

# **UK ETS Common Framework**

## **Summary document**

### **Policy Background**

The UK currently participates in the EU Emissions Trading System (EU ETS), which is the world's largest trading system for greenhouse gas (GHG) emissions. Emissions trading schemes work on the 'cap and trade' principle, where a cap is set on the total amount of certain GHGs that can be emitted by participating installations and aircraft. Within the limits of this cap, participants receive or buy allowances equivalent to their own emissions, which they can trade with one another as needed. The overall cap is reduced over time, so that total emissions fall.

At the end of the Transition Period (on 31st December 2020), the UK will cease to participate in the EU ETS.<sup>1</sup> A replacement carbon pricing policy is required to stimulate emissions reduction from large UK emitters within the industrial, power and aviation sectors currently participating in the EU ETS.

In 2019, the UK Government and devolved administrations (DAs) undertook a public consultation seeking views on the UK's future carbon pricing policy. This consultation set out policy positions for a UK-wide Emissions Trading System (UK ETS), whilst noting that fall-back options included a carbon emissions tax, or remaining in Phase IV of the EU ETS.

The four Governments are open to considering a link between a future UK ETS and the EU ETS, if such a linking agreement is in both sides' interests and recognises both parties as sovereign equals with our own domestic laws. A link between the UK and EU trading schemes could help to establish a much larger carbon market, which could increase opportunities for emissions reduction and cost-efficiency of emissions trading.

### **Rationale for seeking Common Framework**

The UK Government and the DAs are committed to carbon pricing as an effective emissions reduction tool. Placing a price on carbon creates the incentive for emissions to be reduced in a cost effective and technology-neutral way, while mobilising the private sector to invest in emissions reduction technologies and measures.

Climate policy, including the establishment of emissions trading systems, falls within devolved competence. However, the UK Government and DAs have agreed to jointly introduce secondary legislation to establish a single, UK-wide ETS with a common set of rules for participants. There are several benefits of such an approach (as opposed to separate systems in the four UK nations):

- A UK-wide system will create a larger carbon market, with greater liquidity, and a consistent carbon price across the UK.

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<sup>1</sup> By virtue of Article 9, Annex 4 of the Ireland / Northern Ireland Protocol, NI electricity generators will continue to participate in Phase IV of the EU ETS to ensure a common carbon price on the island of Ireland to maintain the SEM (Single Electricity Market)

- Access to a larger carbon market increases opportunity for emissions reduction and the cost effectiveness of emissions trading.
- A common, UK-wide approach to carbon pricing avoids ‘carbon leakage’<sup>2</sup>, which could have a negative effect on the contribution of the policy to reduce emissions in line with international obligations, and the UK’s pathway towards our net zero target.

The UK ETS is designed to operate on a UK-wide basis, and therefore the rules for operators need to apply consistently across the UK to ensure the integrity of the system.

Nonetheless, any proposals for policy divergence between administrations will be considered by the four administrations jointly, using the agreed governance process that will be established in the UK ETS concordat. Any areas in which divergence is proposed will be considered by all parties to the concordat considering any potential impact on the functioning of the UK Internal Market, in line with the Common frameworks principles agreed at JMC(EN).<sup>3</sup>

### **Stakeholder engagement**

Between May and July 2019, the UK Government and DAs jointly consulted on the future of carbon pricing in the UK after EU Exit, setting out policy proposals for a UK-wide ETS which would be operational from 1<sup>st</sup> January 2021. The consultation received over 130 responses, from a range of stakeholders across the UK including current EU ETS participants and NGOs, with the majority of respondents to each question supporting the proposal being put forward.

As part of this consultation, UKG and the DAs ran stakeholder events across England, Wales, Scotland and Northern Ireland. Views from all stakeholders on proposals for a UK-wide ETS were taken into account when considering the final policy design.

The joint Government Response to the consultation was published on 1<sup>st</sup> June 2020 and can be accessed here: <https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing>

### **Approach to framework**

The UK ETS will be established using secondary legislation made using existing primary powers under the Climate Change Act 2008 (the CCA), and through the Finance Act 2020. A non-legislative agreement (concordat) will set out the principles underpinning the ongoing oversight and governance of the system by Officials and Ministers from the four administrations, including decision-making and dispute resolution processes. These elements are explained in more detail below.

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<sup>2</sup> Carbon leakage occurs when businesses transfer production to other countries with less stringent emissions constraints

<sup>3</sup> The JMC(EN) principles can be found here: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/652285/Joint\\_Ministerial\\_Committee\\_communique.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/652285/Joint_Ministerial_Committee_communique.pdf)

## **Legislation**

UK ETS legislation comprises:

