EXPLANATORY MEMORANDUM TO

THE VEHICLE EMISSIONS TRADING SCHEMES ORDER 2023

2023 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Transport ("DfT") and is laid before Parliament by Command of His Majesty.

2. Purpose of the instrument

2.1 The Vehicle Emissions Trading Schemes ("VETS") Order 2023 establishes Great Britain ("GB") wide trading schemes that will contribute to the United Kingdom's ("UK") emissions reduction targets and Net Zero goal. VETS consists of four trading schemes that will implement both a zero emission vehicle ("ZEV") mandate that limits the share of new non-zero emission cars and vans that may be registered[1] in GB and also a carbon dioxide ("CO_2") standard that limits CO_2 emissions from non-zero emission cars or vans. These schemes form a part of the transition to zero emission vehicles that is underpinned by the UK Government's commitment to end the sale of new non-ZEV cars and vans in 2035. This policy framework will replace the UK's existing new car and van CO_2 emissions regulations,[2] which will cease in GB with the commencement of this instrument but will be preserved in Northern Ireland for the time being.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of Parts 2 to 7 and Part 9 of this instrument is England and Wales, and Scotland. The territorial extent of Parts 1 and 8 is the United Kingdom. Parts 2 to 7 and Part 9 relate to VETS and are therefore limited to GB. Part 8 includes revocations of the UK's existing new car and van CO_2 emissions regulations in relation to GB and consequential amendments of it in relation to Northern Ireland. That part therefore extends to the whole UK.

4.2 The territorial application of this instrument is the same as the territorial extent.

5. European Convention on Human Rights

5.1 The Minister of State for Transport, The Rt Hon Jesse Norman MP, has made the following statement regarding Human Rights:

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[1] "Registration" is the process enabling new vehicles to be driven on the road in the UK. A manufacturer is responsible for registrations of vehicles of which it is the manufacturer.

[2] List of new car and van CO_2 emission regulations: Regulation (EU) 2019/631, Regulation (EU) 1014/2010, Regulation (EU) 293/2012, Regulation (EU) 63/2011, Regulation (EU) 114/2013, Regulation (EU) 725/2011, Regulation (EU) 427/2014, Regulation (EU) 2017/1152 and Regulation (EU) 2017/1153 all as amended in different capacities by S.I. 2019/550, S.I. 2020/1418, S.I. 2021/898, S.I. 2021/1242 and S.I. 2022/1361.

"In my view the provisions of the Vehicle Emissions Trading Schemes Order 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 The power to make an instrument to establish a trading scheme relating to greenhouse gas emissions in section 44 of the Climate Change Act 2008 ("CCA") is exercisable by "the relevant national authority" (the Secretary of State, the Scottish Ministers, Welsh Ministers, and the Department for Infrastructure in Northern Ireland),[3] in relation to matters within their legislative competence. This instrument relates to climate policy and is therefore devolved.

6.2 This instrument establishes four separate schemes under section 44 of, and Part 1 of Schedule 2 to, the CCA. The Westminster and Devolved Parliamentary procedures for making a GB-wide trading scheme are set out in Schedule 3 to the CCA. Paragraph 9 of that Schedule enables such a scheme to be established by Order in Council. Pursuant to paragraph 11 of Schedule 3, before a recommendation may be made to His Majesty in Council to make the Order in Council, a draft of the instrument containing the Order in Council must be laid before, and approved by, a resolution of each House of Parliament and the relevant devolved legislatures.

6.3 At the time of laying, the Northern Ireland Assembly is unable to meet this requirement and, as such, the territorial extent of VETS cannot include Northern Ireland. Consequential amendments to the existing new car and van CO_2 Emissions Regulation are made under section 54 of the CCA and preserve that regime for Northern Ireland as described from paragraph 7.20.

6.4 The existing new car and van CO_2 emissions regulations are not included in the Windsor Framework. Retained European Union ("EU") law on the type-approval of vehicles, to which cross-reference is made in this instrument, is included in the Windsor Framework. This instrument therefore refers to both the domestic and the EU versions of the retained EU law on type-approval. This is relevant, for example, to UK (NI) type-approvals, which are valid in GB but continue to follow EU rules.

7. Policy background

What is being done and why?

