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**Llywodraeth Cymru**  
**Welsh Government**

Mike Hedges MS  
Chair  
Climate Change, Environment and Rural Affairs Committee

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16 September 2020

Dear Mike,

Ahead of my attendance at your committee meeting on 8 October to assist in your scrutiny of The Greenhouse Gas Emissions Trading Scheme Order 2020, I attach responses to your written questions, a summary of the Integrated Impact Assessment and the UK Emissions Trading Scheme (UK ETS) Common Framework Summary document.

The proposed UK ETS scheme delivers on our environmental ambition and leads the development of global carbon markets while providing a smooth transition and certainty to businesses and facilitating linking to the EU system. The Order is progressing well through the four UK legislatures, and has been approved by the Scottish Parliament and the House of Commons.

My officials will provide a technical overview of the UK ETS on 24 September and I look forward to discussing the Order and framework with you on 8 October.

Regards

**Lesley Griffiths AS/MS**  
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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

## **Greenhouse Gas Emissions Trading Scheme Order 2020**

### **Welsh Government responses to questions from the Climate Change, Environment and Rural Affairs Committee**

- 1. Are you content that the Welsh Government has played a full role in the development of the proposed framework? Do you have any concerns about any aspect of the proposals?**

My officials and I have been fully involved in the development of the proposed framework. At official level, there is a robust structure of governance in the form of working groups and a senior officials Board. I had the opportunity to discuss the proposals set out in the consultation document with Ministers from the other Governments before jointly agreeing the consultation text. I also agreed the final policy position, which was reflected in the joint Government response document and progressed via this draft Order.

This scheme delivers on our environmental ambition and leads the development of global carbon markets. It also provides a smooth transition and certainty to businesses and facilitates linking to the EU system.

- 2. How are Welsh interests reflected in the proposals? In particular, how do they reflect the emissions profile in Wales?**

This Welsh Government is committed to tackling climate change. In 2018, the latest year for which data is available, approximately 46% of Wales' emissions were generated by the power, industry and aviation participants in the EU ETS and so it is very much in our interest to continue efforts to decarbonise these activities.

The scheme 'cap', the number of allowances available each year in the scheme, will be reviewed in light of the anticipated advice from the UK Committee on Climate Change, which will ensure the scheme reflects the required emissions profile for Wales to meet its climate targets. I believe the scheme strikes the right balance between incentivising action to decrease emissions in high-carbon Welsh installations and maintaining an environment in which businesses can be competitive.

- 3. What is your response to the suggestion by the UK Committee on Climate Change, set out in Lord Deben's letter of 20 March, that the proposals are "inconsistent with the UK's Net Zero ambitions in some respects, primarily relating to the relatively high level of allowed emissions under the proposed cap"?**

The interim cap we are introducing for the launch of the UK ETS is already more ambitious than what it would have been if we remained in the EU ETS.

However, as stated in the joint Government response, we are fully committed to aligning the longer-term cap with all administrations' Net Zero commitments as soon as possible.

We will be able to progress with this work once we have the UK Committee on Climate Change's (CCC) full published advice in December. We will then swiftly consult on the appropriate longer-term trajectory for the cap and implement changes by January 2023, if possible, and certainly no later than January 2024.

- 4. The Committee is aware that the UK governments have responded to Lord Deben's letter, saying that "it is important to put in place a policy which provides a pragmatic and feasible approach to meeting net zero through the ETS." Do you believe that the proposed cap is set at an appropriate level?**

To reiterate my response to question 3, it is important to note this is an interim cap and a new carbon market.

The initial level of the cap enables a smooth transition for businesses, avoids market shocks and maintains business competitiveness as we deal with the economic recovery from Covid-19 and wider impacts of Brexit. It also signals the direction of travel and gives participants time to prepare for a tighter cap. A significantly tighter cap in the early years of the new market might have resulted in extremely high carbon prices in the early years and undermined the establishment of the new scheme.

