

EXPLANATORY MEMORANDUM TO
THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT)
REGULATIONS 2017

2017 No. 1207

1. Introduction

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

2. Purpose of the instrument

- 2.1 These Regulations amend the Greenhouse Gas Emissions Trading Scheme Regulations 2012 (“the 2012 Regulations”), which transpose the provisions of Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community (“the EU ETS Directive”). These Regulations amend the EU Emissions Trading System (EU ETS) 2018 compliance deadlines for stationary installations and aviation operators regulated by the UK, so that they are obliged to verify and report 2018 emissions and surrender allowances for those emissions in 2019 before the date when the UK will leave the EU, 29 March 2020. Without these amendments, the compliance deadlines would fall shortly after the EU exit date.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 These Regulations are made in exercise of the powers conferred by both section 2(2) of the European Communities Act 1972 and section 2 of the Pollution Prevention and Control Act 1999. A combination of these powers is needed as section 2 of the 1999 Act is the appropriate domestic power, but does not extend to Northern Ireland. It is therefore necessary to exercise the powers in section 2(2) of the 1972 Act as well as those in section 2 of the 1999 Act.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 These Regulations are made under s2(2) European Communities Act 1972 (c.68) and section 2 and 7(9) of, and Schedule 1 to, the Pollution Prevention and Control Act 1999 (c.24).

- 4.2 These Regulations make amendments to the Greenhouse Gas Emissions Trading Scheme Regulations 2012 (S.I. 2012/3038). The 2012 Regulations have been amended by S.I. 2013/755, 2013/1037, 2013/3135, 2014/3125, 2015/933, 2015/1388 and 2015/1849.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is England, Wales, Scotland and Northern Ireland.
- 5.2 The territorial application of this instrument is England, Wales, Scotland and Northern Ireland.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

- 7.1 The EU ETS is a cap and trade scheme that limits emissions of carbon dioxide from the EU's power and heavy industrial sectors and aviation operators; there is a cap on all greenhouse gas emissions from covered operators of installations and aviation operators, and within this cap operators can buy, sell or trade allowances. The limit on the total number of allowances available ensures that they have a value. The scheme covers more than 10,000 installations across the EU, mainly large emitters such as fossil fuel power stations, steel plants and refineries. Operators of installations and aviation operators are required to monitor and report their emissions each year and to surrender EU ETS allowances against these emissions (1 allowance = 1 tonne of CO₂).
- 7.2 EU ETS compliance obligations require operators to monitor their emissions during a calendar year, and report emissions and surrender allowances for those emissions by 31 March and 30 April respectively of the following year. Allowances are issued by Member States, with a share allocated for free to participants considered at risk of "carbon leakage"¹ and the rest auctioned. Revenue from UK auctions returns to the Exchequer. HMG is due to issue approximately 150 million allowances in 2018, with approximately a third to be allocated for free participants and two-thirds auctioned.
- 7.3 In October 2017, through a negotiation on the future of aviation in the EU ETS, the European Parliament and Council agreed an amendment to the EU ETS Directive to protect the environmental integrity of the EU ETS against a UK departure from the System in March 2019. This measure was prompted by concerns among the EU institutions that, in the event of no agreed implementation period and an abrupt UK exit from the EU ETS in March 2019, there would be no requirement in EU law for UK regulated operators and aviation operators to comply with their EU ETS obligations for the 2018 calendar year (as compliance obligations will fall after EU Exit). This would mean that UK operators could sell their allowances, which would damage the environmental integrity of the system by artificially inflating the cap on greenhouse gas emissions.

¹ Where, due to the cost of emission allowances, industry relocates to regions outside the EU with a lower carbon price.

- 7.4 The amendment to the EU ETS Directive would have made UK issued 2018 allowances invalid for compliance by operators. This would have negative and disruptive effects on the carbon market by creating two tiers of allowances (UK and other) with different values and would significantly impact the UK specifically:
- EU ETS participants: installations and aircraft operators receiving free allowances expressed concern at the financial burden of not being able to use 2018 issued² allowances to meet compliance obligations for the 2017 scheme year in April 2018. UK regulated businesses are due to receive approximately 58 million free allowances in February 2018, with a current market value of approximately £400 million.
 - HMG is expected to raise about £400 million³ per annum in revenue through auctioning ETS allowances in 2018, though due to a recent rise in the EU ETS price, this figure could increase significantly.

7.5 On 24 October 2017 the European Commission proposed legislation to amend the EU ETS Registry Regulation, to implement the powers prescribed through the amendment to the EU ETS Directive. It proposed a measure to identify 2018 UK issued allowances with a country code, which would render them unusable for compliance. However, on 30 November 2017 the proposal was discussed and voted on by Member State officials at the Climate Change Committee. It was agreed that from 1 January 2018 UK issued 2018 allowances will not be identified with a country code and will be able to be used for compliance, subject to there being an obligation for UK operators to surrender allowances by the latest 15 March 2019 in a legally enforceable manner before the Treaties cease to apply, or to Union law continuing to apply after the EU Treaties cease to apply (i.e. if an implementation period is agreed). The UK will be required to report to the Commission and Member States on compliance by operators immediately after the 15 March 2019, and has committed to enforce any non-compliance with the earlier deadlines, after EU Exit.

