

Explanatory Memorandum to The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024

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

Cabinet Secretary'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 2024.

Huw Irranca Davies

Deputy First Minister and Cabinet Secretary for Climate Change and Rural Affairs

22 October 2024

PART 1

1. Description

1.1 The UK Emissions Trading Scheme (“UK 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 Wales, UK, and Scotland, and the Northern Ireland Executive, who also jointly operate the UK ETS as the UK ETS Authority (“the Authority”). It contributes to the UK’s emissions reduction targets and net zero goal, as well as the emissions reduction pathway in Wales.

1.2 In 2022, the Authority consulted on “Developing the UK Emissions Trading Scheme (UK ETS)”. The Authority Response to the consultation contained several time-critical commitments which were implemented through the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 and The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 (both GB-only) and through the UK Government legislated Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2023. These were temporary solutions required due to the absence of a sitting Northern Ireland Assembly.

1.3 The proposed amendments to be made by the Greenhouse Gas Emissions Trading Scheme (Amendment) (No.2) Order 2024 now incorporate these into the ETS legislation on a 4-nation basis. The amendments made by the Order also include similar commitments to expand the coverage of emissions and improvements to the enforcement provisions of the scheme. Some of the proposals on enforcement provisions were subjected to a targeted consultation.

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

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

3. Legislative background

3.1 Part 3 of Schedule 3 to the CCA states that an emissions trading scheme that applies to Wales, England, Scotland, and Northern Ireland – such as in this case – must be established by Order in Council.

3.2 The procedure for making such an Order in Council is prescribed by section 48 of the CCA.

3.3 The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 contains provisions which are caught by section 48(3) of the CCA. Therefore, the draft affirmative procedure applies.

3.4 The principal Order set up the UK ETS to be operational from 1 January 2021. It runs for ten years, split into two five-year “allocation periods”. The scheme works by requiring operators of energy intensive industrial installations, power generators, and aircraft operators to monitor and report on their emissions and obtain and surrender “allowances” equivalent to their greenhouse gas emissions in each scheme year. There is a cap on the number of allowances that may be created. Some participants receive an allocation of allowances free of charge to help mitigate carbon leakage¹, details of which are published in allocation tables.

3.5 There have been several amendments to the principal Order to give effect to technical changes that improve the operation of the UK ETS for both participants and regulators. These are contained in the following Orders in Council: the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020, the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021, the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022, the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022, the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022, the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023, the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023, and the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2024.

3.6 The principal Order and these amending Orders in Council were made under section 44 of the CCA. The amending Order is also being made under that power.

3.7 There have also been amendments made to the UK ETS via subordinate legislation made under the Finance Act 2020. These are contained in: the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021, the Recognised Auction Platforms and Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2021, the Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2021, the Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) (No. 2) Regulations 2021, and the Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2023.

4. Purpose and intended effect of the legislation

4.1 As the scheme matures, the Authority has been looking to improve how it functions. The 2022 “Developing the UK Emissions Trading Scheme (UK ETS)” consultation proposed several fundamental changes to the scheme,

¹ Carbon leakage is the movement of production and associated emissions from one country to another due to different levels of decarbonisation effort through carbon pricing and climate regulation.

along with amendments necessary to regularise the operation of the UK ETS moving forward.

4.2 The Authority response published in July 2023 sets out the Authority position regarding the consulted-upon amendments.

4.3 While it was the intention of the Authority to implement these changes as soon as possible, the lack of an operational Assembly in Northern Ireland resulted in a stepped approach to legislating.

4.4 Amendments deemed immediately critical to the functioning of the UKETS, during the period where the Northern Ireland Assembly was not sitting, were made as Great Britain-only legislation. These were the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 and The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023.

4.5 The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 included flights from the Great Britain to Switzerland within the scope of the UK ETS from January 2023, while the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 made changes to the use of Free Allocations (FAs) in aviation; carbon capture, transport and storage; and electricity generators.

4.6 This approach was taken with the agreement of the Permanent Secretary for Northern Ireland and with the intention of remedying it as soon as the Northern Ireland Assembly was restored. The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 (“The amending Order”) fulfils this intention.

4.7 Other critical changes were temporarily implemented via the Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2023 due to the same Northern Ireland issue. This reduced the number of allowances that can be auctioned in line with the new UK ETS cap, until the changes to the cap could be implemented via an affirmative SI under the Climate Change Act 2008 (“CCA”). The amending Order now makes those changes.

4.8 The remaining changes, set out in the Authority response to the “Developing the UK Emissions Trading Scheme”, which are due to be implemented by 2025 are legislated for in this amending Order. They sit alongside further minor amendments to civil penalties, some of which were the subject of a targeted consultation in February 2024.

