EXPLANATORY MEMORANDUM TO

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME AUCTIONING (AMENDMENT) (NO. 2) REGULATIONS 2021

2021 No. 917

1. Introduction

1.1 This explanatory memorandum has been prepared by Her Majesty's Treasury ("HMT") and is laid before the House of Commons by Command of Her Majesty.

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

2. Purpose of the instrument

2.1 This instrument amends the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 ("the Auctioning Regulations"). The Auctioning Regulations make provision for the auctioning of emissions allowances to emit 1 tonne of carbon dioxide equivalent under the UK Emissions Trading Scheme (the "UK ETS") and introduce mechanisms to support market stability in this new scheme. The UK ETS was established by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the "UK ETS Order").

2.2 This amending instrument clarifies the policy intent in the Auctioning Regulations as regards the calculation of the auction share and information sharing channels. This amending instrument also allows the Cost Containment Mechanism (CCM) to access allowances that remain unallocated to stationary installations and in the flexible share.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 In their Fourth Report of Session 2021-22 dated 18 June 2021 the Select Committee on Statutory Instruments reported regulation 9 of the Recognised Auction Platforms and Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2021 No. 513 which previously amended the Auctioning Regulations. The report was for defective drafting in respect of a definition of "EU emissions allowance" introduced into regulation 12(5) of the Auctioning Regulations which was not used in the Auctioning Regulations. The Treasury explained that there had been a typographical error and that the definition should have been "EU allowance" which is used in the Auctioning Regulations. This point is corrected in this amending instrument.

3.2 The purpose of this amending instrument is to introduce a number of clarifications to auction policy as well as to make a number of corrections to the Auctioning Regulations. Although the instrument does contain a number of corrections, having consulted the SI Registrar in accordance with paragraph 4.7.6 of Statutory Instrument Practice, the Treasury has concluded that the free issue process is not appropriate in the circumstances of the instrument as a whole.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the whole of the United Kingdom.

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

5. European Convention on Human Rights

5.1 As the instrument is subject to the negative resolution procedure and does not amend primary legislation no statement is required.

6. Legislative Context

6.1 This instrument is made under the power in section 96 of the Finance Act 2020 to make regulations providing for the allocation in exchange for payment of emissions allowances under trading schemes established under Part 1 of Schedule 2 to the Climate Change Act 2008. It relates to the rules for auctioning emission allowances created under the UK ETS, which is such a trading scheme.

7. Policy background

What is being done and why?

7.1 The primary objective of the Auctioning Regulations is to provide the rules covering auctions and the secondary market for emissions allowances.

7.2 This amending instrument will amend the Auctioning Regulations in light of clarifications to policy and to correct a number of technical errors.

7.3 Regulation 9 of the Auctioning Regulations provides the formula for calculating the annual volume of allowances to be auctioned in a calendar year. Regulation 4 of this instrument corrects errors in this formula, primarily to ensure that in calculating the auction share allowances from the New Entrants Reserve and the flexible share are deducted from the overall cap evenly across the UK ETS 1st January 2021 and 31st December 2030 trading period.

7.4 Regulations 10 and 11 of the Auctioning Regulations allow the appointed auction platform to cancel an auction where the proper conduct of an auction is, or is likely to be, disrupted and for consequential amendments to be made to the auction calendar. Regulations 5 and 6 of this instrument amend regulations 10 and 11 of the Auctioning Regulations to provide the appointed auction platform with the option to change the date or time of the opening and close of the bidding window instead of cancelling the auction and for consequential amendments to be made to the auction calendar on that basis.

7.5 Regulation 12 of the Auctioning Regulations provides for a Cost Containment Mechanism, enabling the Treasury to amend the distribution or volume of allowances to be auctioned in any one year if the carbon price exceeds specified limits. Regulation 7 of this instrument amends regulation 12 of the Auctioning Regulations to allow the Treasury to authorise the release of allowances both from those provisionally earmarked for free allocation to certain industrial emitters where they are not in fact so allocated and from allowances which currently form part of the flexible share. Regulation 7(4) of this instrument corrects the error identified by the Select Committee on Statutory Instruments described at paragraph 3.1 above.

7.6 Regulation 21(5), 23(3) and 36(4) of the Auctioning Regulation assigns functions to the Financial Conduct Authority ("the FCA") relating respectively to the deduction of fees by the auctioneer from auction proceeds, the submission of the auction platform's exit strategy and the cooperation requirement to facilitate the effective monitoring of auctions. This instrument amends that position to assign these functions to the auctioneer, the Treasury or both to facilitate appropriately the effective functioning of these regulations.

7.7 Regulation 8 of this instrument amends regulation 21(5) of the Auctioning Regulations to provide that the auctioneer must notify the Treasury of the rationale and amount of fees to be deducted from auction proceeds.

7.8 Regulation 9 of this instrument amends regulation 23(3) of the Auctioning Regulations to require the auction platform to submit its exit strategy to the auctioneer and Treasury within three months of its date of appointment.

