Implementation**

The draft Regulations will enable enforcement in Wales of new legislation relating to EU marketing standards for fruit and vegetables. We will be carrying out a joint consultation with Defra and hope to implement the legislation simultaneously.

Our current domestic regulations, which define the offences and penalties to ensure we are able to enforce the EU marketing standards, need to be replaced to ensure we can fully enforce the new requirements. The draft Regulations will provide some additional powers to enforcement officers and contain the offences and penalties relating to the revised marketing standards. Defra are currently in discussion with the Ministry of Justice and Home Office on this issue, which will include undertaking a legal aid impact test.

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The Regulation is directly applicable and Defra and the Welsh Assembly Government therefore need to implement it in England and Wales. The aim of this revision was to harmonise, consolidate, simplify and deregulate the marketing standards and their application for all fresh fruit and vegetables. Whilst there is an element of deregulation the whole market is not deregulated as some 10 Specific Marketing Standards will remain as well as a new General Marketing Standard being introduced for all other products covered by the Regulation.

The main rationale for the change is that the current legislation imposes costs on businesses and government which may not be necessary to maintain the standards to protect consumers. In addition, the current legislation is considered to lead to excessive waste, where produce do not meet the standards – the draft Regulation will enable sellers to market such produce for ‘processing at home’. The GMS will allow consumers of produce which do not have a Specific Marketing Standard to benefit from the labelling and quality requirements.

In the past, in order to enforce EC marketing standards, prior to devolution, joint Statutory Instruments relating to both England and Wales were made using the powers contained in the Agriculture and Horticulture Act 1964. However, in order to implement the revised standards contained within the Regulation, we have decided to use section 2(2) powers contained within the European Communities Act 1972 to make the draft Regulations.

The draft Regulations which will relate only to Wales will:

- Carry over those existing powers, offences and penalties contained in current legislation which are used by the Rural Payments Agency Inspectorate.
- Make provision for implementation of the derogation in Article 3.3 of the Regulation in relation to the retail sale exemption to the Specific Marketing Standards for products sold to the consumer for their personal use and labelled as ‘intended for processing’.
- Inserting a definition of ‘marketing standards’ which more fully reflects what they now cover. This is because the definition of ‘standard of quality’ which applies in relation to the term ‘Community grading rules’ under existing legislation could be made clearer.
- Inserting powers to allow for enforcement of information particulars required for invoices and distance contracts as contained in Article 4.
- Enhancement of the existing power to allow inspectors to require documents so it includes electronic material.
- Provisions for penalties have been updated to reflect Criminal Justice Act 1982.
- Delete sanction of imprisonment for obstruction.

The standards are currently enforced in England and Wales by the Horticultural Marketing Inspection arm of the Rural Payments Agency Inspection (RPAI) service. Separate arrangements apply in Scotland and

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Northern Ireland. It is envisaged that after the draft Regulations are made, they will be enforced by RPAI as agents of the Welsh Ministers.

The draft Regulations will introduce legally binding regulatory requirements on new products and therefore upon new traders. There is a pertinent need and responsibility to advise these operators of the new requirements and their responsibilities. The technical inspectors within the RPAI can add value by fulfilling the initial and ongoing advice that is needed. Whilst the use of websites and explanatory leaflets is valuable in supporting this, the presence of inspectors in the pertinent sectors of the trade able to reference live produce will play a vital role.

(vi) **Regulatory Impact Assessment**

This is a partial RIA which will be included in the consultation document. It is hoped that the consultation may provide a greater indication of industry costs.

Rural Payments Agency (RPA) has historically collated data on an England and Wales basis and as a result figures cited below are on an England and Wales basis.

a) **Options (for achieving the policy objective – as set out in paragraph (iv) above)**

It is a requirement that the Regulation is implemented we therefore have no choice but to implement it. The policy options are therefore to implement the Regulation (i) taking account of a derogation from the specific marketing standards for products presented for retail sale to consumers for their personal use and specifically labelled as intended for processing and extending the Approved Trader Scheme or (ii) taking account of the derogation as mentioned in option (i) but not extending the Approved Trader Scheme.

The two policy options are broadly similar, save for the allowance for Approved Trader Status in option 1.

Option 1 - To implement the Regulation taking account of derogation from the specific marketing standards for products presented for retail sale to consumers for their personal use and specifically labelled as intended for processing and extending the Approved Trader Scheme.

