EXPLANATORY MEMORANDUM TO

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME AUCTIONING (AMENDMENT) REGULATIONS 2023

2023 No. 994

1. Introduction

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

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 scheme. The UK ETS was established by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the "UK ETS Order"). The UK ETS is operated by the UK ETS Authority, comprising the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland. The scheme is regulated by the Environment Agency, the Scottish Environment Protection Agency, Natural Resources Wales, the Northern Ireland Environment Agency, and the Offshore Petroleum Regulator for Environment and Decommissioning.

2.2 The amendments to the Auctioning Regulations will set the auction share and therefore the number of allowances that enter circulation in line with the proposed net zero consistent cap.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The 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 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.

6.2 This instrument is part of a package of legislation to implement the policy decisions in the Main UK ETS Authority Response to the Developing the UK ETS Consultation[1]. An affirmative-procedure instrument under the Climate Change Act 2008 will be made later this year, subject to Parliamentary approval. The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023, a negative-procedure instrument under the Climate Change Act 2008 was made and laid in Parliament in July 2023.

7. Policy background

What is being done and why?

7.1 The amendments made by this instrument will set the auction share and therefore the number of allowances that enter circulation in line with the proposed net zero consistent cap. This net zero consistent cap limits traded sector emissions to levels which align with the four governments' trajectories towards net zero. This provides a guarantee that traded sector emissions will not increase beyond this in future; a meaningful incentive for further, cost-effective decarbonisation within these sectors; and the certainty needed for investment into low carbon technologies. It does this by reducing the notional pots of allowances by reference to the auction share which is calculated from 2024 onwards. These reductions are in accordance with the final decisions published in the Main UK ETS Authority Response to the consultation described in Section 10.

7.2 The reductions will apply to the annual cap, which determines the baseline cap before a reduction is applied to account for those who have successfully applied for the hospital and small emitter scheme. It will also apply to the industry cap, which is the share of allowances available to be allocated for free; the relative flexible share, which is the annual breakdown of allowances created to be kept in reserve each year for use by the cost containment mechanism (hereafter the 'CCM', which allows HMT to avoid price spikes by taking a decision on whether to auction additional allowances) or cross-sectoral correction factor (which applies a proportional reduction to stationary installations' free allocations in the instance that free allocations are above the level of the industry cap). And it will apply to the new entrants' reserve, which is the annual number of allowances created each year to be used as free allocations for new installations, activity level changes or that can be accessed by the CCM.

7.3 From 2024 to 2027, a number of allowances will be added to the auction share each year to smooth the transition to the net zero consistent cap, set out as "T" in column 6 of the new table in regulation 9 of the Auctioning Regulations. The figure for the flexible share, as described above, in regulation 12 of the Auctioning Regulations is also amended to ensure that the CCM can access these allowances. A further amendment is made to the CCM, consequential on changes to free allocation for manufacturers of lime and malt extract made by the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023.

What did any law do before the changes to be made by this instrument?

7.4 The Auctioning Regulations provided for the auctioning of emissions allowances in accordance with the existing UK ETS cap and the reduction to allowances which can be accessed by the CCM. However, this was not consistent with net zero targets.

[1] The Main UK ETS Authority Response follows the Initial Response, which was published in August 2022.

Why is it being changed?

7.5 The Auctioning Regulations are being amended to ensure that the number of allowances auctioned are in line with the UK and Devolved Administration Governments' net zero targets.

What will it now do?

7.6 The updated figures included in this instrument will ensure that the number of allowances which can go to auction or be used for the purpose of supporting market stability in the scheme are in line with net zero targets.

8. European Union Withdrawal and Future Relationship

8.1 This instrument is being made under powers in the Finance Act 2020.

8.2 This instrument is not being made under the European Union (Withdrawal) Act 2018 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 1 January 2021), as a direct consequence of the UK's withdrawal from the EU.

9. Consolidation

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

10. Consultation outcome

10.1 Between 25 March 2022 and 17 June 2022, the UK ETS Authority ran a public consultation on a package of proposals to develop the UK ETS, including the future of the UK ETS cap.

10.2 The Climate Change Committee (CCC) provided its view on these proposals.

10.3 The consultation resulted in responses from over 300 organisations, representing a wide range of stakeholders from a variety of sectors, such as the energy, industrial and aviation sectors, as well as Non-Government Organisations (NGOs), think tanks, Local Authorities, trade associations, academia and advocacy groups.

10.4 In the Main UK ETS Authority Response to the Consultation, published on 3 July 2023, it was announced that the UK ETS cap would be set to be consistent with net zero. This instrument seeks to achieve this policy intent.

10.5 Full details of the consultation and response can be found at: https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets.

11. Guidance

11.1 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.

12. Impact

12.1 The impact on business, charities or voluntary bodies is set out in the Developing the UK Emissions Trading Scheme Impact Assessment, published alongside the Main UK ETS Authority Response to the Developing the UK ETS Consultation.

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

12.3 The full Impact Assessment is submitted with this memorandum and published alongside the Explanatory Memorandum on the legislation.gov.uk website.

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 operators and aircraft operators with relatively low levels of emissions (who may be small businesses).

14. Monitoring & review

14.1 Article 17 of the UK ETS Order requires the UK ETS Authority to review the operation of the UK ETS (including the measures introduced by this instrument) in 2023 and in 2028. The UK ETS Authority must subsequently publish a report setting out the conclusions of the review.

14.2 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.

15. Contact

15.1 Sam Deaner at HM Treasury email: Samuel.Deaner@HMTreasury.gov.uk can be contacted with any queries regarding the instrument.

15.2 Jennifer Rowland, Deputy Director for Environment and Transport Tax, at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.

15.3 Gareth Davies MP at HM Treasury can confirm that this Explanatory Memorandum meets the required standard.