

**EXPLANATORY MEMORANDUM TO**  
**THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT)**  
**(NO. 3) REGULATIONS 2019**

**2019 No. 1440**

**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 GHG Regulations’), which transpose the provisions of Directive 2003/87/EC establishing a system for greenhouse gas emission allowance trading within the Union (“the EU ETS Directive”), to reflect changes in the EU Emissions Trading System (ETS) for the next phase of the system (Phase IV, 2021-2030) introduced by Directive 2018/410/EU.
- 2.2 The Regulations contain further amendments to the 2012 GHG Regulations to implement to the extent necessary EU Regulations that have been recently adopted in the EU ETS context and to add legislative and policy clarity in certain areas.
- 2.3 Those changes are necessary to deliver on our current legal obligations as an EU member state to transpose Directive 2018/410/EU.

**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(4) 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.

During Phase III of the EU ETS (2013-2020) the Free Allocation Decision (FAD) (Commission Decision 2011/278/EU) governed free allocation adjustments due to significant capacity changes at the installation level. In Phase IV (2021-2030) the concept of significant capacity changes will not be maintained, and free allocation adjustments will be disciplined by the Free allocation regulation (FAR) (Commission Delegated Regulation 2019/331/EU) and a Commission implementing regulation on free allocation adjustments due to activity level changes, currently being adopted at the EU level pursuing article 10a(20) of the EU ETS Directive. Pending formal adoption of the implementing regulation, reference to the FAD were not omitted throughout the 2012 GHG Regulations and further amendments in accordance with the FAR will also be required. These further changes will be reflected in the 2<sup>nd</sup> SI

planned for 2020 and ahead of the beginning of the next Phase, should the UK be in the Implementation Period.

*Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)*

- 3.2 As the instrument is subject to negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

**4. Extent and Territorial Application**

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

**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 EU ETS Directive established a system for greenhouse gas emission allowance trading within the Union. The EU ETS Directive has been transposed with the Greenhouse Gas Emissions Trading Scheme Regulations 2012 (S.I. 2012/3038).
- 6.2 As the EU ETS is moving from Phase III (2013-2020) to Phase IV (2021-2030), reforms to the EU ETS Directive for Phase IV (2021-30) were adopted with Directive 2018/410 in February 2018 and will take effect from January 2021. Member States were given 18 months to transpose these reforms and the deadline for transposition was the 9<sup>th</sup> of October 2019. The transposition of the proposed amendments in UK law has been postponed due to delays in the publication of the consultation on the future of UK carbon pricing, which contains in Chapter 4 the Government proposals should the UK participate in Phase IV of the EU ETS.
- 6.3 The legal framework for Phase IV of the EU ETS is further composed of numerous EU Regulations that have been recently adopted. Among these the Free Allocation Regulation (FAR), the Monitoring and Reporting Regulation (MRR), the Accreditation and Verification Regulation (AVR), the Registries Regulation and the Auctioning Regulation. Further discussions are planned in 2019 and 2020 for Regulations in these and other areas, including determining the details of the process by which free allocation will change to mirror changes in production of 15% or more.
- 6.4 These EU Regulations were implemented with these Regulations to the extent necessary and possible (for example the Registries Regulation entered into force only when the drafting of the present statutory instrument was almost completed). Further amendments to the 2012 GHG Regulations to implement EU tertiary legislation will be included in the 2<sup>nd</sup> SI planned for 2020, should the UK be in the Implementation Period.
- 6.5 A transposition note is attached as an Annex to this Memorandum.

## 7. Policy background

### *What is being done and why?*

- 7.1 The EU ETS is a system for carbon abatement and the system operates by putting a cap on overall emissions for specific sectors. The cap decreases gradually over time, and operators are required to decrease their emissions accordingly. It is often called a 'cap and trade mechanism' as industries can buy emission allowances (equivalent to one tonne of CO<sub>2</sub> of equivalent greenhouse gases) if they have produced more emissions than their free allocation (where a free allocation exists or to equal their emissions where it does not) or sell allowances if they have produced fewer emissions than their free allocation.
- 7.2 There are ~1100 large UK organisations that are part of the EU ETS. Certain members of the commercial and non-commercial aviation sector are also included in the system if they operate within the European Economic Area (EEA) and have recorded over a certain number of flights.
- 7.3 As the EU ETS is moving from Phase III (2013 to 2020) to Phase IV (2021 to 2030), the Commission has introduced legislative changes in the revised EU ETS Directive and EU tertiary legislation.
- 7.4 The EU ETS is transposed in the UK by the Greenhouse Gas Emissions Trading Scheme Regulations 2012.
- 7.5 These Regulations introduce amendments to the 2012 GHG Regulations to: transpose Directive 2018/410/EU, implement newly adopted EU tertiary legislation, and to clarify the policy and legislation in certain areas to reduce the administrative burden for all participants. Further details and examples for each category of amendments are provided in the paragraphs below.

