EXPLANATORY MEMORANDUM TO

THE CARBON DIOXIDE TRANSPORT AND STORAGE (DETERMINATION OF TURNOVER FOR PENALTIES) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by the Department for Energy Security and Net Zero and is laid before Parliament by Command of His Majesty.

2. Declaration

2.1 Sarah Jones, Minister of State for Energy Security and Net Zero, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standards.

2.2 Matthew Taylor, Deputy Director for Carbon Dioxide Transport and Storage Policy, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Jasline Bagga at the Department for Energy Security and Net Zero (jasline.bagga@energysecurity.gov.uk) can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 These regulations are made using the powers at Schedule 3 of the Energy Act 2023 ("the Act") that enables the economic regulator – the Gas and Electricity Markets Authority (GEMA) - to enforce licence conditions on licence holders and to take appropriate action in response to licence breaches. Paragraph 4 of Schedule 3 establishes the power for the economic regulator to impose financial penalties on licence holders. Paragraph 10 of Schedule 3 sets a limit of 10% of the licence holder's turnover as the maximum amount of penalty that may be imposed and enables the Secretary of State to make regulations on how a person's turnover is to be determined for the purposes of the financial penalty.

Where does the legislation extend to, and apply?

4.2 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is England and Wales, Scotland, and Northern Ireland.

4.3 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the 'United Kingdom'. The activities of a carbon dioxide transport and storage company may take place in the United Kingdom, in, above or below the territorial sea adjacent to the United Kingdom, or waters in a Gas Importation and Storage Zone (within the meaning given by Section 1 of the Energy Act 2008).

5. Policy Context

What is being done and why?

5.1 Carbon capture and storage is the process of capturing carbon dioxide (CO_2) and permanently storing it, deep underground where it cannot enter the atmosphere. Carbon dioxide transport and storage (T&S) networks will act as the enabling infrastructure for carbon capture from a range of sources, including power plants, industrial facilities, low carbon hydrogen production, and potentially direct air capture.

5.2 Carbon capture, usage and storage (CCUS) has a key role in helping to meet the UK's legally binding commitment to reduce greenhouse gas emissions to net zero by 2050. As CCUS will also provide flexible energy deployment across power, it has the potential to strengthen our energy security and reduce reliance on unabated fossil fuels, as well as enabling greenhouse gas removals.

5.3 To deliver CCUS within the UK, CO_2 T&S networks will be required to transport CO_2 from carbon capture equipped clusters across the UK's industrial regions, through pipeline, to be permanently stored in sub-surface storage sites (such as depleted oil and gas fields).

5.4 The initial T&S networks have potential monopolistic characteristics, due to the high barriers to entry, such as startup and development costs and that because users of those networks have no alternative option from whom to seek carbon dioxide transport and storage services. Given the risk of a monopoly forming, the existence of a financial penalties regime will help prevent abuse of market power providing benefits to network users and consumers.

5.5 The Energy Act 2023 provides powers for GEMA to regulate T&S Companies (T&SCos) in each T&S network, and the ability to take appropriate action in response to contraventions of economic licence conditions. This includes the power to impose financial penalties on economic licence holders.

5.6 This instrument supports Government's ambitions for the deployment of CCUS in the UK.

What was the previous policy, how is this different?

5.7 This is the first time the UK Government has introduced regulations to determine a T&S licence holder's turnover for the purposes of a calculating the maximum financial penalty that can be imposed by GEMA. Therefore, there is no previous policy.

6. Legislative and Legal Context

How has the law changed?

6.1 Part 1 of the Act makes provision for the implementation of the CO_2 T&S economic licence. This economic licensing framework will help to overcome market barriers to private investment in establishing and scaling-up first-of-a-kind CO_2 T&S infrastructure. Independent economic regulatory oversight is designed to protect network users from anti-competitive behaviour including monopolistic pricing. Even if network users are not taxpayer or consumer funded — either because over time network users do not need public funding or because an initial user's contract term has expired, and they are still connected to the network — users may still be exposed to

the risk of monopolistic pricing and so the economic regulation enabled by the Act remains appropriate.

6.2 The Act establishes GEMA as the economic regulator of CO_2 T&S, and Section 1 of the Act sets out the general duties and principal objectives of the Secretary of State and the economic regulator in carrying out their respective functions. Section 32 sets out that Schedule 3 makes provision for the enforcement of conditions of economic licences and of other requirements imposed on economic licence holders by or under Part 1 of the Act.