7.1 The UK has committed to net zero emissions by 2050, and to achieve this, road transport emissions must be reduced. The UK's transport sector is responsible for the greatest share of the domestic greenhouse gas production and has seen relatively little change since 1990 while emissions from other sectors (such as energy and business) have steadily fallen.[4] Cars and vans alone were responsible for 18% of the UK's total domestic greenhouse gas emissions in 2021, meaning that removing the exhaust emissions from new cars and vans sold in the UK is fundamental to decarbonising transport and the UK economy.[5]

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[3] The definition of relevant national authority is set out at section 47 of the CCA.

[4] 2021 UK Greenhouse Gas Emissions Final Figures, National Statistics, p16-17. https://www.gov.uk/government/statistics/final-uk-greenhouse-gas-emissions-national-statistics-1990-to-2021

[5] Sixth Carbon Budget – The path to Net Zero, Climate Change Committee, p97-98 https://www.theccc.org.uk/wp-content/uploads/2020/12/The-Sixth-Carbon-Budget-The-UKs-path-to-Net-Zero.pdf

7.2 Through the CCA, the UK became the first country to set legally binding carbon budgets, introducing limits on the amount of greenhouse gases the UK can emit over a five-year period. The Act was amended in 2019 to set the UK's target of net zero greenhouse gas emissions by 2050.

7.3 Climate policy, and therefore establishing VETS under the CCA, falls within devolved competence. The development of VETS is one of several policy areas across Government in which a Common Framework is being developed, to establish common approaches to devolved policy areas and agree how the UK Government and Devolved Administrations will jointly manage these policy areas going forward. DfT has worked closely with the Devolved Administrations (as well as His Majesty's Treasury, Department for Business and Trade, and Department for Energy Security and Net Zero) on developing VETS policy and legislation; Scottish and Welsh Ministers will be laying this instrument in draft in the Scottish Parliament and Senedd Cymru where it will be subject to affirmative resolutions of those legislatures.

7.4 Emissions regulation for cars and vans has been present in the UK since the Motor Vehicles (Construction and Use) Regulations 1973. Effectively managing the emissions of road vehicles into the atmosphere is not just a climate policy objective, but a public health imperative recognised globally, including in the EU's new car and van CO_2 emissions regulatory framework that the UK adopted and operated after exiting the EU. The UK has consistently evolved its approach to emissions regulation and VETS represents the next step as the UK continues to lead the transition to ZEVs.

7.5 Having left the EU, the UK no longer is part of the EU's new car and van emissions regulatory framework and is free to pursue a bespoke approach that will deliver a faster transition to zero emission technology. While the UK's current, EU-derived new car and van CO_2 emissions regulation manages emissions only, VETS consists of both a ZEV mandate and a CO_2 emissions standard that together simultaneously increase the number of ZEVs on GB roads while maintaining a limit on the total emissions of non-ZEVs.

7.6 This instrument will set up VETS as four separate GB-wide trading schemes that will be operational from 1st January 2024, or as soon as possible thereafter. Two of the schemes apply to cars: the Non-Zero-Emission Car Registration Trading Scheme ("CRTS") and the Non-Zero-Emission Car CO_2 Trading Scheme ("CCTS"), and two apply to vans: the Non-Zero-Emission Van Registration Trading Scheme ("VRTS") and the Non-Zero-Emission Van CO_2 Trading Scheme ("VCTS").

7.7 The scope of VETS includes all vehicle manufacturers who register a car or van as defined by this instrument in GB, subject to the exemptions and derogations described below. Non-zero emission special purpose vehicles, including wheelchair accessible vehicles, are exempt from VETS but zero emission versions will earn credits. This exemption is necessary to ensure special use cases continue to receive the vehicles they need, while the credit incentivises transitioning such vehicles. Multi-Stage Vehicles[6] have bespoke arrangements in place to fairly assign responsibility for emissions and for ZEV registrations.

7.8 The CRTS and VRTS (together the "ZEV mandate schemes") provide for annual targets for non-zero emission vehicles ("non-ZEV") registrations, decreasing yearly. This is implemented by the schemes' administrator (the Secretary of State for

[6] Multi Stage Vehicles are vehicles that are built in multiple stages, either using complete or incomplete base vehicles.

Transport) allocating CRTS and VRTS allowances to car and van manufacturers by multiplying a manufacturer's registrations in a given year by that year's non-ZEV target. One CRTS/VRTS allowance must be surrendered to the administrator for each non-ZEV registration, referred to as "activity". If a manufacturer registers fewer non-ZEVs than the target allows they will have spare allowances, and if they register more non-ZEVs than the target they will have an allowance deficit.