### Changes to transpose Directive 2018/410/EU.

- 7.6 Many of the changes these regulations are making to the 2012 GHG Regulations are required by the revised EU ETS Directive and are non-discretionary for Member States. For example, the instrument updates several dates to prepare for Phase IV, introduces the distinction between trading periods and allocation periods, eliminates the requirement for regulators to review GHG permits every 5 years, and introduces the obligation to report on the level of compensations offered to certain sectors for the indirect costs of the EU ETS. However, there are two main areas where Member States have discretion over implementation of the revised EU ETS Directive where the UK is proposing to make changes from Phase III. These are the schemes for small emitters opt-outs outlined in Articles 27 and 27a of the revised EU ETS Directive.
- 7.7 Articles 27 and 27a of the EU ETS Directive offer Member States with the opportunity to introduce opt-out schemes for small and ultra-small emitters in order to reduce the administrative burden that the system can cause for smaller installations. Small emitters are installations that produce less than 25,000 tCO<sub>2</sub> per annum and have an installed thermal input capacity of less than 35 MW and the definition of Article 27 also covers hospitals. Ultra-small emitters are installations which produce less than 2,500 tCO<sub>2</sub> per annum.
- 7.8 The UK offered the Article 27 provision through the Small Emitter and Hospitals Opt-out Scheme in Phase III and proposes to continue to do so in Phase IV. Article 27a is a new provision for Phase IV that the UK will offer.

- 7.9 The objective in offering two types of opt-out is to increase the number of eligible Operators for the schemes, minimising the regulatory cost burdens to UK industry whilst meeting EU legislative requirements. The opt-out schemes also ensure UK industry is not placed at a competitive disadvantage as a result of the EU ETS, compared to counterparts elsewhere in the EU who are offering similar schemes.
- 7.10 The opt-out schemes do not discount industry from abating their carbon emissions or do they undermine the system's ambition. It is believed the companies are low risk and require a more hands-off approach because all the installations on the Article 27 and 27a scheme represent less than 2% and 0.1% of emissions, respectively, across the whole system.
- 7.11 The impact assessment estimates that almost all (95%) of eligible Article 27a installations will opt-out (estimated as 160 installations) and a large majority (70%) of the eligible Article 27 installations will opt out (estimated as 195 installations). Implementing the Article 27 scheme (which ran in Phase III) will provide continuity for business and implementing both the Article 27 and 27a schemes will provide an estimated net saving of £120.2 million (2019 prices) across all members of the opt-outs schemes for Phase IV (and a Total Net Present (Social) Value benefit of £164.3 million (2019 prices)).

Some amendments to GHG 2012 Regulations were introduced to implement EU tertiary legislation, in particular:

- 7.12 Domestic legislation has been updated to refer to the updated Monitoring and Reporting Regulations (MRR) and the new Accreditation and Verification Regulations (AVR).
- 7.13 Regulators (the regulatory bodies that ensure the system is running efficiently and that Operators (members of the system) are compliant) have been confirmed as the competent authorities under the Free Allocation Regulations (FAR), for each of the UK territories (i.e. the Environment Agency (EA) for England, Chief Inspector as defined by the PPC regulations for Northern Ireland, Scottish Environment Protection Agency (SEPA) for Scotland, Natural Resources Wales (NRW) for Wales and the Secretary of State for BEIS (OPRED) for offshore installations).
- 7.14 The EA has been assigned as the focal point in respect of the Accreditation and Verification Regulations (AVR). Where more than one competent authority is designated in a Member State as outlined above, the Member State is required to authorise one of those competent authorities to be the focal point for the exchange of information.

Changes to add legal and policy clarity:

- 7.15 The following amendments were not included in the impact assessment as they have no financial impact to industry. They were implemented to clarify the policy and legal framework in certain areas and reduce the administrative burden for all those involved in the system:
- 7.16 Regulators have been provided with an explicit power to redetermine their original calculation of emissions for operators and Aircraft Operators if an error is discovered. Discretionary penalties still apply as a result of under-reporting of emissions.
- 7.17 The Regulations clarify that the mandatory penalty which applies where an operator or aircraft operator has not surrendered sufficient allowances by the relevant deadline is

calculated only by reference to the emissions in the scheme years in which breaches have occurred.

- 7.18 UK legislation has been amended to fully reflect the ruling of the Court of Justice of the European Union in the case of *Bundesrepublik Deutschland v Nordzucker AG* (Case C-148/14). The amendments ensure that an operator is not subject to the full excess emissions penalty for surrendering a number of allowances equal to the verified emissions, where it is established, following an additional verification that those emissions were understated.
- 7.19 Clarification has been added to the legislation to state that emissions reported using Eurocontrol data (estimated fuel consumption based on real distance flown and estimated CO<sub>2</sub> emissions) are regarded as verified emissions.
- 7.20 The EU ETS utilises a registry. The registry is the platform used by the scheme which allows for the trading of allowances (Operators must surrender allowances to account for their carbon emissions). This SI has clarified that to become a user of the registry, applications must prove themselves that they are a “fit and proper person”. Previously this was a requirement of the Regulator to prove.
- 7.21 These proposals were consulted on in conjunction with the proposals for the potential future domestic alternatives. All amendments implemented in this SI were consulted on in Chapter 4 of the consultation. The consultation received 149 responses, including 37 from the Citizen’s Climate Lobby.

