

Explanatory Memorandum to the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023.

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) Order 2023.

Julie James
Minister for Climate Change

21 July 2023

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 further amendments made in December 2021², April 2022³, November 2022⁴ and Dec 2022⁵.

1.3 In 2022, the UK ETS Authority consulted on “Developing the UK Emissions Trading Scheme (UK ETS)” which alongside proposals for fundamental change to the scheme, also contained proposed amendments considered necessary to regularise the operation of the UK ETS moving forward. These technical amendments need to be implemented ahead of the 2024 scheme year.

1.4 The joint Government response published in July set out the UK ETS Authority position regarding the consulted-on technical amendments.

1.5 The current amending Order also includes amendments that were not specifically consulted on, since they did not trigger the requirements for consultation because they are either correcting minor omissions in the legislation or are technical clarifications that stem from matters that were already consulted on.

1.6 Overall, the current amendments cover technical changes in response to changing needs of the scheme participants ascertained via the consultation responses, as well as those identified by Regulators as needed for a more efficient and effective decarbonisation tool.

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.

⁴ The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022

⁵ The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022

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 Her Majesty (now, His Majesty) may by Order in Council make provision for trading schemes. That power may only be exercised to make an Order in Council, that extends or applies both to Scotland and to one or more of England, Wales, and Northern Ireland, as is the case with this Order.

2.2 The procedure for making regulations, which include an Order in Council is prescribed by section 48 to the CCA.

2.3 As it is not felt that the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023 contains any provisions which would be caught by section 48(3) of the CCA, the negative procedure applies to the Order.

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 (S.I. 2020/1557);

3.2.2 The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021 (S.I. 2021/1455);

3.2.3 The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022 (S.I. 2022/454);

3.2.4 The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2022 (S.I. 2022/1173) and

3.2.5 The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 (S.I. 2022/1336).

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 From “Developing the UK Emissions Trading Scheme (UK ETS)” consultation responses, as well as Regulator feedback from the operation of

the UK ETS over the past two years certain elements 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 in exercise of the power conferred by section 44 of the CCA, as well as other powers conferred by the CCA. The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023 is made in exercise of this power, together with others conferred by the CCA.

3.6 As noted above The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023 is being made subject to negative procedure.

4. Purpose and intended effect of the legislation

4.1 The purpose of the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023 is to amend the UK ETS Order and associated legislation 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 Clarify the existing legislation to improve certainty and consistency for scheme participants and Regulators

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

4.3 The main changes are summarised below:

Changes to Greenhouse Gas Emissions Trading Scheme Order-2020-Clarification on Monitoring and Reporting Regulation 2018

4.4 **Article 7** of the amending Order clarifies the link between two legislative provisions relating to the quantification of carbon dioxide transferred between installations, making for easier compliance by scheme participants.

Changes to Greenhouse Gas Emissions Trading Scheme Order 2020-New permission for Registry account authorised representatives

4.5 **Article 8** of the amending Order simplifies the process for operators to appoint authorised representatives with the permission only to surrender or return allowances from the relevant Registry account.

4.6 This amendment would help make the process of compliance much more efficient for operators.

*Changes to Greenhouse Gas Emissions Trading Scheme Order 2020-
Hospital and Small Emitters (HSE) re-entry to the scheme*

4.7 The current ETS legislation provides for a one-off window for participants in the HSE scheme to re-enter the main UK ETS scheme from 2024 onwards, recognising that the rules have changed from those of EU ETS Phase IV to the UK ETS.

4.8 However, it has been noted that if these new entrants, have not been operating throughout the baseline period (as is the case normally) Regulators would need more information on Historic Activity Levels than the current legislation provides for, in order to calculate the Free Allocation for them.

4.9 The amendment at **Article 9** requires operators to furnish extra information if the operator has not been operating for the whole baseline period.

*Changes to Greenhouse Gas Emissions Trading Scheme Order 2020-
Amendments to the Free Allocation Regulation- Putting current benchmark
values into UK law*

4.10 Benchmarks are used in the scheme to ensure those who achieve higher emissions efficiency receive more Free Allocations, thereby incentivising operators to decarbonise.

4.11 **Articles 10-14** brings EU ETS benchmarks that are adopted under EU law and made applicable in UK law by reference in the UK Free Allocation Regulation, directly into UK law (as a new Annex 8), making the scheme provisions more concise.

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

4.12 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.

4.13 **Articles 15-17** of the amending Order allow omission of the 2020 Covid year in the calculation of change in activity level in 2021, 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 2018 would be used instead.

4.14 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 and ensuring consistency in the administration of the scheme.

Changes to Article 6 (3) of Activity Level Changes Regulation

4.15 **Article 18** of the amending Order clarifies Article 6(3) of above Regulation which sets out how the energy efficiency is taken into account when adjustments to Free Allocation are made as part of the activity level change.

4.16 More specifically where there is no PRODCOM code available to attach to a product, Section B or C of Annex 1 (NACE rev. 2), which classifies by economic activities is used. This refers to an EU instrument rather than the domestic SIC codes.

Temporary amendments to benchmarks and carbon leakage list

4.17 **Article 19 (along with Articles 5 and 6)** effects a temporary change to the lime benchmark and the carbon leakage classification of malt extract production.

4.18 This is due to the evidence that the policy is not working as intended for these sectors, resulting in competitive disadvantages or unequal treatment of UK ETS participants, which needs to be redressed urgently.

4.19 The amendment means that the product benchmark for lime is increased and malt extraction is added to the Carbon Leakage List, enabling the operators to potentially have a higher number of Free Allocation.

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)

6. Regulatory Impact Assessment (RIA)

6.1 While this Order contains minor changes to 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 \(legislation.gov.uk\)](#).