- 5. In the Explanatory Memorandum (EM) accompanying the Order, you accept that "It may be necessary to adjust the cap further to ensure it is in line with our net zero ambitions. The UK Committee on Climate Change (CCC) will be providing advice on a pathway to net zero in December (2020) and we have committed to consult on any changes to the cap within 9 months and implement required changes by 1 January 2023 if possible and at the latest by 1 January 2024." Does this delay pose a risk to the likelihood the Welsh Government will meet its 2030 interim target for emissions reduction?**

No, it will not be too late to adjust. From the outset the UK ETS will show greater climate ambition than remaining in the EU ETS, with the cap initially set 5% tighter. This will immediately support compliance with our second Carbon Budget (2021-2025) and signal our intent for future revisions.

Implementing a new, net zero consistent cap by 2023 is possible but ambitious. The commitment to implement no later than 2024 is a backstop in the event we cannot progress with developing proposals, consulting, providing notice to the market and legislating as quickly as we have planned. In December, the CCC are advising on our third Carbon Budget (2026-2030) and 2030 interim target in

addition to advising on the ETS cap, therefore the statutory advice and supporting evidence on which we will take all decisions will be consistent.

**6. How will the Senedd be involved in scrutinising the effectiveness of the scheme in future? What provisions are contained within the proposals in relation to this matter?**

Clause 17 of the Order provides for two whole-system reviews. These will involve reporting on the performance of the scheme, including whether it is achieving the policy intent. Our report will be available to the Senedd to scrutinise. Any recommended major policy changes will then require consultation and legislation and I will be available to discuss these with you and take account of your input, before agreeing final proposals with the Ministers from the other Governments. Any required legislation will also be laid in all four legislatures.

**7. Clause 17 of the Order sets out a review mechanism for the ETS. This consists of the ETS Authority (one or more of the UK governments) reviewing its own scheme and making recommendations to itself. Why do you believe this is an appropriate review mechanism? How will the UK governments ensure a degree of independence in the review process?**

Before setting up a trading scheme, the Climate Change Act 2008 places a duty on national authorities to obtain, and take into account, the advice of the Committee on Climate Change, and to consult with those likely to be affected by the regulations. Each legislature will also have the opportunity to consider the published progress reports and recommendations, and any comments or recommendations you have will be taken into account. As part of reviewing the scheme, consideration will be given by the Welsh Ministers (as part of the UK ETS Authority) as to whether the UK ETS is consistent with targets and budgets set under Welsh legislation.

The Senedd has a role to play in scrutinising legislation relating to Welsh carbon budgets and targets laid under the Environment (Wales) Act 2016, which is the wider picture the UK ETS has been designed to contribute to.

**8. The Order sets out that reviews must be concluded by 31 December 2023 and 31 December 2028. Can you explain why this timeline has been chosen? Can you explain how this will complement the timelines for carbon budgeting and interim targets set out in Welsh legislation?**

The reviews need to look back at the operation and effectiveness of the scheme and to look forward at potential changes.

Given this is a new scheme, there needs to be a reasonable length of time for it to bed in before we can draw robust conclusions from any evaluation. If the review results in proposals for scheme changes, the most appropriate time to

introduce them would be at the start of the second allocation period. Developing proposals by December 2023 provides sufficient foresight of changes to the market and allows time to consult, finalise detailed proposals, draft legislation, undergo scrutiny, prepare operationally and implement changes on 1 January 2026.

The same is true for evaluating the second allocation period by 31 December 2028 to determine whether changes are necessary for the next full phase of the scheme, from 1 January 2031.

Additionally, the reviews are exactly in line with the EU ETS Phase IV reviews and the Paris Agreement Global Stocktake efforts. Aligning the review points with the EU ETS is beneficial in the event the scheme is linked to the EU system. Aligning them with the Global Stocktake dates ensures the UK ETS remains aligned with global ambitions on carbon.

Each consecutive carbon budget is set 5 years before the start of the 5 year budget period. Therefore, the 2023 review and forward looking recommendations will take account of the 2026-2030 carbon budget. Similarly, the 2028 review and recommendations will consider the 2031-2035 carbon budget.

