Cabinet Secretary for Net Zero and Just Transition
Mairi McAllan MSP

Scottish Government
Riaghaltas na h-Alba

T: 0300 244 4000
E: scottish.ministers@gov.scot

Edward Mountain MSP
Convener of the Net Zero, Energy and Transport Committee

The Scottish Parliament
Edinburgh
EH99 1SP

netzero.committee@parliament.scot

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Dear Convener

Main UK Emissions Trading Scheme Authority Response to the 'Developing the UK Emissions Trading Scheme' Consultation

The ETS Authority – UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland – recently published the Main UK Emissions Trading Scheme (UK ETS) Authority Response to the 'Developing the UK Emissions Scheme' Consultation.[1]

This response represents the culmination of significant work across the ETS Authority. We spoke to a wide range of stakeholders, receiving responses from over 300 organisations across ETS participants, Non-Governmental Organisations, Academia and the UK Climate Change Committee. This number includes a significant amount of stakeholders that are based or have significant operations, in Scotland. Their input provided significant support into our decision making process, and I am very grateful to them for their engagement.

In making the decisions set out in the Authority Response, the Authority worked together closely and considered interaction with the wider policy landscape. We also listened carefully to our stakeholders and their requests for long term clarity, strength of climate ambition, and targeted support for businesses in the transition.

[1] Developing the UK Emissions Trading Scheme (UK ETS) - GOV.UK (www.gov.uk)

The full set of decisions that we have taken as an Authority are set out in the response, which has been published online and can be found here. A summary of these decisions is attached as an annex to this letter.

A number of legislative amendments will be required to implement these decisions. The Authority will first introduce a negative-procedure statutory instrument under the Climate Change Act 2008 to amend the Greenhouse Gas Emissions Trading Scheme Order 2020 ("UK ETS Order"). This will make a number of operational changes to the scheme that can be applied UK wide.

One of the most significant changes set out in the Main Response is the considerable reduction in the number of available ETS allowances ("the cap"). This reduction is associated with fewer emissions from the ETS sectors and therefore is an important step in support of our ambitious climate change objectives. The UK Climate Change Act 2008 provides a power to make this amendment by affirmative procedure and, as you will recall, amendments to the UK ETS Order are made by Order in Council in each of the four parliaments represented in the ETS Authority. However, in the absence of a Northern Ireland Executive and sitting Assembly, it is regrettably not possible to bring forward affirmative procedure instruments under the Climate Change Act 2008 at this stage for policies that affect the whole of the United Kingdom, such as the cap.

We have therefore explored alternative ways to give effect to the cap in the short term until the Northern Ireland Assembly is formed, at which point we will be able to lay the affirmative instrument in the Scottish Parliament and the Committee will have the opportunity to scrutinise the new ETS cap trajectory. We have agreed across the Authority for the UK Government to amend the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 (the "Auctioning Regulations") under the Finance Act 2020 to support the policy decision. I see this as a pragmatic, one off step to implement the new cap in the face of the challenges we are unfortunately faced with in terms of progressing in the usual way and the need for the cap to be in place by 1 January 2024 (as set out in the Government Response). If the cap is not in place, a new cap would need to be negotiated.[2] The delay would pose significant risks to climate targets, including Scotland's more ambitious 2030 and 2045 targets.

As the Committee will be aware, the Auctioning Regulations are a normal part of the UK ETS framework and are used to determine the share of allowances which can be brought to auction each year. This amendment will, as a short-term solution, reduce the number of allowances being created as part of the Auction Share and remove references to the Greenhouse Gas Emissions Trading Scheme Order 2020, instead inserting figures directly into the Auctioning Regulations. This will mean the number of allowances available to the market is in line with a lower cap consistent with reaching net zero. The amendments to the Auctioning Regulations do not themselves change the cap in the UK ETS Order. Further amendments will be needed to deliver policy in the long term and these will be brought forward as soon as practicable.