6.3 Paragraph 4 of Schedule 3 to the Act provides that where the economic regulator is satisfied that a licence holder has contravened or is contravening any relevant condition or requirement, the economic regulator may impose on the licence holder a penalty of such amount as is reasonable in all the circumstances of the case. Paragraph 10(1) of Schedule 3 to the Act provides that such a penalty may not exceed 10 per cent of the licence holder's turnover. Paragraph 10(2) enables the Secretary of State to make regulations to set out how a person's turnover is to be determined for the purposes of such a financial penalty. This instrument defines the activities to which the turnover is related, and the accounting basis for calculating this turnover which is capped at 10 per cent of the licence holder's turnover.

6.4 This instrument makes provision which relates to a new regime in relation to a new activity which has not been regulated in this way before. There is therefore no direct comparison with the status quo, but all potential market actors have for some time been aware of the existence of this new regime. Therefore, it is appropriate for the regulations to be brought into force on the day after the day on which they are made.

Why was this approach taken to change the law?

6.5 The Energy Act 2023 introduced a new regime for licensing of carbon dioxide transport and storage. Central to this new regime is ability of the economic regulator (GEMA) to enforce compliance with licence conditions and take appropriate action in response to contraventions of those licence conditions, which includes the power to impose financial penalties on licenced operators (T&SCos). This is the first set of Regulations using the enabling powers under Schedule 3 paragraph 10 of the Act. For the economic regulator to determine company turnover for the purpose of imposing financial penalties, this instrument defines the activities to which turnover is related, and the accounting basis for calculating this turnover. This would allow the economic regulator to meet their legal obligations associated with regulating the energy market. As a result, consumers and businesses would both benefit.

6.6 This instrument provides necessary legislative certainty for the new regulatory regime.

7. Consultation

Summary of consultation outcome and methodology

7.1 A Government consultation on "the Duties and Functions of an Economic Regulator for Carbon Dioxide Transport and Storage", published in August 2021, set out proposals to provide enforcement powers to the economic regulator for breaches of licence conditions, including the ability of the economic regulator to impose financial penalties. The response to the consultation was published in January 2022.

7.2 The consultation, and the response to the consultation, are published on gov.uk at: https://www.gov.uk/government/consultations/carbon-capture-usage-and-storage-

ccus-duties-and-functions-of-an-economic-economic regulator-for-co2-transport-and-storage.

7.3 The Department has also engaged with stakeholders as part of the development of this instrument.

8. Applicable Guidance

8.1 There is no guidance requirement for the Department. Under paragraph 5 of Schedule 3 of the Energy Act 2023, GEMA is required to publish (and consult upon, as it considers appropriate) a Statement of Policy with respect to the imposition of penalties and the determination of their amount setting out its approach to decide whether to impose a financial penalty and determining the amount of any penalty. A consultation by GEMA on its proposed Statement of Policy was carried out between 22 May 2024 and 3 July 2024. This was published on the Ofgem website at: https://www.ofgem.gov.uk/consultation/consultation-co2-transport-and-storage-enforcement-guidelines-and-penalty-policy

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A full Impact Assessment has not been prepared for this instrument because the Department found the drafted regulations to fall below the threshold for producing one.

Impact on businesses, charities and voluntary bodies

9.2 The impact on businesses, charities and voluntary bodies is deemed to be minimal. It can be said with confidence that the administrative costs associated with this measure are expected to be below £1m. The figure is of course dependant on enforcement action and T&SCo behaviour therefore, it is only possible to provide an indication, rather than an absolute figure. This measure does not carry a direct cost to business. Whilst T&SCos could be subject to a financial penalty if they are found to contravene T&S licence conditions, this "cost" is entirely dependent on their behaviour, rather than the direct implementation of this instrument. The economic regulator will determine the amount of penalty which must be reasonable in the particular circumstances and will be subject to representations made by licence holders.

9.3 The instrument does not have a significant impact on small or micro businesses as T&SCo and parent company licence holders do not meet the threshold for being small and micro businesses. Therefore, a Small and Micro Business Assessment has not been carried out.

9.4 There is no, or no significant, impact on the public sector because penalties will be recovered from T&SCos.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation will be through the ongoing development of the carbon dioxide transport and storage business model.

10.2 The instrument does not include a statutory review clause, in line with section 28 of the Small Business, Enterprise and Employment Act 2015, Sarah Jones, Minister of

State for Energy Security and Net Zero, at the Department for Energy Security and Net Zero, has made the following statement:

"It would not be appropriate in the circumstances to make provision for a review as a review would be disproportionate taking into account that the direction making powers and enforcement action are expected to be used only as a last resort and are expected to have an annual net impact of less than £5 million."

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 Rt Hon Edward Miliband, Secretary of State for Energy Security and Net Zero, at the Department for Energy Security and Net Zero has made the following statement regarding Human Rights:

"In my view the provisions of The Carbon Dioxide Transport and Storage (Determination of Turnover for Penalties) Regulations 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").