**9. Do you have any concerns about the governance arrangements arising from the framework, including arbitration arrangements in the case of disputes?**

We are finalising the governance arrangements for the framework within the Framework Outline Agreement and Concordat. However, unlike many other emerging frameworks, the roles for Welsh Ministers are defined within the legislation. Therefore, the Concordat is in large part a means of operationalising the governance requirements.

The governance structure consists of several levels – official level working groups, the senior Official level Board, then Ministerial level quadrilaterals. The final step, should Ministers fail to agree, would be escalation to the JMC[EN].

However, we are also required to seek advice from the CCC ahead of legislating for trading schemes and, therefore, we will all receive the same independent evidence to support our decisions. Based on this, and the statutory emissions reduction targets we all need to work to, I would anticipate us being closely aligned in our thinking and unlikely to resort to dispute resolution.

**10. The response of the four governments to the consultation on the proposed UK ETS said that “55 respondents indicated that they had a UK-wide interest in the operation of the system, whereas 19 indicated England, 8 indicated Scotland, 6 indicated Wales and 2 indicated Northern Ireland. Note that respondents were able to select multiple locations.” In the EM accompanying the Order, you also referred to two stakeholder events**

**“held in Wales to gather views of interested parties including potential scheme participants.” Are you satisfied that Welsh businesses and stakeholders have been consulted sufficiently?**

I’m satisfied we gave interested parties a good opportunity to comment, including issuing alerts on the consultation and invites to our virtual events through NRW’s contact list to all scheme participants in Wales. In reality, many operators choose to issue responses through their trade bodies or other industry representatives.

Given the nature of the scheme, many participants have multiple installations across the UK. It is, therefore, unsurprising only to receive 6 responses from those located only in Wales.

- 11. The EM says that the ETS scheme will incur staffing costs for Natural Resources Wales. However, “it is not anticipated the scheme will result in any additional staff costs compared to” remaining in the EU ETS. Can you confirm that you are satisfied that NRW has sufficient resources to undertake its work as a regulator of the UK ETS in Wales?**

The role of NRW as environmental regulator of the UK ETS is comparable to the role it currently performs under the EU system. Therefore, on the basis the scope will be maintained in the early years, I am confident NRW has sufficient resources. In future, if the scope were to be expanded and significantly more installations or operators came under the scheme, staff resources would be reviewed.

In terms of funding this activity, the regulators charge participants to undertake their regulatory activities and, consequently, NRW would have the facility to cover any future increases in cost.

- 12. In the EM, you explain that, currently, funds generated by the EU ETS scheme are “not hypothecated but contribute to general Treasury coffers”. You go on to say that “an alternative approach the Welsh Government supports for is the establishment of an industrial decarbonisation fund to recycle auction receipts into funding packages for deep decarbonisation of our industries.” Can you confirm whether funds generated by the proposed UK ETS scheme will continue to be returned to the treasury? Can you explain the status of your proposed “alternative approach” for an industrial decarbonisation fund?**

I put forward my strong preference for a fund during Ministerial discussions in the Spring and would expect further discussions with UK Ministers on this aspect over the coming months. The decision on a fund is wrapped up in much wider considerations around the costs of the transition to net zero and has not yet been finalised. I am encouraged the UK Government is open to establishing a

Ministerial forum to discuss policies for net zero and would expect funding options to feature in those discussions.

- 13. The UK Government has undertaken an impact assessment for the Order. The assessment does not consider certain issues that are specific to Wales, such as the impact of the proposals on the Welsh language or an assessment of the measure against the wellbeing goals. Are you content with the impact assessment that has been undertaken?**

The impact assessment was undertaken by BEIS analysts on behalf of the UK scheme and I agreed to its content ahead of publication. An integrated impact assessment was also conducted by my officials and I attach the summary for your information.

- 14. Will the proposed framework have any impact on existing or planned Welsh legislation and/or policies?**

The ETS scheme framework doesn't require changes to any other Welsh legislation. However, it is one of a suite of policies to support industrial decarbonisation and our move away from fossil fuelled power generation. We will consider the scope and impact of the UK ETS when developing future policies in this area.

