
EXPLANATORY NOTE

(This note is not part of the Order)

The United Kingdom Emissions Trading Scheme (the “UK ETS”) was established by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the “UK ETS Order”). The UK ETS runs for ten “scheme years” beginning in 2021, divided into two “allocation periods”, the 2021-2025 allocation period and the 2026-2030 allocation period. Operators of certain industrial installations and certain aircraft operators are required to monitor, report on, and surrender “allowances” equivalent to, their greenhouse gas emissions in each scheme year.

This Order amends the UK ETS Order and other legislation, largely to provide for a registry for the UK ETS and for the free allocation of allowances. The legislation amended includes Commission Delegated Regulation (EU) 2019/331 (the “Free Allocation Regulation”) and Commission Implementing Regulation (EU) 2019/1842 (the “Activity Level Changes Regulation”). Both Regulations are retained EU law, originally made for the EU Emissions Trading System (“EU ETS”), but adapted for the UK ETS.

For provision for the registry, see new Schedule 5A to the UK ETS Order; for provision for free allocation for installations, see new Part 4A of the UK ETS Order, the Free Allocation Regulation and the Activity Level Changes Regulation; and for provision for free allocation for aircraft operators, see new Part 4A of the UK ETS Order.

Registry

The Order establishes a registry for the UK ETS to record the creation, allocation (whether by free allocation or auction), transfer and surrender of allowances. Operators and aircraft operators are required to have accounts in the registry in order to comply with their obligations under the scheme. Others may apply for trading accounts for the purpose of trading in allowances.

Registry functions are exercised by the “registry administrator”, defined as the Secretary of State, the Environment Agency, the Natural Resources Body for Wales, the Scottish Environment Protection Agency and the Northern Ireland chief inspector: see new article 8A of the UK ETS Order.

Free allocation of allowances

Operators of eligible installations and eligible aircraft operators may apply for the free allocation of allowances. Decisions about free allocation are made by the Secretary of State, the Northern Ireland Department of Agriculture, Environment and Rural Affairs, the Scottish Ministers and the Welsh Ministers, referred to as the “UK ETS authority”. Allowances are allocated to successful applicants in each scheme year in an allocation period in accordance with allocation tables published by the UK ETS authority. The allowances may be traded or surrendered to comply with the scheme obligation.

For installations, the Order provides for free allocation in both allocation periods in respect of (a) “incumbent installations” - installations for which a greenhouse gas emissions permit is issued by a specified cut-off date, who apply for free allocation for all scheme years in an allocation period; and (b) “new entrants” – new installations in respect of which such a permit is issued after the cut-off date, who apply for free allocation for scheme years in an allocation period after operation starts. For the 2021-2025 allocation period, only operators of installations who applied for free allocation under the EU ETS are eligible for free allocation under the UK ETS as “incumbent installations”.

The number of allowances allocated in respect of incumbent installations is subject to an “industry cap” and may be reduced by a cross-sectoral correction factor: see new Article 16a of the Free Allocation Regulation. Allocations in respect of new entrants are reduced by an annual reduction factor over an allocation period: see new Article 18a of that Regulation. Operators of installations are required to report on their “activity level” each year, which may lead to an increase or decrease

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in the allowances allocated: see the Activity Level Changes Regulation. Allowances allocated in respect of new entrants and increases in allocations in respect of all installations come from a reserve of 30,249,066 allowances known as the “new entrants' reserve” until the reserve is exhausted: see new article 34G of the UK ETS Order.

For aircraft operators, the Order provides for free allocation in the 2021-2025 allocation period only. There is no provision for “new” aircraft operators to apply. Allocations are reduced by an annual reduction factor over the allocation period, but otherwise do not change: see new article 34M of the UK ETS Order. Only an “aircraft operator” as defined in article 6 of the UK ETS Order, that is a person who operates above a specified minimum threshold, is entitled to an allocation of allowances.

Where allowances have been over-allocated, operators and aircraft operators may be required to return them or an equivalent number may be taken directly from registry accounts: see new articles 34S to 34V of the UK ETS Order. The allocation of allowances may be withheld whilst investigation is underway into circumstances which may lead to a change in allocation: see new article 34W of the UK ETS Order. There are also some specific provisions, in article 34O, which take into account that it is not always possible to be certain whether a person will be an aircraft operator in a particular year (and so have an entitlement to free allocation) at the time allowances for that year are due to be allocated. These provide for allowances to be withheld if a person was not an aircraft operator in the previous year and for adjustments in later years where necessary. A regulatory impact assessment of the effect that the UK ETS will have on the costs of business, the voluntary sector and the public sector is available from the Industrial Energy Directorate, Department for Business, Energy and Industrial Strategy, 1 Victoria Street, London SW1H 0ET and is available alongside the UK ETS Order on www.legislation.gov.uk.

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