EXPLANATORY MEMORANDUM TO

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT) ORDER 2025

2025 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.

1.2. This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Declaration

2.1. Sarah Jones MP, Minister for Industry at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

2.2. Charlie Lewis, Deputy Director for the UK Emissions Trading Scheme, at the Department for Energy Security and Net Zero confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1. Sophie West at the Department for Energy Security and Net Zero. Telephone: 07754056291 or email: Sophie.west@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. This instrument makes amendments to the legislation which gives effect to the UK Emissions Trading Scheme (the "UK ETS"). This includes providing for the recalculation of the volume of free allocation which an operator is entitled to in circumstances in which one or more sub-installations have "ceased operation". That recalculation ensures that the volume of free allocation which an operator is entitled to reflects actual activity levels at the relevant sub-installation in the final year in which those operations permanently ceased. The instrument includes an exemption from this recalculation in circumstances in which the cessation is a part of a series of changes which result in an improvement in the carbon efficiency of the activities carried out at the installation. This Order also makes changes to circumstances in which an installation or sub-installation has "ceased operation" for the purposes of UK ETS legislation and provides a power for a scheme regulator to issue a notice which provides that an installation or sub-installation has "ceased operation" where it is not satisfied that certain conditions are met.

Where does the legislation extend to, and apply?

4.2. The extent of this instrument is the whole of the United Kingdom.

4.3. The territorial application of this instrument is the whole of the United Kingdom.

5. Policy Context

What is being done and why?

5.1. The UK ETS is a UK-wide greenhouse gas emissions trading scheme to incentivise emissions reductions in line with the UK's net zero targets. The UK ETS replaced the UK's participation in the EU Emissions Trading System from 1st January 2021.

5.2. The scheme is governed by the UK ETS Authority, comprising UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland, hereinafter "the Authority". The UK ETS is regulated by the Environment Agency, the Scottish Environment Protection Agency, Natural Resources Wales, the Northern Ireland Environment Agency and the Secretary of State (Offshore Petroleum Regulator for Environment and Decommissioning), hereinafter "the Regulators".

5.3. Under the UK ETS, participants are required to monitor, report on, and surrender allowances in respect of their greenhouse gas emissions. Participating operators at risk of carbon leakage[1] are given a certain number of UK ETS allowances for free, to manage their exposure to the carbon price and the risk that business' decarbonisation efforts could be undermined by higher-carbon imports. Participants can also buy emission allowances at auction and in secondary markets.

5.4. The UK ETS has opt-out schemes for Hospital and Small Emitter ("HSE") installations and Ultra Small Emitter ("USE") installations, as they either provide services to hospitals or are installations emitting less than 25,000 and 2,500 tonnes respectively of carbon dioxide equivalent (CO2eq) per year. Installations eligible for these schemes do not have to surrender allowances in respect of their emissions.

5.5. This instrument changes the UK ETS legislation such that the volume of free allocation which an operator is entitled to in the final year in which operations are carried out at one or more sub-installations is calculated by reference to the level of activity at the relevant sub-installation in that year (the "final year rule"). To facilitate this, amendments are made to UK ETS legislation requiring operators to prepare an activity level report in respect of the final year in which operations are carried out at a sub-installation. That activity level report will be used to recalculate the volume of free allocation the operator is entitled to in the final year in which operations are carried out at a sub-installation and any overallocation must be returned in accordance with existing scheme rules.

5.6. This instrument includes an exception to the final year rule in circumstances in which the permanent cessation of operations at a sub-installation is part of a series of changes which result in a material increase in the carbon efficiency of activities which continue to be carried out at the installation.

5.7. This exception to the final year rule will incentivise decarbonisation, as operators which can demonstrate that the relevant requirements are met will continue to be entitled to the free allocation calculated in accordance with usual UK ETS scheme rules (which is calculated in advance on the basis of historic activity levels).

5.8. This instrument also amends the circumstances in which an installation or sub-installation has "ceased operation" for the purposes of the UK ETS Order. The updated definitions provide that an installation has ceased operation when the relevant activity (in the case of an installation) or operation (in the case of a sub-installation)

[1] Carbon leakage is the movement of production and associated emissions from one country to another due to different levels of decarbonisation effort through carbon pricing and climate regulation.

has permanently ceased to be carried out at the installation. For these purposes an installation has "ceased operation" if all regulated activities have permanently ceased to be carried out (and a sub-installation has "ceased operation" if all operations have permanently ceased to be carried out). This amendment increases certainty for both the scheme regulators and operators.

5.9. This instrument also introduces a requirement for the operators to notify the relevant scheme regulator of circumstances in which regulated activities cease to be carried out at an installation by the end of the scheme year in which the cessation occurs and confirm whether the operator intends for one or more regulated activities to resume at the installation. Operators are similarly required to provide details of a cessation of operations in respect of sub-installation in annual activity level reports.

5.10. Providing scheme regulators with the power to issue a notice which determines that an installation or sub-installation has "ceased operation" will increase certainty for operators and facilitate equivalent treatment for all installations undergoing a cessation.

What was the previous policy, how is this different?

5.11. Under previous UK ETS policy, in cases of permanent cessations of activity, free allowances were no longer distributed in the year after the year in which the relevant sub-installation ceased operation. However, free allowances that operators were entitled to during their final year were retained (without recalculation to account for the cessation within the scheme year). This had the potential to result in overallocation of free allowances beyond the volume required for carbon leakage mitigation.

5.12. The previous definition of the circumstances in which an installation or sub-installation had "ceased operations" was considered to be difficult to apply consistently in practice.

6. Legislative and Legal Context

How has the law changed?