- 15. In your letter, you refer to a second, more technical Order that is due later this year. Can you clarify when the Committee can expect to see this Order, what it will cover, and the extent to which the Senedd will have an opportunity to scrutinise it?**

We are finalising an Order which will be made using the negative procedure. This will deal with the allocation of free allowances and matters concerning the registry of allowances. Subject to the Order currently laid being approved by the Senedd and other legislatures, we are planning to take both Orders to the Privy Council meeting in November before laying the second Order in each of the UK legislatures for scrutiny.

# UK EMISSIONS TRADING SCHEME

## Welsh Government Integrated Impact Assessment – Summary

Copies of the full assessments are available upon request

### WHAT ACTION IS THE WELSH GOVERNMENT CONSIDERING AND WHY?

The proposed UK Emissions Trading Scheme (UK ETS) policy framework and associated legislation will establish a UK-wide carbon market, to encourage cost-effective emissions reductions from the power, industrial and aviation sectors. This is a policy replacement for the UK's participation in the EU Emissions Trading System (EU ETS), which will cease at the end of the Brexit Transition Period. The proposed UK scheme also allows for a potential link between a UK ETS and the EU ETS in due course, subject to negotiation between the UK Government and the EU.

Emissions trading systems ensure the 'polluter pays' principle is adopted by deploying a 'cap and trade' mechanism, where a cap is set on the total amount of certain greenhouse gases that can be emitted by installations and flights covered by the system. Within the cap, participants receive or buy emission allowances which they can trade with one another as needed. This cap is reduced over time, so that total emissions fall.

The proposed UK ETS sets out the scope of participants, the environmental ambition as indicated by the cap and trajectory of allowances, requirements for monitoring, reporting and verification, charging, compliance and enforcement, penalties and appeals, and scheme reviews.

#### **Long Term, Prevention and Integration**

Climate change is a serious and global threat to the wellbeing of current and future generations. The associated environmental, ecological, economic, health and social impacts are well documented. The current EU ETS participants within Wales account for around 46% of Wales' total emissions. Hence this policy is a crucial part of the Welsh Government's efforts to achieve its climate change ambitions and statutory targets.

The first phase of the UK ETS is set for 10 years from 1 January 2021 to 31 December 2030. This provides long term certainty for scheme participants, supporting informed investment decisions.

#### **Collaboration and Involvement**

The development and future governance of the proposed UK ETS are being managed through a collaborative 'Common Framework' approach between all four governments across the UK nations and their regulators.



The proposed UK ETS will decarbonise those sectors of our economy responsible for the greatest carbon emissions. The four governments must ensure this is achieved in a way which retains and strengthens industry in the UK and does not simply result in industry facing insurmountable economic headwinds. The scheme seeks to avoid the risk of closures and associated regional economic shocks, as well as the risk of 'offshoring' emissions.

Working with the industries targeted by the policy is crucial. A 10 week consultation ran from 2 May 2019 to 12 July 2019, setting out the preferred approach to UK carbon pricing and seeking views on the design of a future scheme. In addition to UK Government run events, two stakeholder events were held in Wales – one in Swansea and one in Llandudno.

Following publication of the Government response and further to a UK wide event, a Wales event with industrial stakeholders was held on 16 June 2020 to discuss the results of the consultation.

The joint government response to the consultation, which includes a summary of the consultation responses, is available at <https://gov.wales/future-uk-carbon-pricing> .

Stakeholder engagement between policy teams, regulators and future scheme participants is ongoing. On a practical basis, this includes stakeholder testing of the new IT systems, support to ensure the required registrations and permits are in place and assistance to ensure a smooth transition from the EU ETS to the UK ETS. Additionally, we will be seeking stakeholder input into future ad hoc and whole system reviews of the scheme.

## **Impact**

The Welsh Government's Explanatory Memorandum to The Greenhouse Gas Emissions Trading Scheme Order 2020 includes a Regulatory Impact Assessment on the proposed UK ETS. Overall, the analysis concludes that a standalone UK ETS design would be expected to deliver significant decarbonisation benefits, with minimal impacts upon industry and business competitiveness when compared with continued participation in the EU ETS. A linked scheme could provide a wider carbon market, which would be likely to result in reduced costs for businesses.