7.6 These Regulations amend the 2012 Regulations to bring forward the 2018 deadlines to report emissions and surrender allowances for those emissions from 30 March 2019 and 30 April 2019 to 11 Mar 2019 and 15 March 2019 respectively. While the deadline to surrender allowances is a week before the proposed date of 22 March 2019 in the draft Statutory Instrument consulted upon (see below), this aligns with what has been agreed in EU legislation and will therefore avoid the damaging effects of UK allowances being identified with a country code and invalidated from 1 January 2018.

7.7 UK EU ETS participants have been asking for clarity 2018 compliance obligations during the UK's withdrawal from the EU. Amending the 2012 Regulations will also provide clarity to participants on their 2018 compliance obligations.

Consolidation

7.8 Although a number of amendments have now been made to the 2012 Regulations, the Department has not made consolidating regulations at this time, given the limited nature of these amendments, and the fact that negotiations have recently

² Free allowances are allocated in February to cover the emissions that will occur during that calendar year, though operators are able to use allowances issued in February for compliance with the previous year's emissions (e.g. allowances issued in February 2018 could be surrendered in April 2018 for compliance with 2017 emissions).

³ Economic and Fiscal Outlook (March 2017): <http://budgetresponsibility.org.uk/efo/economic-fiscal-outlook-march-2017/>

concluded on Phase IV of the EU ETS, which will lead to substantial changes to the EU ETS Directive, and therefore potentially to the UK legislation. It is therefore more appropriate for consolidated regulations to be made in respect of those more extensive amendments.

8. Consultation outcome

- 8.1 A public consultation commenced on 6 November 2017 for a three week period concluding on 24 November 2017. An invitation to respond was issued to any organisation or individual, but it was of particular interest to all UK regulated EU ETS operators with obligations to comply in the power, aviation and industrial sectors. The Department for Business, Energy & Industrial Strategy held a stakeholder consultation event and call on 17 November 2017 to discuss the consultation and listen to views on the proposal to bring forward the 2018 compliance deadlines. Sixty one stakeholders called in to the meeting and twelve attended in person.
- 8.2 There were ninety four responses to the consultation. There was near unanimous support that bringing forward the compliance deadlines is a proportionate response to an alternative of UK issued allowances being identified with a country code from 1 January 2018. A significant number of stakeholders, including organisations that verify the emissions of operators before reporting, expressed concerns that a date of 28 February 2019 to report emissions would be practically challenging to meet; there was significant support to move this deadline back to a date in March 2019. The majority of respondents agreed with the proposed surrender deadline of 22 March 2019, and to align with the objective to provide more time to report emissions, supported reducing the proposed period of three weeks between the dates to report emissions and surrender allowances. A full consultation response will be published on gov.uk after these Regulations are laid in Parliament.

9. Guidance

- 9.1 The Department for Business, Energy & Industrial Strategy will work with UK regulators and devolved administrations to communicate the changes to the 2018 compliance deadlines to stakeholders and to UK regulated operators.
- 9.2 This will include, but is not limited to, specific communications directly to each regulated operator when these Regulations are laid in Parliament and in May 2018 after their 2017 compliance obligations have been completed. Additional communications through stakeholder forums and trade associations will take place periodically. Where appropriate other communications with regulated operators and stakeholders will include information on the compliance obligations for UK operators in 2018. Many UK EU ETS operators are already aware of the likelihood of the change in compliance deadlines through the consultation and associated processes of stakeholder engagement and will have begun to consider the steps they will need to take to meet them.

10. Impact

- 10.1 HMG recognises that bringing forward the 2018 compliance deadlines may result in a small additional burden on operators and verifiers. Both groups may experience a familiarisation cost as they adapt to understand the change in compliance deadlines. Further, there may be small additional administrative costs from reallocating personnel and resources to meet the earlier deadlines. However consultation responses

did not bring to light any significant issues and we expect any impacts to be minimal, especially as there is more than a year to prepare for these changes.

- 10.2 There could also be small additional costs for UK regulators. They will be required to amend operator permits to amend the conditions referring to compliance deadlines.
- 10.3 A full regulatory impact assessment has not been produced for this instrument as no significant impact on the private or voluntary sectors is foreseen.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 For Phase III of the EU ETS, the UK has implemented a ‘Small Emitter and Hospital Opt-out Scheme’, which provides for a simplified procedure for small businesses. Installations in the opt-out scheme are required to report their emissions for a compliance year by 31 March, but there is no requirement to surrender allowances for those emissions. Therefore these Regulations do not amend the 31 March 2019 deadline for installations in the UK opt-out scheme to report their 2018 emissions.

12. Monitoring & review

- 12.1 Regulation 2 of the 2012 Regulations places an obligation on the Secretary of State to carry out a review of those Regulations, and to publish a report which must in particular: (a) set out the objectives intended to be achieved by the regulatory system established by these Regulations; (b) assess the extent to which those objectives are achieved; and (c) assess whether those objectives remain appropriate and, if so, the extent to which they could be achieved with a system that imposes less regulation.
- 12.2 The Department for Business, Energy & Industrial Strategy is planning to publish a review of the first five years of implementation of the 2012 Regulations in early 2018. These amendments to the 2012 Regulations will not form part of this review, though they may be considered as part of any future review of the Regulations.

13. Contact

- 13.1 Luke Burton at the Department for Business, Energy & Industrial Strategy can answer any queries regarding the instrument. Email: luke.burton@beis.gov.uk or telephone 0300 068 5881.