There are a number of key impacts on traders from this option:

- The reduction to 10 SMS from the current 36 will reduce for the remaining 26 products the requirement to:
 - Grade products into classes.
 - To label, indicating packer/dispatcher ID, size, class, etc
- Reduction of the burden on the trade imposed by the current level of Marketing Standard legislation e.g. each Specific Marketing Standard had its own specific regulation. The 10

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remaining SMSs have been brought into this one new regulation.

- General Marketing Standard for an extended product range, which, for example, will require produce to be labelled with country of origin
- Auditable risk based checking system for 10 SMS to be consistently applied across England and Wales.
- Removal of the requirement to notify and certify consignments for processing (for 2007 this amounted to 106,000 tonnes of produce, with 2,250 certificates being issued.
- The reduction of SMS to 10 accounts for 50% of the UK trade in fresh fruit and vegetables and so this has a potential (subject to risk assessment) to reduce RPAI inspections.
- Approved Trader Status to remain and can be extended to more traders. This allows the concession to be extended to allow these traders to issue their own certificates of conformity where there is a regulatory requirement for such a certificate.

There are also a number of benefits to consumers from this option:

- Products not previously checked for quality are now covered by the GMS.
- Rural Payment Agency Inspectorate (RPAI) staff will be able to advise, educate and inform the trade over a broader range of fresh products.
- Requirement for country of origin labelling on all products which allows the purchaser to make an informed choice.
- The introduction of a transparent generic simple minimum standard to protect the consumer.
- New opportunities for consumers to buy appropriately labelled and specifically marketed product at retail for home processing, i.e. making jam, pickles, juicing, etc.
- Possibility for a price reduction in some fruit and vegetables due to reduced industry costs.
- Extends consumer protection to internet sales.
- Existing benefits of marketing standards to remain for all products:
 - Removal of rotten produce,
 - Transparency of marketing standards,
 - Facilitation of trade.

Option 2 – To implement the Regulation taking account of the derogation as mentioned in option 1 but not extending the Approved Trader Scheme.

This will mean that RPAI will not allow the concession for these traders to issue their own certificates of conformity where there is a regulatory requirement.

Sectors affected

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This applies to all stages in the fruit and vegetable chain (import, export, packing, distribution, wholesale, retail and consumption).

Implications for Government

There will be some initial costs to RPAI/Government from changes that will be needed to IT systems such as PEACH, for example to allow for the incorporation of the General Marketing Standard and for retraining. Whilst the deletion of 26 Specific Standards effectively relate to 50% of UK trade and could in theory mean a sizable reduction in the number of inspections in England and Wales i.e. by 12,500. However, inspections will still have to take place in Wales to cover the ten SMS still required under 1580/2007 as well as GMS inspections which will be undertaken simultaneously. Inspectors will now have to apply the General Marketing Standard to a number of products and a wider trader base so the exact impact is not currently measurable.

b) **Benefits**

The costs and benefits for option 1 and 2 will be similar, except for those costs and benefits relating to the Approved Trader Scheme which do not accrue for option 2. The main parties affected are the RPAI and industry, as well as consumers.

Monetised Benefits

The major benefit to the RPAI is the ability to reduce the number of inspections, as the “the Regulation” allows for inspections to be more targeted. This should lead to cost savings (estimated at £65,000 to £205,000) as activities are reduced and staff numbers can decline slightly at import points in England (by approximately two full-time-equivalents).

It is likely that activities relating to grading produce will largely continue, however, benefits to industry are likely to arise relating to the reduction in activities relating to regrading and relabelling produce where the RPAI would currently deem this necessary, but would no longer be necessary for those products which will be moving from having their own specific standard to the general standard (for example where foreign bodies must be removed from produce). Again we can consider the duration of activities as follows: around 2 hours per tonne, multiplied by 13,500 tonnes (relating to the number of tonnes of produce for which action was required in 2007) and the employment cost of £8.91 per hour, giving total cost savings of £240,500. These reductions will apply in Wales at wholesale points with fewer SMS standards applying in future.

Another benefit to importers of consignments for processing is the removal of the need to register these using PEACH. In 2007 there were 2,250 certificates issued for these consignments in England and Wales. Using the same methodology as above, £8.91 x 2250 x

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7 minutes (90% will take around 5 minutes, 10% around 25) = £2,500.

