

EXPLANATORY MEMORANDUM TO

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT) (NO. 2) ORDER 2022

2022 No. 1173

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy (the “Department”) and is laid before Parliament by Command of His Majesty.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument makes various operational amendments to the UK Emissions Trading Scheme (the “UK ETS”). In broad terms these amendments are intended to enable changes to free allocation for installations to be based on activity levels that do not include the 2020 COVID year; to provide a window for Hospitals and Small Emitters (HSEs) to re-enter the main scheme; to update Global Warming Potential values to meet international obligations; and to make several other minor operational amendments.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 This instrument makes a number of corrections to the Greenhouse Gas Emissions Trading Scheme Order 2020 (the “2020 Order”) and other UK ETS legislation including, for example, correcting an incorrect cross-reference. The Department has decided not to apply the free issue procedure, since the provisions making corrections represent only a small proportion of the instrument. In accordance with paragraph 4.7.6 of *Statutory Instrument Practice*, the Department has consulted the SI Registrar.
- 3.2 The Committee previously asked the Department to explain why the amendments made to the 2020 Order by article 36 of the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020 referred to standard EN ISO 14065:2013 rather than to EN ISO 14065:2020. The Department’s response (published in Appendix 4 of the Committee’s Fortieth Report of Session 2019-21) stated that the legislation would be “updated in due course”. This instrument now makes provision about EN ISO 14065:2020.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the whole of the United Kingdom.
- 4.2 The territorial application of this instrument is the whole of the United Kingdom.

5. European Convention on Human Rights

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

- 6.1 The UK ETS was established under the Climate Change Act 2008 by the 2020 Order as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions which will contribute to the UK’s emissions reduction targets and net zero goal. This scheme replaced the UK’s participating in the EU Emissions Trading System (EU ETS), and the 2020 Order applied EU ETS rules on the monitoring, reporting and verification of emissions with modifications to ensure that they work for the UK ETS.
- 6.2 The 2020 Order was subsequently amended by the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020 to include provisions for the free allocation of allowances and the UK ETS Registry. Regulations under the Finance Act 2020 established the rules for auctioning allowances and mechanisms to support market stability.
- 6.3 Technical and operational amendments, including additional penalties, and improvements to monitoring, reporting and enforcement of scheme rules were made by the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021 and the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022.
- 6.4 Subject to approval by Parliament, the Senedd, the Scottish Parliament and His Majesty in Council, a further amendment to include flights to Switzerland within the scope of the UK ETS from 1 January 2023 will be made by a further instrument (the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022), a draft of which has been laid before Parliament¹.

7. Policy background

What is being done and why?

- 7.1 The UK ETS Phase 1 runs for ten “scheme years” beginning in 2021. Operators of certain industrial installations and certain aircraft operators are required to monitor, report on, and surrender “allowances” equivalent to, their greenhouse gas emissions in each scheme year. Some operators and aircraft operators receive an allocation of allowances free of charge, details of which are published in allocation tables. Allowances are held in accounts in the UK ETS Registry, and there is a cap on the number of allowances that may be created. For installations that meet the eligibility criteria, there are two opt-out schemes, one for HSEs, the other for “ultra-small emitters (USEs)”. Such installations are not required to surrender allowances.
- 7.2 The main changes made by this instrument are as follows:
- 7.3 *Flexible share:* The amendment allows the UK ETS authority (i.e., UK Government, Scottish Government, Welsh Government and Department for Agriculture Environment, and Rural Affairs, Northern Ireland (DAERA)) to create up to the total number of allowances from the “flexible share” (40,984,970 allowances), in addition to the annual cap. This will avoid a scenario where the flexible share could be prevented from fulfilling its intent to mitigate the triggering of a cross-sectoral correction factor (which, if triggered, reduces free allocation for installations). The flexible share allowances have not been used previously.