A number of reviews of the UK ETS will be conducted following the launch of the scheme. The aim of the reviews will be to ensure the UK ETS continues to be fit for purpose and meet its policy objectives.

## **Costs and Savings**

The main additional costs of the UK ETS, compared with the current EU ETS arrangements, are the administrative costs to Government in setting up the UK ETS (in particular the IT systems), the cost of amending or issuing permits, and additional resource costs to scheme participants due to the risks of higher carbon costs under the standalone UK ETS.

The IT systems being developed for the UK ETS are a registry to hold emissions allowances and a system for permitting, monitoring, reporting and verification (PMRV). Both systems will replace

the corresponding EU systems which the UK currently access. The estimated costs are £3.45 million for the registry and £3.25 million for the PMRV system. There will be additional costs in the event of a linking agreement, to facilitate interaction with the EU systems. The majority of the cost for both systems is funded through the UK Government's EU exit funding pot. However, from 2021/22 it is anticipated the Welsh Government will contribute to the PMRV development costs, and future enhancements of both systems. An estimate of costs for 2021/22 is £80,000 - £120,000. Thereafter, costs are projected to be significantly lower.

Mechanisms have been introduced into the scheme to manage extremes of carbon prices, ensuring the incentive to decarbonise remains while protecting businesses against extremely high costs. This includes an auction reserve price (ARP) of £15 per allowance. Additionally, free allowances are allocated to some industrial installations to ensure they remain globally competitive.

The degree to which these costs are significant to individual businesses will depend on a wide range of factors and will vary depending on the characteristics of the business affected and the amount of free allocation that they receive. However, higher carbon costs in the short term could also increase the sustainability of our industrial base through an increased incentive for more innovation and investment in low-carbon technologies, which will improve their long-term competitiveness.

## CONCLUSION

### **How have people most likely to be affected by the proposal been involved in developing it?**

The proposed UK ETS applies directly to particular energy intensive installations and sectors of industry. There are no anticipated significant impacts upon individuals or particular groups of people.

The development and future governance of the proposed UK ETS are being managed through a collaborative 'Common Framework' approach between all four governments across the UK. The environmental regulators and those who will be responsible for managing the IT systems are also collaborating on the scheme design, bringing with them valuable experience of working within the EU ETS regime.

Industry stakeholders have been, and will continue to be, consulted on the development and operation of the scheme. A 10 week consultation ran from 2 May 2019 to 12 July 2019, setting out the preferred approach to UK carbon pricing and seeking views on the design of a future scheme. This included stakeholder events held in Wales.

The UK ETS has no direct links with the Welsh Government's Cymraeg 2050 strategy but Welsh Language provisions are included in all stakeholder engagement and communications, in compliance with the Welsh Government's Welsh language Standards.

### **What are the most significant impacts, positive and negative?**

The main (beneficial) impact of the proposed UK ETS will be to reduce emissions from particular energy intensive installations and sectors of industry. The ‘traded sector’ to which this carbon-trading scheme applies accounts for around 46% of Wales’ total carbon emissions. As such, the benefits of the scheme will be highly significant in meeting Wales’ overall emissions reduction targets. The design of the scheme provides for maximum overall emissions reduction while minimising impacts upon business competitiveness as far as possible. Furthermore, it seeks to avoid undue shock to scheme participants by maintaining arrangements that are as close as possible to the existing EU ETS arrangements (which the UK will be leaving at the end of the Brexit Transition Period), and through specific pricing control mechanisms built into the scheme.

The potential long-term impacts of climate change are far-reaching and highly significant. The UK ETS will contribute to minimising the associated long-term impacts on climate, natural resources and society.

No significant negative impacts have been identified. There may be marginal additional costs to business compared to the counterfactual, remaining in the EU ETS.