4.9 Specifically, the purpose of the amending Order is to amend the principal Order and associated legislation to:

- 4.9.1 Regularise legislation providing for the UK ETS cap, resetting the amount of allowances that can be given freely for participants at risk of carbon leakage (the “industry cap”) and creating a reserve of allowances that can be used to smooth unexpected price and volume fluctuations in the market (the “flexible reserve”). These changes will align the UK ETS with the net zero ambitions of the four UK nations and enable the UK ETS market to function effectively.
- 4.9.2 Extend the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 to Northern Ireland – to implement changes to the use of FAs in aviation; carbon capture, transport and storage; and electricity generators.
- 4.9.3 Expand the scope of the UK ETS to include flights from Northern Ireland to Switzerland to restore the 4-nation approach of the UK ETS following the return of the Northern Ireland Executive and Assembly.
- 4.9.4 Expand the scope of the UK ETS to include carbon dioxide (CO₂) venting from the upstream oil and gas sector to strengthen the decarbonisation potential of the UK ETS.
- 4.9.5 Strengthen and regularise the enforcement of the UK ETS by introducing new civil penalties and an enforcement notice, amending existing penalties for better parity across the UK ETS.

4.10 The territorial extent of this Order is the whole of the United Kingdom.

4.11 The main changes are summarised below:

Changes to the principal Order

4.12 **Article 5** of the amending Order changes the meaning of flights in scope of the ETS to include flights from Northern Ireland to Switzerland. It also changes the meaning of “surrender” obligations to account for the changes brought about by the amending Order.

4.13 **Article 6** of the amending Order changes the UK ETS cap for the trading periods 2021-2025 and 2026-2030, bringing it in line with the changes already made to the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021.

4.14 **Articles 7** of the amending Order changes the formula for calculating the ceiling for allowances that may be created in a scheme year, to allow for more flexible use of allowances within the year, but prevents that ceiling from applying to various reserves that are critical for long term stability of the market, while **Article 8** amends the base cap figures to be in line with the Net Zero consistent cap.

4.15 **Article 9** of the amending Order creates the flexible reserve and provides for various purposes it can be used for, including the use as FAs for incumbent installations and for the top up of auctions. Consequential amendments are made to the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 by **Articles 40** and **41** of the amending Order.

4.16 **Article 10** removes redundant provisions relating to the surrender of allowances by aircraft operators, following the introduction of the deficit notice as described in paragraph 4.19 below.

4.17 **Article 11** – resets the number of allowances in the New Entrants Reserve following the change to the cap, and clarifies the various uses of allowances from the reserve.

4.18 **Articles 12 and 13** enable the updating of the FA tables for aviation operators after re-calculations of FAs to take into account historic aviation activity between Northern Ireland and Switzerland as explained in paragraph 4.40.

4.19 **Articles 14 and 15** introduce the deficit notice where emissions exceed allowances surrendered, requiring proper surrender to take place. **Article 15** also sets out the content and the procedures associated with the deficit notice.

4.20 **Articles 16 and 17** amend the provisions for penalty notices to allow a penalty notice to be served where a person is liable to a civil penalty for non-compliance with a deficit notice. They also streamline the provisions on timeframes relevant to the daily penalty which may form part of the civil penalty thus imposed.

4.21 **Article 18** disapplies the civil penalty provisions under Article 51 of the principal Order for hospitals and small emitters (HSEs) for exceeding emissions criteria, by reference to the newly applicable penalties prescribed at Article 57 of the principal Order.

4.22 **Article 19** removes factors which are no longer needed to be taken into account when determining the excess emissions penalty for a failure to surrender allowances, due to the introduction of the deficit notice and amends the formula for calculating the inflation factor.

4.23 **Article 20** varies the formula for calculating the civil penalty where there is a failure to transfer or surrender allowances when underreporting is discovered after transfer. This makes it consistent with the newly introduced deficit penalty.

4.24 **Article 21** amends the penalty HSEs who have under-reported their emissions, to make it more consistent and proportionate with the equivalent penalty for main scheme participants.