- *The Greenhouse Gas Emissions Trading Scheme Order 2020*: an affirmative procedure Order in Council under the **CCA** to set up a UK-wide ETS which will be operational from 2021. Key provisions included in this instrument cover the scope of the system, monitoring and reporting requirements, the cap and trajectory and the roles of the regulators in monitoring and enforcing the rules of the system. This Order was laid in the UK and Devolved Parliaments in July and is expected to be in force by the end of the Transition Period in all four nations.
- *The Greenhouse Gas Emissions Trading Scheme Order (Amendment) 2020*: a negative procedure Order in Council under the Climate Change Act which will amend the affirmative procedure instrument once made to include provisions for free allocation and the UK ETS registry. This Order is due to be laid in the UK and devolved Parliaments in November.
- A charging clause to be taken in the *Finance Act 2020*, to provide for the UK Government to charge participants for emissions allowances at auction.
- An affirmative procedure statutory instrument to be introduced under the Finance Act 2020 to establish rules for the auctioning of emissions allowances and mechanisms to support market stability. This instrument is expected to be laid in the UK Parliament in November.
- Additionally, the *Recognised Auction Platforms (Amendment) Regulations 2020* will be laid in draft before both the Commons and the Lords. This SI will set out the regulations for the trading of emissions allowances in the UK Emissions Trading System (ETS), including establishing the rules for access to the auction platform and rules for the relevant disclosures. It will enshrine an oversight role for the Financial Conduct Authority (FCA) such that the FCA can monitor the auctioning process and secondary market trading to prevent market abuse and ensure the effectiveness of the system. This SI will ensure that UK emissions allowances are subject to the relevant regulatory oversight and treatment as Financial Instruments.

## **UKG/DA governance concordat**

The UK Government and DAs have together developed UK ETS governance principles and arrangements over the past two years, including processes for decision-making and dispute resolution. A non-legislative agreement in the form of a concordat will set out governance arrangements for the UK ETS, including processes for making decisions and resolving disputes under the system.

Governance processes shall be set out in more detail in the UK ETS Framework Outline Agreement (FOA), and in the resulting concordat. Key governance principles, which UK Government (BEIS, HMT and DfT) and the DAs have agreed to adhere to, are set out below:

- Proposals relating to all areas of UK ETS policy should be considered using the joint governance process.
- The four administrations are committed to, wherever possible, taking decisions jointly. Where the four administrations agree that an individual administration holds exclusive competence over a particular matter, that administration will not exercise that competence to take a decision unilaterally without first having discussed it with all other administrations.
- All four administrations will endeavour to ensure market and legislative stability throughout the agreed ETS phases. The UKG and DAs should adhere to planned review points and ensure that significant legislative and policy changes are aligned with these planned review points.
- The four administrations are committed to seeking advice from their statutory advisors, the Committee on Climate Change prior to laying legislation.
- Working groups for discussion of policy decisions and system interventions under the UK ETS should include representation from BEIS, the DAs, HMT, DfT (where appropriate) and the environmental regulators (where appropriate).
- At ministerial level, BEIS and DA Ministers (and DfT Ministers, where appropriate) will be sighted and engaged in discussions where a policy decision relating to elements of the policy set out under the Finance Act is being considered. A ministerial level discussion should constitute a two-way exchange, with BEIS and DA Ministers allowed sufficient time to consider the decision and raise challenges. Responsibility for final sign-off of decisions relating to the elements of a UK-wide emissions trading system set out in Finance Act provisions will lie with the Chancellor (HMT). Before final sign-off, HMT Ministers should respond to challenges raised and provide justification for decisions reached. Should a UKG or DA Minister dispute a decision in a reserved policy area, this can be escalated to the JMC Secretariat.
- As the UK Government department responsible for aviation policy, DfT should have the option to attend all Official and Senior level groups given the potential impact of decisions made under a UK ETS on aviation. Agreement from DfT ministers must be gained before agreeing a UK Government policy position focused on aviation under a UK ETS.
- For the most effective use of the governance structure, and ultimately the operation of the system, proposals should be discussed and, where possible, a recommendation agreed at Official Level working groups.
- For all proposals, the UK Government and DAs should seek to obtain appropriate and relevant evidence to support recommendations reached. Any relevant evidence obtained must be taken into account in reaching a recommendation.
- In all decision-making, the parties to the framework will adhere to the common framework principles agreed at JMC (EN) in October 2017.

## **Process for completion**

### ***Legislation***

<b>UK ETS Legislation</b>		
<b>Instrument</b>	<b>Laying date</b>	<b>In force date</b>
The Greenhouse Gas Emissions Trading Scheme Order 2020	13 <sup>th</sup> July (UK Parliament, Scottish Parliament), w/c 15 <sup>th</sup> July, (Welsh Parliament) 15 <sup>th</sup> July (NI Assembly)	Mid-November
The Greenhouse Gas Emissions Trading Scheme Order (Amendment) 2020	Mid-November	Mid-November
Finance Act 2020 (charging clause)	17 <sup>th</sup> March 2020	22 <sup>nd</sup> July 2020 (Royal Assent)
Auctioning and market stability mechanisms SI	October/November 2020 (TBC)	December 2020 – January 2021
Recognised Auction Platforms (Amendment) Regulations 2020	TBC	TBC

### ***Framework Outline Agreement (FOA)***

The UK ETS FOA will set out, in more detail, our approach to the common framework and proposed decision-making and dispute resolution processes. It has been used as a policy development tool.

The UK ETS FOA shall be cleared by UK Government and DA Ministers and will be presented to the UK and Devolved Parliaments alongside the concordat.

### ***Governance concordat***

Following JMC(EN) clearance of the provisional framework, the FOA and concordat will become available for parliamentary scrutiny. We expect that the FOA and concordat will be available for scrutiny in late October/early November.