### **In light of the impacts identified, how will the proposal:**

- **maximise contribution to our well-being objectives and the seven well-being goals; and/or,**
- **avoid, reduce or mitigate any negative impacts?**

The UK ETS is designed to provide a replacement for the EU ETS. It will play a significant part in meeting Wales’ emissions reduction targets. In so doing, it will be contributing to the Wellbeing of Future Generations in the following ways:

- A prosperous Wales – ensuring a low carbon society which recognises the limits of the global environment and therefore uses resources efficiently and proportionately (including acting on climate change). This includes developing frameworks which both incentivise decarbonisation, but do so in a way which strengthens industry in Wales and protects employment.
- A resilient Wales – Limiting additional impacts upon biodiversity and the natural environment associated with long-term emissions.
- A healthier Wales – Avoiding the impacts of climate change upon health and wellbeing.
- A more equal Wales – Avoiding wider, secondary, impacts of climate change upon society.

Climate change has been shown to impact disproportionately on disadvantaged sections of society. The contributions this scheme makes to decarbonising Wales will ensure these

impacts are not exacerbated further. The scheme will also compliment work done elsewhere to create equality in Wales by protecting jobs

- A Wales of cohesive communities – Supporting local economies and communities by providing a sustainable approach towards decarbonisation of industry and supply chains.
- A globally responsible Wales – Contributing to global emissions reduction, policy designed to protect against offshoring of emissions.
- A Wales of vibrant culture and thriving Welsh language – all stakeholder engagement to follow Welsh Language policy guidelines by ensuring the sustainability of natural resources within our communities and living environments this proposal indirectly also support the sustainability of Welsh speaking communities.

**How will the impact of the proposal be monitored and evaluated as it progresses and when it concludes?**

The Greenhouse Gas Emissions Trading Scheme Order 2020 specifies two major, whole system reviews during the 10 year phase. An initial review of the UK ETS to be conducted from 2023 to assess whole system performance during the first half of the phase (2021-2025) with any necessary changes to design features implemented by 2026; a full review from 2028 onwards to assess whole system performance across all of Phase I (2021-2030) with any update to the UK ETS rules implemented for 2031 (Phase II). These reviews are aligned with the EU ETS Phase IV reviews and Paris Agreement Global Stocktake efforts.

# **UK ETS Common Framework**

## **Summary document**

### **Policy Background**

The UK currently participates in the EU Emissions Trading System (EU ETS), which is the world's largest trading system for greenhouse gas (GHG) emissions. Emissions trading schemes work on the 'cap and trade' principle, where a cap is set on the total amount of certain GHGs that can be emitted by participating installations and aircraft. Within the limits of this cap, participants receive or buy allowances equivalent to their own emissions, which they can trade with one another as needed. The overall cap is reduced over time, so that total emissions fall.

At the end of the Transition Period (on 31st December 2020), the UK will cease to participate in the EU ETS.<sup>1</sup> A replacement carbon pricing policy is required to stimulate emissions reduction from large UK emitters within the industrial, power and aviation sectors currently participating in the EU ETS.

In 2019, the UK Government and devolved administrations (DAs) undertook a public consultation seeking views on the UK's future carbon pricing policy. This consultation set out policy positions for a UK-wide Emissions Trading System (UK ETS), whilst noting that fall-back options included a carbon emissions tax, or remaining in Phase IV of the EU ETS.

The four Governments are open to considering a link between a future UK ETS and the EU ETS, if such a linking agreement is in both sides' interests and recognises both parties as sovereign equals with our own domestic laws. A link between the UK and EU trading schemes could help to establish a much larger carbon market, which could increase opportunities for emissions reduction and cost-efficiency of emissions trading.

### **Rationale for seeking Common Framework**

The UK Government and the DAs are committed to carbon pricing as an effective emissions reduction tool. Placing a price on carbon creates the incentive for emissions to be reduced in a cost effective and technology-neutral way, while mobilising the private sector to invest in emissions reduction technologies and measures.

Climate policy, including the establishment of emissions trading systems, falls within devolved competence. However, the UK Government and DAs have agreed to jointly introduce secondary legislation to establish a single, UK-wide ETS with a common set of rules for participants. There are several benefits of such an approach (as opposed to separate systems in the four UK nations):

- A UK-wide system will create a larger carbon market, with greater liquidity, and a consistent carbon price across the UK.

