

Explanatory Memorandum to the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022.

This Explanatory Memorandum has been prepared for the Minister for Climate Change by the Directorate of Climate Change, Energy and Planning and is laid before Senedd Cymru in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

Minister's Declaration

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022.

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Minister for Climate Change

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PART 1

1. Description

1.1 The UK Emissions Trading Scheme (“ETS”) was established by the Greenhouse Gas Emissions Trading Scheme Order 2020 (“the principal Order”) as a UK-wide greenhouse gas emissions trading scheme, to encourage cost-effective emissions reductions from the power, industry, and aviation sectors. It was designed jointly by the Governments of the UK, Scotland, Wales, and the Northern Ireland Executive. It contributes to the UK’s emissions reduction targets and net zero goal, as well as the emissions reduction pathway we have in Wales. Amendments to the 2020 Order were made at the end of 2020¹ to enable the UK ETS to operate from 1 January 2021.

1.2 The legislation underpinning the UK ETS is being delivered incrementally, through a series of statutory instruments. The timing and order of this series has been designed to ensure that specific legal provisions are introduced as they become operationally necessary, with two further amendments made in December 2021² and April 2022³.

1.3 Earlier in 2022, the UK ETS Authority consulted on “Developing the UK Emissions Trading Scheme (UK ETS)” which contained a number of proposed amendments considered necessary to address technical and operational needs identified during the first year of operation of the UK ETS. These need to be implemented ahead of the 2023 scheme year. The initial Government response published in August set out the UK ETS Authority position regarding the consulted-on technical amendments.

1.4 Certain amendments resulting from the above were included in the Greenhouse Gas Emissions Trading Scheme (Amendment) (No.3) Order 2022 that was laid on 27 September in the Senedd, and debate concluded on 18 October.

1.5 The current amendments cover technical detail that will help strengthen the functioning of the ETS, while also affording increased transparency of the working of the scheme, to the benefit of both participants and general public.

2. Matters of special interest to the Legislation, Justice and Constitution Committee

2.1 Part 3 of Schedule 3 to the Climate Change Act 2008 (“CCA”) states that an emissions trading scheme that applies to England, Scotland, Wales and

¹ The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020.

² The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021.

³ The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022.

Northern Ireland – such as in this case – must be established by Order in Council.

2.2 The appropriate procedure for an Order in Council is prescribed by section 48 to the CCA.

2.3 As the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021 does not contain any provisions which would be caught by section 48(3) of the CCA, the negative procedure will be used.

2.4 As the Order in Council will be subject to UK Parliamentary scrutiny, it is not considered reasonably practicable for this instrument to be made or laid bilingually.

3. Legislative background

3.1 The principal Order set up the UK ETS to be operational from 1 January 2021 and runs for ten scheme years. The scheme works by requiring operators of energy intensive industrial installations, power generators, and aircraft operators to monitor, report on, and surrender “allowances” equivalent to their greenhouse gas emissions in each scheme year. Some participants receive an allocation of allowances free of charge, details of which are published in allocation tables.

3.2 There have been several amendments to the principal order –

3.2.1 The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020;

3.2.2 The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021;

3.2.3 The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022; and

3.2.4 The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022.

3.3 The purpose of the above amendments was to effect technical changes to improve the operation of the UK ETS for both participants and regulators.

3.4 During the operations of the UK ETS over the past two years certain areas have been identified as needing improvement, to make it a more effective instrument to help decarbonisation.

3.5 The principal Order and the several amendments were made under section 44 of the CCA. The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022 is also being made under the powers given by the same.

3.6 As noted above, the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022 is being made under the draft negative resolution procedure.

4. Purpose and intended effect of the legislation

4.1 The purpose of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022 is to amend the UK ETS Order to:

- 4.1.1 Respond to impacts on the scheme operation brought about by the Covid-19 pandemic;
- 4.1.2 Strengthen the existing provisions to help improve the effectiveness of the scheme while making it more flexible for participants;
- 4.1.3 Regularise the publication of information from the scheme registry to improve transparency.

4.2 The territorial extent of this Order is England, Wales, Scotland, and Northern Ireland.

4.3 The main changes are summarised below:

Amendment to the Activity Level Changes Regulations due to the 2020 Covid year impacts

4.4 Activity Level changes are used to calculate the entitlement of Free Allowances for certain qualifying industries, to cover a portion of their emissions and are calculated by comparing against historic activity levels.

4.5 Articles 6 and Articles 23-24 allow omission of the 2020 Covid year in the calculation of change in activity level in 2022, for those operators who can demonstrate to the Authority significant discrepancies between reductions in activity and correlating emissions, caused by the Covid-19 pandemic. Year 2019 would be used instead.

4.6 The amendment is aimed at proportionately and fairly addressing the most affected participants by allowing them to submit verified data and evidence of Covid-19 impact on their 2020 activity levels, while minimising any delays to the activity level change process.

Changes to the Greenhouse Gas Emissions Trading Scheme Order 2020 (Principal Order)

- *Cap for scheme years – use of Flexible share*

4.7 Article 5 amends the Principal Order by enabling the Authority to create allowances from the whole of the flexible share (40,984,970 allowances) in addition to the annual cap. The flexible share mitigates against the use of the

cross-sectoral correction factor use, which affects the free allocation for installations indiscriminately.

4.8 The amendment addresses an anomaly in the current UK ETS legislation which prevents the ETS Authority from utilising the full amount of allowances from the flexible share in a scheme year, thereby hindering the purpose of the legislation.

