POLICY NOTE

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME ORDER 2020

SI 2020/XXX

The above instrument is to be made in exercise of the powers conferred on all the four administrations (Scottish, UK, Welsh and Northern Ireland governments) by sections 44, 46(3), 54 and 90(3), schedule 2 and paragraph 9 of schedule 3 of the Climate Change Act 2008. The Order in Council is subject to affirmative procedure.

Summary Box

This is a joint instrument between the four administrations (Scottish, UK, Welsh and Northern Irish governments) to establish a single UK-wide Emissions Trading Scheme ("UK ETS"). This implements the four administrations' shared policy as set out in the joint Government Response published on 1 June 2020.[1] The UK ETS is a replacement for the UK's participation in the EU Emissions Trading System ("EU ETS") after the end of the Transition Period on 31 December 2020.

The UK ETS is a 'cap and trade' scheme based on the design of the EU ETS to encourage cost-effective greenhouse gas emissions reduction from the "traded sector" (energy intensive industries, power generation and aviation). The UK ETS will be operational from 1 January 2021 to provide continuity for participants and maintain a key mechanism for contributing to Scotland's (and the rest of the UK's) statutory emissions reduction targets.

Policy Objectives

The UK will no longer participate in the EU ETS following the end of the Transition Period on 31 December 2020. The EU ETS established a carbon market for the traded sector across Europe, ensuring an level playing field, incentivising cost-effective decarbonisation, and providing protection against carbon leakage.[2]

Scotland has participated in the EU ETS since its creation 2005, with the Scottish traded sector made up of around 100 participants that collectively accounted for 28% of Scotland's greenhouse gases emissions in 2018. Therefore participation in the EU ETS was one of the key mechanisms to decarbonise the traded sector and meet Scotland's statutory climate change targets. This instrument establishes a UK ETS to replace the EU ETS, ensuring continued regulation of greenhouse gas emissions from the traded sector to meet Scotland's statutory targets and net zero ambitions. This will avoid any policy gap after the end of the Transition Period, which could lead to an increase in emissions.

The instrument establishes a scheme with UK-wide application, maintaining the approach to implementing the EU ETS to ensure continuity for participants that operate throughout the UK. It is the culmination of negotiations between the Scottish Government and the other three administrations on a Common Framework in a devolved area after leaving the EU. This

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[1] Joint Government Response on the Future of Carbon Pricing – 1 June 2020
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/889037/Government_Response_to_Consultation_on_Future_of_UK_Carbon_Pricing.pdf

[2] Carbon leakage is where competitors with lesser carbon cost (i.e. from jurisdictions outwith the EU), impact on the competitveness of EU industries that cannot absorb the carbon costs. This could ultimately lead to industry relocating to jursdictions outwith the EU, without any reduction greenhouse gases emissions.

instrument is made by the Scottish Ministers collectively with Ministers from the other three administrations, each using powers under part 3 of the Climate Change Act 2008. This will follow the Order in Council procedure, with the instrument laid in all four legislatures simultaneously, and if approved by each, recommended to Privy Council to be made in November.

This first instrument establishes the structure of the UK ETS, with the design closely replicating the EU ETS (scope, reducing cap on scheme wide emissions, activities and greenhouse gases covered, qualification criteria, reporting and verification requirements, calculation methodologies, enforcement rules, role for regulators, distribution of allowances, etc). The UK ETS will take effect on 1 January 2021 and does not impose any significant new burdens on participants (other than reforms that would have come into effect from 2021 had we remained in the EU ETS). The UK ETS will deliver a net benefit to society UK-wide in its initial years compared to continued UK participation in the EU ETS due to a reduction in the emission cap. A description of the UK ETS is provided in the accompanying Explanatory Memorandum.

A second instrument made by all four administrations using the same Climate Change Act 2008 powers will also be made at the November Privy Council to provide for the free allocation of allowances and establish the UK ETS Registry. However as the ability to auction allowances is explicitly excluded from the Climate Change Act 2008, the UK Government intends to make further secondary legislation for auctioning allowances later in 2020 using reserved powers. All these instruments will collectively constitute the UK ETS. Further subsequent instruments to amend aspects of the UK ETS may be needed, for future evolution of the UK ETS as envisaged in the joint Government Response.

This instrument establishes the structure of a UK ETS that can operate on a "standalone" basis within the UK. The Scottish Government's preference is for the UK ETS to be linked to the EU ETS to maintain the benefits of access to a larger carbon market (cost effective decarbonisation and carbon leakage protection). Designing the UK ETS to mirror the EU ETS, in particular the monitoring and reporting requirements, seeks to facilitate any future agreement to link the two schemes. The UK ETS is capable of being linked to the EU ETS, subject to ongoing negotiations between the UK Government and the EU, and any amendments necessary to implement a link.

Consultation
To comply with the requirements of section 48(1)(b) of the Climate Change Act 2008 a public consultation took place from May to July 2019. The consultation took place on a joint basis between the Scottish, UK, Welsh and the Northern Ireland governments.

Over 130 responses were received UK wide to the consultation, from a range of traded sector participants, NGOs and think tanks. The majority of respondents were supportive of the overall UK ETS proposals with a range of views expressed on specific technical aspects. The joint Government Response, published on 1 June 2020, summarises the stakeholder responses to protect commercial confidentiality and confirms the implementation of the UK ETS.

Impact Assessments
The instrument will create a new UK-wide market for emissions from the UK traded sector and Scottish participants will be able to trade allowances across the UK. The criteria, obligations and rules will apply universally throughout the UK without any differentiations between the four administrations. The UK Government and the devolved administrations have therefore

conducted a joint Impact Assessment of the overall UK-wide application of the scheme.[3] Whilst the joint Impact Assessment does not disaggregate impacts specifically to the Scottish Government or Scotland, it demonstrates that the impacts are not inconsistent with those currently experienced under the EU ETS, which this UK ETS will replace. Therefore no further impact assessments have been conducted.

Financial Effects
The Cabinet Secretary for Environment, Climate Change and Land Reform confirms that no BRIA is necessary as a joint Impact Assessment was published alongside the joint Government Response on 1 June 2020.

Scottish Government
Directorate for Energy and Climate Change

July 2020

[3] UK ETS Imapct Assessment – 1 June 2020
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/889038/The_future_of_UK_carbon_pricing_impact_assessment.pdf