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<sup>1</sup> By virtue of Article 9, Annex 4 of the Ireland / Northern Ireland Protocol, NI electricity generators will continue to participate in Phase IV of the EU ETS to ensure a common carbon price on the island of Ireland to maintain the SEM (Single Electricity Market)

- Access to a larger carbon market increases opportunity for emissions reduction and the cost effectiveness of emissions trading.
- A common, UK-wide approach to carbon pricing avoids ‘carbon leakage’<sup>2</sup>, which could have a negative effect on the contribution of the policy to reduce emissions in line with international obligations, and the UK’s pathway towards our net zero target.

The UK ETS is designed to operate on a UK-wide basis, and therefore the rules for operators need to apply consistently across the UK to ensure the integrity of the system.

Nonetheless, any proposals for policy divergence between administrations will be considered by the four administrations jointly, using the agreed governance process that will be established in the UK ETS concordat. Any areas in which divergence is proposed will be considered by all parties to the concordat considering any potential impact on the functioning of the UK Internal Market, in line with the Common frameworks principles agreed at JMC(EN).<sup>3</sup>

### **Stakeholder engagement**

Between May and July 2019, the UK Government and DAs jointly consulted on the future of carbon pricing in the UK after EU Exit, setting out policy proposals for a UK-wide ETS which would be operational from 1<sup>st</sup> January 2021. The consultation received over 130 responses, from a range of stakeholders across the UK including current EU ETS participants and NGOs, with the majority of respondents to each question supporting the proposal being put forward.

As part of this consultation, UKG and the DAs ran stakeholder events across England, Wales, Scotland and Northern Ireland. Views from all stakeholders on proposals for a UK-wide ETS were taken into account when considering the final policy design.

The joint Government Response to the consultation was published on 1<sup>st</sup> June 2020 and can be accessed here: <https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing>

### **Approach to framework**

The UK ETS will be established using secondary legislation made using existing primary powers under the Climate Change Act 2008 (the CCA), and through the Finance Act 2020. A non-legislative agreement (concordat) will set out the principles underpinning the ongoing oversight and governance of the system by Officials and Ministers from the four administrations, including decision-making and dispute resolution processes. These elements are explained in more detail below.

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<sup>2</sup> Carbon leakage occurs when businesses transfer production to other countries with less stringent emissions constraints

<sup>3</sup> The JMC(EN) principles can be found here: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/652285/Joint\\_Ministerial\\_Committee\\_communique.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652285/Joint_Ministerial_Committee_communique.pdf)

## **Legislation**

UK ETS legislation comprises:

- *The Greenhouse Gas Emissions Trading Scheme Order 2020*: an affirmative procedure Order in Council under the **CCA** to set up a UK-wide ETS which will be operational from 2021. Key provisions included in this instrument cover the scope of the system, monitoring and reporting requirements, the cap and trajectory and the roles of the regulators in monitoring and enforcing the rules of the system. This Order was laid in the UK and Devolved Parliaments in July and is expected to be in force by the end of the Transition Period in all four nations.
- *The Greenhouse Gas Emissions Trading Scheme Order (Amendment) 2020*: a negative procedure Order in Council under the Climate Change Act which will amend the affirmative procedure instrument once made to include provisions for free allocation and the UK ETS registry. This Order is due to be laid in the UK and devolved Parliaments in November.
- A charging clause to be taken in the *Finance Act 2020*, to provide for the UK Government to charge participants for emissions allowances at auction.
- An affirmative procedure statutory instrument to be introduced under the Finance Act 2020 to establish rules for the auctioning of emissions allowances and mechanisms to support market stability. This instrument is expected to be laid in the UK Parliament in November.
- Additionally, the *Recognised Auction Platforms (Amendment) Regulations 2020* will be laid in draft before both the Commons and the Lords. This SI will set out the regulations for the trading of emissions allowances in the UK Emissions Trading System (ETS), including establishing the rules for access to the auction platform and rules for the relevant disclosures. It will enshrine an oversight role for the Financial Conduct Authority (FCA) such that the FCA can monitor the auctioning process and secondary market trading to prevent market abuse and ensure the effectiveness of the system. This SI will ensure that UK emissions allowances are subject to the relevant regulatory oversight and treatment as Financial Instruments.