7.9 The effect of these schemes is that manufacturers must register increasing numbers of ZEVs as a proportion of their overall registrations each year. Manufacturers may trade allowances amongst themselves or make use of other flexibilities, such as banking previous years' over-compliance, to meet their targets. Manufacturers who do not have enough CRTS or VRTS allowances to meet their targets are required to make a payment of £15,000 per CRTS allowance. For VRTS this payment is £9,000 per VRTS allowance in 2024, increasing to £18,000 from 2025 onward. Overall allowances and activity in these two schemes are limited as required by paragraph 7(2) and (3) of Schedule 2 to the CCA. The limits on activity in articles 12(3) and 44(3) are based on the maximum number of allowances and credits that may be acquired over the schemes' lifetime and that therefore may be surrendered in return for the registration of a non-ZEV. The limits on allowances are set out in articles 13 and 45.

7.10 The CCTS and VCTS (together the "CO_2 standard schemes") set a baseline per-vehicle emissions target derived from a manufacturer's 2021 performance and compliance; a manufacturer that was compliant with the existing regulations in 2021 will receive a target the higher of their actual emissions or their 2021 target and a manufacturer that was not compliant with the existing regulations in 2021 will receive a target that is their 2021 performance tightened by the percentage by which they missed their target. The schemes' administrator will allocate CCTS and VCTS allowances to car and van manufacturers annually. One CCTS or VCTS allowance is equivalent to 1gCO_2e/km. Allowances are calculated by reference to the emissions of CO_2 from the non-ZEVs registered each year, multiplied by a participant's 2021 baseline target. The administrator will then calculate a manufacturer's in year average emissions multiplied by their total non-ZEV registrations to calculate the number of allowances. If the allocation is greater than the requirement then the manufacturer has a surplus of CCTS or VCTS allowances, if the allocation is less, the manufacturer has a deficit.

7.11 Manufacturers must therefore keep per-vehicle average emissions the same or lower than in 2021 while selling fewer non-ZEVs as set out in the ZEV mandate schemes. There are no credits under the CO_2 standard schemes, but manufacturers may make use of flexibilities during the trading window. At the end of each scheme year, a manufacturer must have one CCTS or VCTS allowance for every gCO_2e/km from their car or van registrations that year. Manufacturers who do not have enough CCTS or VCTS allowances to meet their targets are required to make a payment of £86 per CCTS or VCTS allowance.

7.12 The ZEV mandate schemes have a number of flexibilities to allow a variety of routes to compliance. There is a banking mechanism where over-performance in early years may be used in later years, a borrowing mechanism where allowances can be borrowed from a participant's own future allocation, and conversions. Vehicle manufacturers may also earn credits for registering zero emission special purpose vehicles and zero emission wheelchair accessible vehicles, and if the zero emission vehicle is used by a car club. These credits are awarded on the basis that the specified use cases represent a particular benefit in CO_2 emissions reduction. One CRTS or VRTS credit is equal to one CRTS or VRTS allowance.

7.13 There is limited interaction between the CRTS and the CCTS, and between the VRTS and VCTS, as permitted by paragraph 11(1) of Schedule 2 to the CCA. CRTS allowances may be converted into CCTS allowances at an exchange rate, and CCTS allowances may be converted into CRTS credits at an exchange rate. The same is true of VRTS and VCTS with different exchange rates. There is no interaction between the car schemes (CCTS and CRTS) and the van schemes (VCTS and VRTS).

7.14 There are derogations from the ZEV mandate schemes. Micro volume manufacturers registering fewer than 1,000 cars or vans receive an automatic derogation. Small volume manufacturers registering more than 999 but fewer than 2,500 vehicles may make an application for a derogation. Derogated manufacturers do not have a target for non-ZEV registrations, but still receive an allocation of allowances based on their actual numbers of non-ZEV registrations.

7.15 There is also an exemption to the CO_2 standard schemes. In the CO_2 standard schemes micro volume manufacturers registering fewer than 1,000 non-zero emission vehicles are automatically exempted, as well as those registering only ZEVs.