¹ <https://www.legislation.gov.uk/ukdsi/2022/9780348238761/contents>

- 7.4 *Global Warming Potentials*: The amendment will apply updated Global Warming Potential values (GWPs) set out in the Intergovernmental Panel on Climate Change's Fifth Assessment Report (AR5), as agreed at COP24 and COP 26. GWPs allow comparisons of the global warming impacts of different gases by measuring how much energy the emissions of one tonne of a gas will absorb over a given period of time relative to one tonne of CO₂. The larger the GWP figure, the more the gas warms the Earth compared to CO₂ over a given time period. The updated GWP figures will apply to nitrous oxide and two perfluorocarbons (PFCs). Since the updated GWP figures set out in the AR5 are lower than the previous GWP figures, in practice this will mean that fewer allowances will be required to be surrendered per tonne of either nitrous oxide or PFCs as they will now be equivalent to a lesser amount of CO₂.
- 7.5 *Activity Level Changes and COVID*: The amendment to the Activity Level Changes Regulation² will enable operators to apply for changes to free allocation in 2022 to be based on their activity levels in 2019 and 2021 (i.e., omitting 2020) if they can demonstrate a discrepancy of at least 15% between reductions in output and emissions caused by the COVID-19 pandemic.
- 7.6 *Hospitals and Small Emitters to re-enter the main scheme*: The amendment will offer a one-off window between January and March 2023 for operators of HSEs in the 2021-2025 allocation period to re-enter the main UK ETS scheme from 2024 onwards. This recognises that operators made the decision to apply to be HSEs when expecting a different set of rules than those currently in use (EU ETS Phase IV rules rather than those of the UK ETS). Additionally, operators who re-enter the main scheme in this way are eligible for free allocation provided they made a previously successful application for free allocation.
- 7.7 *References to EN ISO 14065:2013*: The amendment will require scheme verifiers to be accredited to the updated version of standard EN ISO 14065 (EN ISO 14065:2020) by 1 July 2024, with transitional arrangements in place until then. This maintains the consistency of the UK ETS with international standards. The legislation currently references ISO 14065:2013.
- 7.8 *Publication of scheme information*: The amendment will require the UK ETS authority to publish certain information held in the Registry (including information about the emissions of, and allowances surrendered by, participants in the main scheme and information about trading accounts) and emissions targets and reportable emissions of HSEs. (Some of this information is currently published under the Environmental Information Regulations 2004.) A power is also provided that allows for the publication of other scheme information to ensure the effective operation of or to inform the public about the operation of the UK ETS.
- 7.9 *Additional minor amendments*: The Order makes several minor technical and operational amendments which are described in the government response mentioned in section 10.5 of this explanatory memorandum, including a number of corrections and clarifications.

² Commission Implementing Regulation (EU) 2019/1842, as it forms part of domestic law.

Explanations

What did any law do before the changes to be made by this instrument?

- 7.10 Currently, the 2020 Order does not provide for the amendments referred to in sections 7.3-7.9 of this explanatory memorandum. For example, the GWP values do not currently reflect the international obligations for climate reporting; ISO standards do not align with international standards; the Order does not allow for publication of key compliance information.

Why is it being changed?

- 7.11 As a result of feedback from the public consultation the Authority are proposing amendments which will support businesses and effective scheme operation. In addition, UK ETS delivery partners (UK Government, Scottish Government, Welsh Government and Department for Agriculture Environment, and Rural Affairs, Northern Ireland (DAERA), and the scheme regulators) identified a list of minor technical amendments needed to support effective operation. This led to a package of outstanding technical and operational issues which need to be addressed in this instrument.

What will it now do?

- 7.12 The instrument will make relatively minor changes to a broad range of operational scheme aspects and will amend the Order to reflect the policies outlined in sections 7.3-7.9).

8. European Union Withdrawal and Future Relationship

- 8.1 This instrument is not being made under the European Union (Withdrawal) Act but relates to the withdrawal of the United Kingdom from the European Union because the UK ETS is a policy replacement for the UK's participation in the EU ETS.

9. Consolidation

- 9.1 There are no plans to consolidate the legislation amended by this instrument.