## **UKG/DA governance concordat**

The UK Government and DAs have together developed UK ETS governance principles and arrangements over the past two years, including processes for decision-making and dispute resolution. A non-legislative agreement in the form of a concordat will set out governance arrangements for the UK ETS, including processes for making decisions and resolving disputes under the system.

Governance processes shall be set out in more detail in the UK ETS Framework Outline Agreement (FOA), and in the resulting concordat. Key governance principles, which UK Government (BEIS, HMT and DfT) and the DAs have agreed to adhere to, are set out below:

- Proposals relating to all areas of UK ETS policy should be considered using the joint governance process.
- The four administrations are committed to, wherever possible, taking decisions jointly. Where the four administrations agree that an individual administration holds exclusive competence over a particular matter, that administration will not exercise that competence to take a decision unilaterally without first having discussed it with all other administrations.
- All four administrations will endeavour to ensure market and legislative stability throughout the agreed ETS phases. The UKG and DAs should adhere to planned review points and ensure that significant legislative and policy changes are aligned with these planned review points.
- The four administrations are committed to seeking advice from their statutory advisors, the Committee on Climate Change prior to laying legislation.
- Working groups for discussion of policy decisions and system interventions under the UK ETS should include representation from BEIS, the DAs, HMT, DfT (where appropriate) and the environmental regulators (where appropriate).
- At ministerial level, BEIS and DA Ministers (and DfT Ministers, where appropriate) will be sighted and engaged in discussions where a policy decision relating to elements of the policy set out under the Finance Act is being considered. A ministerial level discussion should constitute a two-way exchange, with BEIS and DA Ministers allowed sufficient time to consider the decision and raise challenges. Responsibility for final sign-off of decisions relating to the elements of a UK-wide emissions trading system set out in Finance Act provisions will lie with the Chancellor (HMT). Before final sign-off, HMT Ministers should respond to challenges raised and provide justification for decisions reached. Should a UKG or DA Minister dispute a decision in a reserved policy area, this can be escalated to the JMC Secretariat.
- As the UK Government department responsible for aviation policy, DfT should have the option to attend all Official and Senior level groups given the potential impact of decisions made under a UK ETS on aviation. Agreement from DfT ministers must be gained before agreeing a UK Government policy position focused on aviation under a UK ETS.
- For the most effective use of the governance structure, and ultimately the operation of the system, proposals should be discussed and, where possible, a recommendation agreed at Official Level working groups.
- For all proposals, the UK Government and DAs should seek to obtain appropriate and relevant evidence to support recommendations reached. Any relevant evidence obtained must be taken into account in reaching a recommendation.
- In all decision-making, the parties to the framework will adhere to the common framework principles agreed at JMC (EN) in October 2017.



## **Process for completion**

### ***Legislation***

<b>UK ETS Legislation</b>		
<b>Instrument</b>	<b>Laying date</b>	<b>In force date</b>
The Greenhouse Gas Emissions Trading Scheme Order 2020	13 <sup>th</sup> July (UK Parliament, Scottish Parliament), w/c 15 <sup>th</sup> July, (Welsh Parliament) 15 <sup>th</sup> July (NI Assembly)	Mid-November
The Greenhouse Gas Emissions Trading Scheme Order (Amendment) 2020	Mid-November	Mid-November
Finance Act 2020 (charging clause)	17 <sup>th</sup> March 2020	22 <sup>nd</sup> July 2020 (Royal Assent)
Auctioning and market stability mechanisms SI	October/November 2020 (TBC)	December 2020 – January 2021
Recognised Auction Platforms (Amendment) Regulations 2020	TBC	TBC

### ***Framework Outline Agreement (FOA)***

The UK ETS FOA will set out, in more detail, our approach to the common framework and proposed decision-making and dispute resolution processes. It has been used as a policy development tool.

The UK ETS FOA shall be cleared by UK Government and DA Ministers and will be presented to the UK and Devolved Parliaments alongside the concordat.

### ***Governance concordat***

Following JMC(EN) clearance of the provisional framework, the FOA and concordat will become available for parliamentary scrutiny. We expect that the FOA and concordat will be available for scrutiny in late October/early November.