6.1. The UK ETS was established under the Climate Change Act 2008 by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the "2020 Order"). The 2020 Order applies EU rules on the monitoring, reporting and verification of emissions with modifications to ensure that they are appropriate for the UK ETS. The 2020 Order was subsequently amended by the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2020 to include provisions for the free allocation of allowances for eligible installations and the UK ETS Registry.

6.2. In addition, UK ETS legislation includes assimilated law relating to the free allocation of allowances, which has similarly been amended to apply it to the UK ETS, this is contained in the Free Allocation Regulation[2] and the Activity Level Changes Regulation[3].

6.3. The Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 (made under the Finance Act 2020) established the rules for auctioning allowances and mechanisms to support market stability.

6.4. A number of amendments have been made since the UK ETS was established which can be found in the Greenhouse Gas Emissions Trading Scheme Order 2020, available

[2] Commission Delegated Regulation (EU) 2019/331 (the "Free Allocation Regulation").
[3] Commission Implementing Regulation (EU) 2019/1842 (the "Activity Level Changes Regulation").

on legislation.gov.uk and assimilated law in the Free Allocation Regulation and the Activity Level Changes Regulation.

6.5. This instrument amends the 2020 Order, the Free Allocation Regulation and the Activity Level Changes Regulation. The main changes are to: the definition of when an installation or sub-installation has "ceased operation", the requirement to notify regulators of a cessation, the requirements relating to the submission of activity level reports in the year after the permanent cessation of an installation or sub-installation in order to facilitate the recalculation of free allocation entitlement in relation to the final year of activity, and an exemption from that re-calculation in the final year of activity for operators who can demonstrate that the cessation is a part of a series of changes which result in an improvement in the carbon efficiency of the activities carried out at the installation.

Why was this approach taken to change the law?

6.6. As this instrument extends to the UK as a whole, it is necessary for it to be made jointly by the Secretary of State and the devolved governments.

6.7. Other options to achieve the policy intent were considered, for example a consideration of whether free allocation distribution could happen after activity levels had been confirmed, to avoid the risk of over-allocation. However, it was deemed that these approaches would not be appropriate due to the flexibility offered to UK ETS participants in the early distribution of free allowances, ahead of compliance, to support with the decarbonisation incentive provided by the ETS.

7. Consultation

Summary of consultation outcome and methodology

7.1. Between 18 December 2023 and 11 March 2024, the UK and devolved governments ran a consultation seeking views on proposals to alter the free allocation methodology for the stationary sectors to better target those most at risk of carbon leakage and ensure that free allocations are fairly distributed. The 'UK Emissions Trading Scheme: Free Allocation Review' covered the provisions included in this instrument on permanent cessations.

7.2. The consultation received responses from over 60 organisations, with broad support of the proposed technical changes to the treatment of permanent cessations.

7.3. The Authority Response to this consultation will be delivered in two parts. An early response to the proposals on permanent cessations has been published and can be found at https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review. A further response on the other proposals will be provided in due course.

7.4. Following the consultation, the advice of the Climate Change Committee (CCC) on the associated policy proposals in this instrument was sought. The CCC reviewed these proposals and had no comments.

7.5. Full details of the consultation can be found at: https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review

8. Applicable Guidance

8.1. The UK ETS guidance has been published and is available at https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-

in-the-uk-ets. Guidance will be updated regularly, and updates will take account of relevant changes to legislation, as necessary, including the changes in this instrument.

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 it is not a regulatory provision.

9.2. An analytical annex is included in the Free Allocation Review Initial Government Response which has been published and can be found at https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review.

9.3. This is also available from the Industrial Decarbonisation and Emissions Trading Directorate, Department for Energy Security and Net Zero, 3-8 Whitehall Place, London, SW1A 2EG.

Impact on businesses, charities and voluntary bodies

9.4. The impact on business, charities or voluntary bodies relating changes to permanent cessations has been published in an analytical annex alongside the initial Government Response to the Free Allocation Review in November 2024.

9.5. The changes made to legislation through this instrument do impact small or micro businesses. To minimise the impact of the overall scheme requirements on small or micro businesses (employing up to 50 people), operators with relatively low levels of emissions are either not caught by the scheme or participate in the HSE or USE schemes, which have lower compliance burdens than the main UK ETS.

9.6. There is no significant impact on the public sector. Hospitals participate in the HSE scheme, which has lower compliance burdens than the main UK ETS.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1. The approach to monitoring this legislation is set out in the 2020 Order. Article 17 of the 2020 Order requires the UK ETS Authority to review the operation of the UK ETS in 2023 and in 2028. The UK ETS Authority published the 2023 scheme review in December 2023 https://www.gov.uk/government/publications/uk-emissions-trading-scheme-review-2023.

10.2. The instrument does not include a statutory review clause. The requirement under section 28(2) of the Small Business, Enterprise, and Employment Act 2015 to make provision for review does not apply to this instrument as it falls within an exception in section 28(3) of that Act.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

11.1. The provisions of this instrument come into force on the day after the date on which it is made, except for a limited number of provisions relating to changes to reporting requirements in relation to the final year in which operations are carried out at an installation or sub-installation. The Department does not consider that this instrument imposes obligations on UK ETS participants that are significantly more onerous than before or requires them to adopt different patterns of behaviour for the purpose of compliance with scheme rules. In particular, whilst there is a new obligation to prepare a report on an installation's activity levels in the final year of operation, operators are currently required to monitor those activity levels. Accordingly, the Department does not consider that a later commencement date is necessary.

12. European Convention on Human Rights

12.1. The Minister for Industry at the Department for Energy Security and Net Zero has made the following statement regarding Human Rights:

"In my view the provisions of the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2025 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"). It does however relate to the withdrawal of the United Kingdom from the European Union because the UK ETS is a policy replacement for the UK's participation in the EU ETS.