10. Consultation outcome

- 10.1 Between 25th March and 17th June 2022, the UK Government, Scottish Government, Welsh Government and Department for Agriculture Environment, and Rural Affairs, Northern Ireland (DAERA), ran a public consultation on a package of proposals to develop the UK ETS, including the policy content of this instrument referred to in sections 7.3 to 7.7.
- 10.2 Alongside the consultation, the UK Government, Scottish Government, Welsh Government and Department for Agriculture Environment, and Rural Affairs, Northern Ireland (DAERA), jointly sought the advice of the Committee on Climate Change (CCC) on the public consultation. The CCC reviewed the policy content of these proposals and only had clarification questions and no further comments.
- 10.3 The public consultation section relating to the content of this explanatory memorandum received 90 responses. These included a variety of stakeholders, including those from the Aviation, Chemical, Transport, Manufacturing, Financial, Power, Food and Drink, and Steel sectors, as well as other Trade Associations, Local

Authorities, Consultancies, Think Tanks and NGOs, and other sectors. The majority of responses agreed with the proposals.

- 10.4 The Government Response to the consultation was published on 31st August 2022.
- 10.5 Full details of the consultation and response can be found at: <https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets>
- 10.6 An additional consultation was conducted to seek views on the provision referred to in section 7.8. This consultation received 59 responses, with the majority in favour of proceeding to legislate to allow for compliance data to be published. The CCC were consulted on this provision and had no comments. Due to the fact that the proposals included the publication of “personal data”, the Department consulted the Information Commissioner in accordance with Article 36(4) of the UK General Data Protection Regulation³ and was advised that the impact on individuals was negligible and that action therefore did not need to be taken. The government response will be published in early November 2022.
- 10.7 A number of amendments (referenced in section 7.9 above) were not included in either consultation mentioned above, either because they will have very limited impact on operators, are primarily administrative in nature or make minor corrections or clarifications to legislation. The Department took the view that the policy represented by some of these amendments is within the scope of the consultations previously carried out (including previous advice from the CCC) and is covered by the Government Responses to those consultations. The scheme regulators were consulted on the policy proposals. The CCC was also separately consulted on the additional provisions. Neither exercise raised substantive concern or observation that had a material impact on the policy proposals.

11. Guidance

- 11.1 The UK ETS guidance has been published and is available at: <https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-in-the-uk-ets>. Guidance will be updated regularly, and updates will take account of relevant changes to legislation as necessary.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies of the amendments to the Activity Level Changes Regulation due to the impact of COVID in 2020 and inclusion of UK to Switzerland flights are set out in the analytical annex to the Government Response (referenced in paragraph 10.5).
- 12.2 The other sections of this initial Government Response are not covered in this annex, as they are technical amendments with no substantial direct impacts to be assessed. A full Impact Assessment has not been prepared for this instrument because it is not a regulatory provision.
- 12.3 A June 2020 regulatory impact assessment of the effect of the UK ETS on the costs of business, the voluntary sector and the public sector is available from the Industrial Decarbonisation and Emissions Trading Energy Directorate, Department for Business,

³ Regulation (EU) 2016/679 of the European Parliament and of the Council, as if forms part of domestic law.

Energy and Industrial Strategy, 1 Victoria Street, London SW1H 0ET and is available alongside the 2020 Order on www.legislation.gov.uk.

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 of the UK ETS on small businesses, operators and aircraft operators with relatively low levels of emissions are either not caught by the scheme or can take advantage of opt-outs.

14. Monitoring & review

- 14.1 Article 17 of the 2020 Order commits the UK ETS authority to reviewing the operation of the UK ETS (including the measures introduced by this instrument) in 2023 and in 2028. The UK ETS authority must subsequently publish a report setting out the conclusions of the review.
- 14.2 The instrument does not include a statutory review clause. The requirement under section 28(2) of the Small Business, Enterprise and Employment Act 2015 to make provision for review does not apply to this instrument as it falls within an exception in section 28(3) of that Act.

15. Contact

- 15.1 Francis Collie at the Department for Business, Energy and Industrial Strategy (telephone: 07552818912 or email: francis.collie2beis.gov.uk) can be contacted with any queries regarding the instrument.
- 15.2 Charlie Lewis, Deputy Director for Emissions Trading, at the Department for Business, Energy and Industrial Strategy can confirm that this explanatory memorandum meets the required standard.
- 15.3 The Rt Hon Graham Stuart MP, Minister of State for Climate, at the Department for Business, Energy and Industrial Strategy can confirm that this explanatory memorandum meets the required standard.