- 4.25 **Article 22** varies the formula for calculating the civil penalty for the scenario in which an operator of a HSE fails to notify when the HSE ceases to meet the criteria for being a HSE. This enables a consistent use of the punitive penalty element of the civil penalty.
- 4.26 **Article 23** similarly varies the calculation formula to make the penalty for under-reporting of emissions by ultra-small emitters (USEs) more proportionate to similar penalties for main scheme participants.
- 4.27 **Article 24** creates a new civil penalty for failure to submit information to regulators detailed in article 27A of the 2020 Order (where no application for FAs are made but certain information is required to be submitted)
- 4.28 **Article 25** creates a new civil penalty for failure to comply with a deficit notice, while **Article 26** deals with appeal provisions against a deficit notice.
- 4.29 **Article 27** adds flights from the UK to Switzerland to the definition of aviation activity, following the expansion of UK ETS aviation coverage to include NI to Switzerland routes.
- 4.30 **Article 28** amends the definition of “regulated activity” to include Greenhouse Gas (GHG) removal from oil and gas processing at an upstream site which results in venting of carbon dioxide (CO₂). It also sets out the various qualifying criteria associated with the definition.
- 4.31 **Article 29** amends the amendments made by the principal Order to Commission Implementing Regulation (EU) 2018/2066 (the Monitoring and Reporting Regulation 2018) as it applies in domestic law. It sets down the scope and specific monitoring rules including monitoring methodologies applicable to upstream GHG removal.
- 4.32 **Article 30** amends the amendments by the principal Order to Commission Implementing Regulation (EU) 2018/2067 (the Verification Regulation 2018) as it applies in domestic law. It includes upstream GHG removals in the scope of accreditation required for verifiers, to allow emissions for the newly included activity described in paragraph 4.30 to be verified.
- 4.33 **Article 31** amends the provisions on the UK ETS registry, consequential to the introduction of the flexible reserve and the deficit notice (as mentioned in Paragraphs 4.15 and 4.19 above).
- 4.34 **Article 32** makes changes to the provisions dealing with GHG permits, incidental to the changes made elsewhere in the amending Order such as the deficit notice.

Changes to the Commission Delegated Regulation (EU) 2019/331 (the Free Allocation Regulation, (FAR)) as it applies in domestic law

4.35 **Article 34** of the amending Order adds a definition of “upstream GHG removal” to the FAR, following the inclusion of the same in the UK ETS, described in paragraph 4.30.

4.36 **Articles 35 and 38** of the amending Order makes ancillary changes to how relevant inputs, outputs or emissions are attributed in reporting for FA purposes in the context of newly included upstream GHG removal activity.

4.37 **Article 36** amends the formula for calculating the cross-sectoral correction factors (a mechanism which uniformly reduces FA entitlements of participants if the eligibility for FAs in an allocation period exceeds the industry cap) to account for the use of flexible reserve for this purpose. It also amends the level of the industry cap.

4.38 **Article 37** excludes the newly added upstream GHG removal related venting, which is not eligible for FAs, from being treated as process emissions when determining historical activity levels in the calculation of FA eligibility.

Changes to the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021

4.39 **Articles 40 and 41** amend the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 to allow for updating of the auction volumes in the auction calendar pursuant to adjustments to the flexible share and the use of the flexible reserve for cost containment purposes.

Other changes

4.40 **Articles 42 and 43** allow corrections to FA calculations for flights from Northern Ireland to Switzerland, and also for new FA applications to be made recognising historical activity levels pursuant to the inclusion of this route in the UK ETS.

4.41 **Article 44** revokes the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 which, as a preliminary measure, included flights from GB to Switzerland. It is now redundant, as flights from the UK to Switzerland are included in the UK ETS.

4.42 **Article 45** amends the scope of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 from GB to the whole of the UK.

5. Consultation

5.1 Before making an Order in Council under section 44 of the CCA, the Welsh Ministers are required to obtain, and take into account, the advice of the Climate Change Committee (section 48(1)(a) CCA). They are also required to consult such persons affected by the draft legislation as they consider appropriate (section 48(1)(b) CCA).

5.2 A focussed consultation with relevant stakeholders was held from 23 February 2024 to 08 March 2024, given the limited scope of the change. The Authority Response to this has been shared with stakeholders on 30 September 2024. A copy is available on request.

5.3 The Climate Change Committee was consulted and has indicated that it is content for this legislation to be progressed.

6. Regulatory Impact Assessment (RIA)

6.1 While this Order contains minor changes to regulatory provisions to iron out irregularities, 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 \(legislation.gov.uk\)](#).

6.4 A further impact assessment was published alongside the Main UK ETS Authority Response to the Developing the UK ETS Consultation in June 2023, in which the UK ETS Authority announced changes to the scheme including UK ETS Cap and carbon dioxide venting legislated for by this Order. The Welsh Government Impact Assessment is available at : [UK Emissions Trading Scheme: proposed amendments: impact assessments | GOV.WALES](#)