[2] The overall cap applies to this "phase" of the ETS – which runs from 2021 to 2030. The revision was based on the cap being in place from 2024-2030. If the limit on auctioned allowances (the cap) is not in place by January 2024, more substantial restrictions are instead needed for the later years of the phase to ensure the overall phase aligns with net zero. This is why the negotiated cap cannot simply be implemented at a later date.

Officials are also finalising the Business and Regulatory Impact Assessment (BRIA) and Island Communities Impact Assessment (ICIA) for these policy decisions, and these will be published on the Scottish Government website in the near future.

MAIRI MCALLAN

ANNEX 1 – Sumary of Changes to the UK ETS

- **Reducing the UK ETS cap so that it better supports our Net Zero objectives.** We have chosen to implement the cap at the top of the range that was consulted upon last year. This will support a smooth transition for participants and enable continued flexibility to mitigate market risks and carbon leakage. In line with our prior commitments, the net zero cap will be implemented for 2024.
- **Smoothing the transition to the net zero cap**: through releasing additional allowances from the reserve pots to the market between 2024-2027 we will ensure that there is no sudden drop in allowance supply between 2023 and 2024. These allowances have already been created in previous scheme years within the overall cap limits, and so the strength of overall ambition will not be affected. This will be a gradual transition, allowing the market and participants time to adapt.
- **Setting the Industry Cap at 40% of the overall cap:** we recognise businesses need time and support to decarbonise. Setting a higher limit on the quantity of allowances available to be distributed for free, compared with retaining a limit of 37%, will ensure we can continue to provide free allowances to those sectors at most risk of carbon leakage. A higher industry cap will also enable flexibility for the future decisions regarding the distribution of free allowances in the second phase of the free allocation review.
- **Providing long term market resilience:** we recognise that the ETS may encounter unprecedented or unforeseen challenges. We will therefore put aside additional allowances for future market management (equivalent to roughly 3% of the overall cap). This will provide the Authority with resilience to respond in a way that is flexible, targeted and timely in the face of market challenges. It will also support the ongoing market review which will set the design of future UK ETS markets policy.
- **Free allocation technical changes:** we have listened to concerns regarding features of industrial free allocation policy which are not working as intended and are taking action to address this. Our review into free allocations will continue with an aim to update the methodology to better target support at sectors most at risk of carbon leakage.
- **Phasing-out of aviation free allocation:** in line with findings that there is a minimal risk of carbon leakage for the aviation sector, we will not extend free allocation to the aviation sector for the 2026-2030 allocation period. We recognise that businesses will need time to prepare for the withdrawal. The Authority will ensure there are provisions to support airlines and individual routes. If required, we will consider what appropriate mitigations may be needed to prevent negative outcomes. Aircraft operators' free allocation entitlement for the 2024 and 2025 scheme years will be capped to 100% of their verified emissions.
- **Expanding the scope of the scheme:** including additional sectors in the UK ETS and capping a greater proportion of UK emissions will further contribute to delivering net zero and UK carbon reduction targets at lowest cost for industry. Subject to further consultation on the details of implementation, we intend to expand the scope of the UK ETS to include domestic maritime by 2026, and energy from waste and waste incineration in 2028 (preceded by a two-year phasing period from 2026-2028, where operators will monitor, report and verify their emissions, before full cost exposure). Further, we will expand the existing scope of the scheme to create a level playing field

between operators who use pipeline and non-pipeline modes of transportation of CO_2. CO_2 venting from upstream oil and gas will be brought into the scope of the UK ETS, and we will consult on introducing UK ETS biomass sustainability criteria for all biomass to develop a greater understanding of its impacts upon markets and operators.

- **Incorporating Greenhouse Gas Removal (GGR) technologies:** we believe that the UK ETS is an appropriate long-term market for GGRs. We intend to include engineered GGRs in the UK ETS, subject to further consultation; a robust monitoring, reporting and verification (MRV) regime being in place; and the management of wider impacts. We believe the UK ETS may offer an appropriate long-term market for high quality nature-based GGRs, and will be doing further work to consider the range of potential issues brought forward through the Call for Evidence and by the CCC regarding permanence, costs and wider land management impacts.