Another benefit that could arise is a reduction in the delays to consignments awaiting inspection decisions due to more targeted risk assessment. The reduction in delays is estimated at around 17,000 consignments, for around four hours each. The benefit to traders of this reduction depends on the value of consignments, the rate of deterioration (if any) and the time value of money. The high, medium and low benefit scenarios in this Impact Assessment consider a range of average container values of £10,000, £20,000 and £25,000, with real interest rates on business overdrafts (i.e. the rate charged, adjusted for inflation) of 2.5%, 4.5% and 6.5%. For the middle impact scenario, the delays are to produce worth £20,000 x 17,000, but only for a very small proportion of the year. This is equivalent to a delay of one year on around £150,000 worth of produce. At 4.5% interest (this is close to the average from January 1999 to November 2008); this would bring benefits to industry of around £7,000 per annum.

Non-Monetised Benefits

Consumers will benefit from higher quality produce where fruit and vegetables which were not covered by the former standards are covered by the new GMS.

The main benefit which is not monetisable is the impact of allowing a new market for fruit and vegetables to be sold for processing at home. The possible benefits include: a reduction in costs of production for standard quality produce, which could benefit producers and/or consumers; consumer benefits from additional choice, and; producer benefits from increasing revenues. There is a large range as to the estimated extent of these benefits. The key uncertainties are (i) the potential size of the market, and (ii) the value added by selling produce 'for processing at home', compared with the current alternative use. The greatest benefit would arise where firms are able to sell produce that would otherwise be discarded at a price only slightly below the price of standard quality produce. The worst case scenario would exist if shops decline to sell produce for processing at home.

For background, wasted fruit/vegetables are said to amount to up to 40% (<http://www.foodchaincentre.com>) of the cultivated product, but only a smaller proportion, about one eighth, is due to not meeting quality standards. These standards are a combination of those imposed by supermarkets, as well as the current marketing standards. As such, there is a risk that a reduction in marketing standards would not have any impact – if supermarkets demand that suppliers continue to grade/label fruit and vegetables as they do currently.

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Additional non-monetisable benefits may arise due to reduced delays to containers awaiting inspection decisions, such as more efficient haulage.

The benefits of the Approved Trader Scheme (only relevant for option 1) relate to the cost savings associated with gaining Approved Trader Status, which may be realised by both industry and the RPAI. Only businesses who expect to receive a net benefit from seeking Approved Trader Status are expected to expose themselves to costs relating to the criteria that they must satisfy, as this may mean significant investment in systems and procedures, so the inclusion of the ATS option is unlikely to impose additional costs on businesses. At this stage, no estimate of the extent to which firms will take up the option is made.

c) **Costs**

Monetised Costs

The main costs to the RPAI relate to the one-off costs of modifying the IT systems and retraining staff.

The one off cost of modifying the IT systems is expected to be in the range of £25,000 to £75,000 (based on similar sized projects). These costs will not directly effect Wales due to no active importers presently trading in Wales.

The average RPAI inspector will require one day's training relating to the changes to marketing standards. The salary for an HEO/EO is equivalent to around £130 per day, including employment-related costs, such as pensions and National Insurance. There are 57 staff who are expected to require this training. The total one off cost of retraining is therefore expected to be around £7,000 which includes two staff members based primarily in Wales,

The main costs to firms are likely to relate to the additional need to register consignments with the RPAI which will be covered by the GMS but which are not currently covered by any SMS.

The cost of registering additional consignments with PEACH, with a duration of 2 minutes and a salary of approximately £6.86 (taken from the standard cost model's Horticultural Trades wage uprated to 2009 prices), plus 30% non-wage costs is around 30 pence per consignment. The RPAI expect a 25% increase on the 180,000 current registrations, equal to 45,000 additional registered consignments, costing businesses around £13,500. This is not applicable to Wales as there are no active importers presently trading in Wales.

Non-Monetised Costs

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Consumers who are aware of the changes could believe that a reduction in the number of inspections by the RPAI might lead to a reduction in the expected quality of produce, imposing a cost. Furthermore, where customers are used to buying graded produce, and the grade of a product is no longer provided, the consumer may suffer.

There may also be a cost imposed on industry in developing their understanding of the new regime. This would be a one-off cost, e.g. the time spent due to having to read through the regulation.