7.16 Derogations and exemptions for car and van schemes are applied separately and assessed on an annual basis. A participant may be derogated or exempted for the van schemes but not for the car schemes and vice versa or may be derogated or exempted for both car and van schemes depending on their registrations. A participant may be derogated or exempted in one year and brought in scope for the next if their registrations cross the respective thresholds.

7.17 VETS participants are subject to a system of monitoring and reporting that underpins compliance with and the integrity of the schemes. The data that is used to assess compliance is primarily collected by the Driver and Vehicle Licensing Agency through vehicle registration. Participants then have the opportunity to correct that data and supply evidence to support any corrections. The data collected and the process of error correction are largely unchanged from the existing new car and van CO_2 emissions regulations.

7.18 VETS sets up a robust and proportionate enforcement system. The enforcement of VETS rules will be carried out by the appointed trading schemes administrator. The administrator has the power to require information from participants, and failure to comply results in escalating civil penalties and enforcement measures, culminating in the power to question officers of a company, the power to demand information, and the power to apply for a warrant to search premises and seize documents and records. The administrator will work closely with participants and the Devolved Administrations to ensure civil penalties included in VETS are effective, dissuasive and proportionate.

7.19 Where VETS participants are aggrieved by decisions of the administrator made under this instrument, a complaints procedure will be available and some decisions may be appealed.

New car and van emissions regulations for Northern Ireland

7.20 As set out in paragraph 6.3, Northern Ireland is currently unable to join VETS. To ensure that Northern Ireland is covered as appropriate by existing regulations, consequential amendments are made in Part 8 of this instrument to the UK's new car and van CO_2 emissions regulations. These are made in close consultation with the Department for Infrastructure (Northern Ireland). The amendments will preserve the existing regulations in Northern Ireland alone and scale them appropriately for that market. They will also preserve, with minor amendments, the current system for approving eco-innovations (innovative technologies that produce CO_2 savings beyond what is measured over the standardised test cycle during vehicle type approval) which are relevant for measuring activity in the CCTS and VCTS, as well as under the regime that will continue to apply in Northern Ireland.

7.21 The relevant parts of this instrument have been drafted to meet two criteria:

- That at the point at which GB moves to VETS, Northern Ireland remains covered by an appropriate emissions regulation.
- To maintain regulations that as closely as possible match the current arrangements in the UK in order to minimise any potential additional burden to both administration and environmental performance as a direct consequence of GB's move to VETS.

7.22 In the current UK-wide application of these regulations, manufacturer targets are established by formulae which compare the mass of all newly registered cars and/or vans in a manufacturer's fleet against the average mass of all such vehicles in the UK. This formula ensures that, as it is only the fleet average that is regulated, manufacturers may register any vehicle they like within the UK market, thereby protecting the diversity of the fleet, whilst the fleet as a whole becomes more efficient. These targets and formulae will remain in place for Northern Ireland, and compliance with these targets will be assessed using registrations in Northern Ireland only.

7.23 Manufacturers may currently apply for derogations from the formula that establishes the manufacturer fleet CO_2 target if their total registrations for any calendar year fall beneath pre-defined thresholds. These derogations will remain in place for Northern Ireland, and eligibility for these derogations will continue to be assessed based on UK-wide registrations levels, to ensure no change in burden levels for manufacturers that have been eligible for derogations in the existing new car and van CO_2 emissions regulations to date.

7.24 "Excess emissions premiums" are levied for non-compliance of manufacturer CO_2 targets. At the point at which VETS starts and Northern Ireland alone is subject to these regulations, the fine will be £86 per gram of exceedance per vehicle registered.

7.25 UK Government, Welsh Government, and Scottish Government are open to Northern Ireland joining VETS at such time as a sitting Assembly chooses. It is further the joint position of the UK Government, Welsh Government, and Scottish Government that the benefits of VETS including reducing emissions, increased ZEV ownership, and regulatory certainty for industry should be enjoyed UK-wide.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

9. Consolidation

9.1 As this instrument establishes new trading schemes and only includes consequential amendment of retained EU legislation, no consolidation is appropriate.

10. Consultation outcome

10.1 Between 30th March 2023 and 24th May 2023, the UK Government and Devolved Administrations ran a public consultation seeking views on "A zero emission vehicle (ZEV) mandate and CO2 emissions regulation for new cars and vans in the UK". This consultation stated that emissions trading schemes are the UK Government and Devolved Administrations' preferred policy approach to transitioning to zero emission vehicles.