7.9 Regulation 11 of this instrument amends regulation 36(4) of the Auctioning Regulations to provide that the FCA and auction platform must cooperate with and upon request provide information relating to auctions to the auctioneer and the Treasury.

7.10 Regulation 13 of this instrument amends regulation 38 of the Auctioning Regulations to ensure that the appointed auction platform must inform the auctioneer and the Treasury of the fact of reports of market abuse to the Financial Conduct Authority.

7.11 Regulation 40 of the Auctioning Regulations allows the appointed auction platform to impose maximum bid sizes and other remedial measures to be imposed in case of a risk of market abuse following consultation with the Financial Conduct Authority. Regulation 14 of this instrument amends regulation 40 of the Auctioning Regulations to also require consultation with the auctioneer before such a remedial measure is imposed. This regulation is also amended so that maximum bid sizes may be imposed on single entities as well as groups.

7.12 Regulation 15 of this instrument amends Regulation 44 of the Auctioning Regulations to require the appointed auction platform to include details of the auctions to which the volume of any unsold allowances will be carried over, for example under any adjustment of the auction calendar through regulation 10 of the Auctioning Regulations.

7.13 Regulation 16 of this instrument amends regulation 45 of the Auctioning Regulations to ensure that the methodology for determining the prevailing secondary market prices under regulation 7(4) of the Auctioning Regulations, is to be treated as confidential. The same regulation also corrects errors to ensure that the exchange of confidential information between the auction platform and the auctioneer, the UK ETS Authority and the Treasury is not precluded.

7.14 A small number of other technical errors have also been corrected at the same time.

8. European Union Withdrawal and Future Relationship

8.1 This instrument is not being made under the European Union (Withdrawal) Act but relates to the withdrawal of the United Kingdom from the European Union. This instrument amends legislation that was part of a legislative package which introduced a policy replacement for the UK's participation in the EU ETS. Except in relation to certain electricity generators in Northern Ireland, the UK ceased to participate in the

EU ETS at the end of the Transition Period (from 1st January 2021), as a direct consequence of the UK's withdrawal from the EU.

9. Consolidation

9.1 This instrument is the third time that the Auctioning Regulations have been amended. HMT currently has no plans to consolidate the relevant legislation.

10. Consultation outcome

10.1 Between 2nd May 2019 and 12th July 2019, the UK Government and Devolved Administrations ran a public consultation seeking views on the UK's future carbon pricing policy. The consultation set out policy proposals for a UK ETS and sought views on these proposals from stakeholders. The public consultation included policy proposals for auctioning and market stability mechanisms in a standalone UK ETS. This instrument amends the auctioning aspect of the legislation as described above.

10.2 Alongside the consultation, the UK Government and Devolved Administrations jointly commissioned the Committee on Climate Change (CCC) for advice on both a standalone and linked UK ETS.

10.3 The public consultation received over 130 responses, from a range of stakeholders including current EU ETS participants and NGOs, with the majority supporting most of the proposals on the design of a UK ETS.

10.4 The Government Response to the consultation was published on 1st June 2020.

10.5 Full details of the consultation and the response can be found at: https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing

10.6 The Energy White Paper was published on 14th December 2020. This paper confirmed that the UK would introduce the UK ETS to replace participation in the EU ETS following the end of the Transition Period. It also stated that 'the UK is open to linking the UK ETS internationally in principle and we are considering a range of options, but no decision on our preferred linking partners has yet been made.'

11. Guidance

11.1 Guidance for UK ETS auction participants has been published on gov.uk.[1]

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 Although Government policy does not require an Impact Assessment for this instrument because it is not a regulatory provision, an Impact Assessment of the UK ETS policy was produced. This Impact Assessment considered the expected costs and benefits of the UK ETS in its initial years of operation (from 2021 to 2024) in an unlinked context. It covers UK ETS policy contained within the UK ETS Order and the Auctioning Regulations. A separate impact assessment has not been produced for this instrument because it is limited in scope to a number of clarifications to auction policy as well as to make a number of corrections to the Auctioning Regulations.

[1] https://www.gov.uk/government/publications/participating-in-the-uk-ets/participating-in-the-uk-ets

12.4 The Impact Assessment was published on the gov.uk website, alongside the Government Response to the Future of UK Carbon Pricing consultation on 1st June 2020.

13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 To minimise the impact of the requirements of small business (employing up to 50 people) the approach taken is to either not apply or provide derogations from UK ETS obligations for UK ETS operators and aircraft operators with relatively low levels of emissions (who may be small business).

14. Monitoring & review

14.1 The approach to monitoring of this legislation is to review the operation of the Auctioning Regulations along with other aspects of the UK ETS under Article 17 of the UK ETS Order. This article commits the UK Government (and Devolved Administrations) to reviewing the operation of the UK ETS in 2023 and 2028.

15. Contact

15.1 Calum Boyd, Calum.Boyd@hmtreasury.gov.uk 07789944591, at Her Majesty's Treasury can be contacted with any queries regarding the instrument.

15.2 Alanna Barber, Deputy Director for the Energy and Transport Tax team can confirm that this Explanatory Memorandum meets the required standard.

15.3 John Glenn, Economic Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.