- *Hospital and Small Emitters (HSE) re-entry to the scheme*

4.9 The amendment at Article 15 allows a one-off window between January and March 2023 for participants in the HSE scheme to re-enter the main UK ETS scheme from 2024 onwards. This recognises that operators made the decision 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). Therefore the amendment will help regularise the function of the scheme.

- *Virtual site visits by verifiers of aircraft operators*

4.10 Article 12 permits verifiers of aviation activities to conduct remote site visits where appropriate and with Regulatory approval, therefore improving flexibility and efficacy to the scheme participants.

Amendments to the Free Allocation Regulations

- *Application for free allocation by new entrants (electricity generators)*

4.11 Article 18 amends existing provisions so that a “new entrant” electricity generator installation, can apply for free allocation in respect of measurable heat produced by means of high-efficiency cogeneration if the installation has been operating (and has demonstrated the energy savings required for eligibility) for a full calendar year.

4.12 This is a longer period than currently used and strengthens the evidence base on which relevant industrial operators can apply for free allowances and is in line with the overall goals of the UK ETS scheme.

- *Permit transfers, mergers, and splits*

4.13 The amendment to Article 20 fills a gap in the legislation regarding the merger or split of sites which result in permits transfers. The UK ETS legislation currently does not clearly set out whether and if so, how, the allocation of free allowances should be merged, issued and adjusted in the year in which the permit transfer occurs.

4.14 The amendment aligns the allocation with the annual activity level reporting deadline - 31 March. By doing so, the Authority is able to give clarity and certainty to operators taking part in the transaction as to what their obligations are.

Other amendments include the following trivial technical changes aimed at consistency, updating or removal of redundant provisions in the current ETS and related legislation

- 4.15 New values for the global warming potentials (in tonnes of carbon dioxide equivalent) of certain greenhouse gases covered by the UK ETS are adopted for the 2023 and subsequent scheme years (Article 11(6)).
- 4.16 From 1 July 2024, verifiers of emission reports must be accredited to a new standard (Article 12(2)).
- 4.17 In the activity level changes process for installations, the decision about whether free allocation should be adjusted where questions of energy efficiency arise, will be made by the UK ETS authority, rather than the regulator (Article 25).
- 4.18 To clarify, and remove duplicate or unnecessary requirements from, the permitting regime for installations (Article 15(3)).
- 4.19 To modify further the Monitoring and Reporting Regulation 2018 and the Verification Regulation 2018 to make corrections to, or remove unnecessary wording from, the original text (Article 19).
- 4.20 To provide for when an emission factor of zero may be claimed for tallow used at an installation; and to clarify when an emission factor of zero may be claimed for aviation biofuel (Article 11(2)).
- 4.21 This Order also corrects an incorrect cross-reference in paragraph 4(3) of Schedule 8A (Article 16) and amends Article 26 of the Free Allocation Regulation to provide correctly for the scheme year in which free allocation ceases where an installation ceases to operate (Article 14).

Amendments to include provisions on compliance data publication in the Greenhouse Gas Emissions Trading Scheme Order 2020

- 4.22 The effect of the amendments are two-fold. Under Article 8 they require the Authority to publish certain specified information (where similar information used to be published under the EU ETS) while at the same time, under Article 9, giving it the power to publish other information publication of which is essential for the effective operation of the Scheme.
- 4.23 The amendment in Article 31(1) provides for the publication of information from the Registry relating to following accounts- operator holding accounts (installations); aircraft operator holding accounts; and trading accounts.
- 4.24 Article 31(2) covers the types of information from installations and aircraft operators that must be published such as account number; open/closed status; account holder's name and address; permit number and regulator; number of free allowances allocated; annual reportable emissions;

number of allowances surrendered annually; and whether these are sufficient to cover the reportable emissions.

4.25 The amendments at Article 34 also provide for the publication of data on transfer of allowances between accounts.

4.26 The amendments caveat the publication of the above information as subject to the interests of national security (Article 10) and also protects commercially sensitive information as appropriate (Article 9 and 34(3)).

5. Consultation

5.1 A consultation, “Developing the UK Emissions Trading Scheme (UK ETS)” was held from 25 March to 12 June 2022, running for 12 weeks on the proposed amendments. It also contained other proposals not subject to this Order.

5.2 Full details of the consultation and response covering the current amendment can be found at: [Developing the UK Emissions Trading Scheme \(UK ETS\) - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets)

5.3 Another consultation targeting the relevant stakeholders was conducted in from 8th July to 24th July 2022, inviting views on the proposals to publish the compliance data from the UK ETS Registry and the government response to this consultation has been published on 31 October at : [Developing the UK Emissions Trading Scheme \(UK ETS\) - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets)

6. Regulatory Impact Assessment (RIA)

6.1 While this Order contains minor changes regulatory provisions, the amendments do not alter the policy (or its impact) in any significant way or how it is applied in a given situation. There is no or negligible costs or savings on the public, private, charity or voluntary sectors as a result of this amendment. Therefore, an RIA is not required. This is in line with the policy set out in the Welsh Ministers’ code of practice for carrying out regulatory impact assessments for subordinate legislation.

6.2 It should also be noted that the overall level of climate ambition in the UK ETS is unchanged by the proposals.

6.3 Although not required by Government policy, a regulatory impact assessment of the effect of the UK ETS on the costs of business, the voluntary sector and the public sector was produced and is available alongside the principal Order at: [The Greenhouse Gas Emissions Trading Scheme Order 2020 - Impact Assessment \(legislation.gov.uk\)](https://legislation.gov.uk/uksi/2020/1262/impact-assessment).