10.2 Alongside the consultation, the UK Government and Devolved Administrations jointly commissioned the Committee on Climate Change ("CCC") for advice on the design of a ZEV mandate and CO_2 standard in accordance with section 48 of the CCA. This advice was published by the CCC and is available at: www.theccc.org.uk/publication/letter-zero-emission-vehicle-mandate/

10.3 The consultation received over 148 responses, from a range of stakeholders including vehicle manufacturers, chargepoint operators, and NGOs, with the majority supporting most of the proposals on the design of a ZEV mandate and CO_2 emissions standard. A large proportion of stakeholders expressed a preference that the schemes be UK-wide in their territorial extent.

10.4 The key points raised by respondents to the consultation were:

- VETS should apply UK-wide (Q1 & Q2): Approximately 96% of respondents who answered the relevant question wanted VETS to apply UK wide. While it is not practically possible for VETS to apply in Northern Ireland due to the reasons outlined in paragraph 6.3, the regulation will apply across GB. At such time as the Northern Ireland Assembly chooses to pass any necessary legislation, the schemes will apply UK wide.
- VETS should be delayed from 2024 to 2025 (Q3): Around 8% of respondents to question 3 advocated for a delay of the mandate from 2024 to 2025, or for 2024 to be a "monitoring year" without payments. The UK Government, Welsh Government, Scottish Government, and Department for Infrastructure (Northern Ireland) agreed new flexibilities following the consultation that provide assurances for early years of the schemes in response to concerns that the early years were too challenging for some participants, and kept the 2024 commencement in light of this.
- CO_2 standard baseline methodology (Q14): Approximately 45% of respondents to question 14 felt that the proposal did not fairly account for CO_2 emissions reductions under the existing regulations, proposing various measures to remedy this. The UK Government, Welsh Government, Scottish Government, and Department for Infrastructure (Northern Ireland) agreed a new methodology that recognises manufacturers who were over-compliant in 2021 more effectively, rewarding historic emissions savings.

10.5 The Government Response to the consultation was published on 28th September 2023. Full details of the consultation can be found at: A zero emission vehicle (ZEV) mandate and CO2 emissions regulation for new cars and vans in the UK - GOV.UK (www.gov.uk)

10.6 The consultation built on the two preceding consultations: Policy design features for the car and van zero emission vehicle (ZEV) mandate - GOV.UK (www.gov.uk)[7] (consultation open 7th April – 10th June 2022) and CO2 emissions regulatory framework for all newly sold road vehicles in the UK - GOV.UK (www.gov.uk)[8] (consultation open 14th July – 22th September 2021).

11. Guidance

11.1 Guidance for VETS participants will be published prior to the start of the scheme on 1st January 2024 or as soon as possible thereafter. Draft guidance will be shared with those manufacturers who will be subject to the regulation in advance of publication.

12. Impact

12.1 There is no significant impact on charities or voluntary bodies.

12.2 There is no significant impact on the public sector.

12.3 A full cost benefit analysis is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 To minimise the impact of the requirements on small businesses (employing up to 50 people), the approach taken is to offer derogations from ZEV mandate schemes to participants registering 2,499 or fewer cars or vans and an exemption from the CO_2 standard schemes for manufacturers registering fewer than 1,000 non-zero emission cars or vans. See paragraph 7.14.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is for a statutory post-implementation review in 2029, supplemented by non-statutory annual reporting, a non-statutory mid-point review in 2027, and continuous monitoring of vehicle data by the administrator to safeguard against any potential adverse effects.

14.2 A statutory review clause is included in this instrument.

15. Contact

15.1 James Vickery at the Department for Transport Telephone: 07773 074513 or email: james.vickery@dft.gov.uk can be contacted with any queries regarding the instrument.

15.2 Bob Moran, Deputy Director for Decarbonisation Strategy, at the Department for Transport can confirm that this Explanatory Memorandum meets the required standard.

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[7] https://www.gov.uk/government/consultations/policy-design-features-for-the-car-and-van-zero-emission-vehicle-zev-mandate

[8] https://www.gov.uk/government/consultations/co2-emissions-regulatory-framework-for-all-newly-sold-road-vehicles-in-the-uk

15.3 The Rt Hon Jesse Norman MP, the Minister of State for Transport at the Department for Transport can confirm that this Explanatory Memorandum meets the required standard.