## **8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union**

- 8.1 This instrument does not relate to withdrawal from the European Union / trigger the statement requirements under the European Union (Withdrawal) Act.

## **9. Consolidation**

- 9.1 Although a number of amendments have now been made to the 2012 GHG Regulations, the Department has not made consolidating regulations at this time, given that further amendments to the 2012 GHG Regulations are expected in 2020 with a second SI implementing the remaining policy proposals contained in Chapter 4 of the Consultation document, whilst in the Implementation Period.

## **10. Consultation outcome**

- 10.1 A public consultation was issued for 10 weeks by UK Government and Devolved Administrations from 2<sup>nd</sup> May – 12<sup>th</sup> July. The consultation sought views on the future of UK carbon pricing in the UK. Four options were covered: a linked UK Emissions Trading System (linked UK ETS), a standalone UK ETS, a tax on carbon and finally, remaining in Phase IV of the EU ETS. The consultation received 149 responses. Respondents included many participants of the EU ETS from a large variety of sectors, trade associations representative of large body of industry. Finally, think tanks, academics and members of the public also responded.
- 10.2 Chapter 4 titled “Continued UK Membership of the EU ETS for Phase IV” of the public consultation relates to this SI. Chapter 4 covered the transposition of mandatory elements of the EU ETS Directive, tertiary legislation, Article 27 and 27a schemes, and further changes for Phase IV not mandated by EU legislation. The area where UKG had the most discretion was the Article 27 and 27a schemes. Respondents

were asked if they supported the continuation of the Article 27 scheme and 91% of respondents who answered that question were in favour. Respondents were asked if they supported the implementation of the Article 27a scheme and 79% of respondents who answered that question were in favour.

10.3 Finally, throughout the Chapter a majority of respondents favoured all proposals put forward.

10.4 Full details of the Government's response to Chapter 4 can be found shortly at: <https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing>

## **11. Guidance**

11.1 UK Government and Devolved Administrations will offer guidance on the Article 27 and 27a schemes. Communications have also been sent out to assist operators with their data collection exercise.

## **12. Impact**

12.1 The impact on business, charities or voluntary bodies for the Article 27 and 27a schemes is an estimated net benefit of £120.2 million (2019 prices), across all members of the opt-outs schemes for Phase IV. There is a Total Net Present (Social) Value benefit of £164.3 million (2019 prices).

12.2 The impact on the public sector is not negligible due to the administrative burden on regulators.

12.3 A full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the [legislation.gov.uk](http://legislation.gov.uk) website.

## **13. Regulating small business**

13.1 The legislation applies to small business in so far as they meet the activity or capacity thresholds for regulation under the EU ETS Directive.

13.2 To minimise the impact the approach taken is to address the disproportionate burdens of the EU ETS on small emitters by providing two opt-out schemes for small emitters and hospitals and ultra-small emitters. Article 27 and 27a of the EU ETS Directive contains provisions for Member States to choose to exclude small emitters (with annual greenhouse gas emissions of less than 25,000 tCO<sub>2</sub>eq and, where the installation undertakes combustion activities, thermal input below 35MW) and hospitals and ultra-small emitters (with annual greenhouse gas emissions of less than 2,500 tCO<sub>2</sub>eq, there is no thermal input requirement for this scheme).

13.3 The basis for the final decision on what action to take to assist small business includes both the Impact Assessment prepared for these policies and consultation with relevant stakeholders. The opt-out Schemes have been designed to meet Article 27 and 27a requirements and aim to offer a simple alternative to the EU ETS which reduces the regulatory burden on opted-out small and ultra-small emitters whilst maintaining incentives for emissions reductions.

## **14. Monitoring & review**

14.1 Regulation 2 of the 2012 GHG 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.

14.2 The Department for Business, Energy & Industrial Strategy have published a review on [legislation.gov.uk](http://legislation.gov.uk) of the first five years of implementation of the 2012 GHG Regulations in September 2019.

14.3 These amendments to the 2012 GHG Regulations will not form part of this review, though they may be considered as part of any future review of the Regulations.

## **15. Contact**

15.1 Albert Clark at the Department for Business, Energy and Industrial Strategy Telephone: 020 7215 4290 or email: [albert.clark@beis.gov.uk](mailto:albert.clark@beis.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 Kwasi Kwarteng MP, Minister of State for Business and Energy at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.