The Table below shows the sum of the monetised costs and benefits.

Cost/Benefit Description	One-off/ Annual	Amount	Present Value
Modifying IT Systems	One-off	(£25k-75k)	(£25k-75k)
Retraining RPAI Staff	One-off	(£7k)	(£7k)
Registration of Additional Consignments in PEACH	Annual	(£13.5k)	(£111.2k)
Reduction in RPAI Staff numbers	Annual	£65k-£205k	£0.5M-1.7M
Reduction in Re-grading/Re-labelling Costs	Annual	£241k	£2M
Reduction in Registration of Consignments in PEACH	Annual	£2k	£19.5k
Total			£2.5M-3.6M

Impact on Administrative Burdens

Some of the costs calculated above relate to Administrative activities which must be calculated in 2005 prices. The table below shows the impact on Administrative Burdens in 2005 prices.

Cost/Benefit Description	Annual Amount
Registration of Additional Consignments in PEACH	(£12k)
Reduction in Registration of Consignments in PEACH	£2k
Net Impact	(£10k)

The monetised costs and benefits of both options show a positive Net Present Value of around two and a quarter million pounds. It is likely that the non-monetised costs and benefits also represent a positive value. Option 1 includes the derogation to allow traders to seek Approved Trader Status, so is likely to have benefits which equal or exceed the benefits of Option 2.

d) **Competition Assessment**

As all Member States of the EC are required to adopt the practices under the relevant EC Regulations, the draft Regulations will underpin fair

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competition within the common market rather than distort it. Intra-Community trade is thereby facilitated by the draft Regulations.

The Regulation is unlikely to have a negative impact on competition in the fruit and vegetable industry as all areas of the industry will have to adhere to the same rules. The proposal will have no disproportionate effect on small and medium sized businesses as the vast majority of the businesses that will be impacted by the changes are SMEs.

The competition filter test	
Question	Answer yes or no
Q1: In the market(s) affected by the new regulation, does any firm have more than 10% market share?	No
Q2: In the market(s) affected by the new regulation, does any firm have more than 20% market share?	No
Q3: In the market(s) affected by the new regulation, do the largest three firms together have at least 50% market share?	No
Q4: Would the costs of the regulation affect some firms substantially more than others?	No
Q5: Is the regulation likely to affect the market structure, changing the number or size of firms?	No
Q6: Would the regulation lead to higher set-up costs for new or potential suppliers that existing suppliers do not have to meet?	No
Q7: Would the regulation lead to higher ongoing costs for new or potential suppliers that existing suppliers do not have to meet?	No
Q8: Is the sector characterised by rapid technological change?	No
Q9: Would the regulation restrict the ability of suppliers to choose the price, quality, range or location of their products?	No

e)

Consultation

An 8 week public consultation is being undertaken in order to seek industry views on the policy options and implementation of the Regulation. As many of the key stakeholders are common and the RPA will enforce in both Wales and England, this exercise will be carried out jointly with colleagues in Defra, with Defra taking the lead. The consultation will include both the Welsh and English draft Regulations and the Welsh Explanatory Memorandum and Regulatory Impact Assessment and Defra's Impact Assessment. The consultation will combine a written exercise with industry and consumer focussed workshops. The responses to that consultation will be analysed and a summary of responses will be published on the Defra and Welsh Assembly Government websites at the following links within 12 weeks of the consultation closing date <http://www.defra.gov.uk/corporate/consult/foodfarming.htm>

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and

<http://wales.gov.uk/consultations/closedconsultations/environment/?lang=en>

f) **Post implementation review**

It is hoped that a Service Level Agreement will be agreed with the RPA and this will include the provision of information for monitoring purposes. In line with Defra policy, we intend to review this policy within three years of implementation.

g) **Summary**

The Welsh Assembly Government has no choice as to whether the derogations provided for in the EC legislation are exercised. The presumption is that they will be applied unless stakeholders demonstrate powerful reasons to the contrary.

The Defra Impact Assessment for this policy estimated monetised costs and benefits of both options show a positive Net Present Value of around two and a quarter million pounds for Wales and England. It is likely that the non-monetised costs and benefits also represent a positive value. Option 1 includes the derogation to allow traders to seek Approved Trader Status, so is likely to have benefits which equal or exceed the benefits of Option 2.