

Net Zero, Energy and Transport Committee
Tuesday 19 November 2024
34th Meeting, 2024 (Session 6)

Note by the Clerk on Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 (draft)

Overview

1. At this meeting, the Committee will take evidence from the acting Cabinet Secretary for Net Zero and Energy and officials on the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 (draft) before debating a motion in the name of the Cabinet Secretary inviting the Committee to recommend approval of the instrument.
2. This is a draft Statutory Instrument (SI), which requires approval by resolution of the Parliament before it can become law. More information about the instrument is summarised below:

Title of instrument: Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 (see Annexe)

Laid under: Sections 44, 54 and 90(3) of, and Schedule 2 and paragraph 9 of Schedule 3 to, the [Climate Change Act 2008](#).

Laid on: 22 October 2024

Procedure: Affirmative

Lead committee to report by: 6 December 2024

Commencement: See Article 2 of the instrument

Procedure

3. Under the affirmative procedure, an instrument must be laid in draft and cannot be made (or come into force) unless it is approved by resolution of the Parliament. In this case, the instrument also requires approval by resolution of Senedd Cymru, the Northern Ireland Assembly and both Houses of the UK Parliament.
4. Once laid, the instrument is referred to:
 - the Delegated Powers and Law Reform (DPLR) Committee, for scrutiny on various technical grounds, and
 - a lead committee, whose remit includes the subject-matter of the instrument, for scrutiny on policy grounds.

5. The lead committee, taking account of any recommendations made by the DPLR Committee (or any other committee), must report within 40 days of the instrument being laid.
6. In line with standard practice for affirmative instrument, there will be two agenda items for this item:
 - an evidence session with the relevant Minister and officials, followed by
 - a formal debate on a motion, lodged by the Minister, inviting the lead committee to recommend approval of the instrument.
7. Only MSPs may participate in the debate, which may not last for more than 90 minutes. If there is a division on the motion, only committee members may vote. If the motion is agreed to, it is for the Chamber to later decide whether to approve the instrument.

Delegated Powers and Law Reform Committee consideration

8. The DPLR Committee considered the instrument on 29 October and reported on it in its [61st Report, 2024](#). It made no recommendations about the instrument but noted that the original draft of this instrument was withdrawn on 9 October 2024, and the present version re-laid on 22 October 2024 to correct an error, following [a question raised by the Committee with the Scottish Government](#).

Purpose of the instrument

9. This instrument makes various changes to the UK Emissions Trading Scheme (the “UK ETS”). The UK ETS is a system of carbon reduction and trading for UK businesses in energy-intensive sectors, run by the governments of the United Kingdom. It aims to reduce overall emissions by imposing a cost on them and therefore creating a financial incentive to decarbonise.
10. This SI expands the scope of the scheme to carbon dioxide venting in the upstream oil and gas sector, introducing a new type of enforcement notice called a ‘deficit notice’, and making technical changes to the scheme’s penalties.
11. In addition, the policy note states that this instrument will ensure legislative consistency by implementing changes that were previously unable to be made on a UK-wide basis under the Climate Change Act 2008 (CCA) in the absence of a sitting Northern Ireland Assembly.
12. This instrument will also implement the reduction in the total number of allowances available for free allocation¹, expand the scope of the scheme to

¹ Free allocation in the Emissions Trading System (ETS) refers to the practice of distributing a portion of emission allowances to certain sectors or installations at no cost. This is done to mitigate the risk of carbon leakage, where companies might relocate to regions with less stringent emission regulations. Free allocation is typically based on performance benchmarks and is gradually reduced over time to encourage emissions reductions.

flights from Northern Ireland to Switzerland, and extend legislation to Northern Ireland that currently only extends to England, Wales and Scotland.

13. The Policy Note accompanying the instrument is included in the annexe. It includes a summary of consultation undertaken on the instrument, impact assessments carried out, and the anticipated financial effects.

Report

14. The Convener will invite the Committee to delegate to him authority for considering and approving a draft report prepared by the clerks after the meeting. In relation to any report finalised in this way, Committee Members may ask to see the draft and comment on it before the Convener authorises it for publication.

**Clerks to the Committee
November 2024**

Annexe A: Instrument

This draft Statutory Instrument has been laid before Parliament and published in consequence of defects in S.I. 2020/1265 and 2020/1557 and is being issued free of charge to all known recipients of those Statutory Instruments.

Draft Order in Council laid before Parliament, the Northern Ireland Assembly, the Scottish Parliament and Senedd Cymru under paragraph 11 of Schedule 3 to the Climate Change Act 2008 for approval by resolution of each House of Parliament, the Northern Ireland Assembly, the Scottish Parliament and Senedd Cymru.

D R A F T S T A T U T O R Y I N S T R U M E N T S

2024 No. 0000

CLIMATE CHANGE

The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024

Made - - - - 2024

Coming into force in accordance with article 2

At the Court at Buckingham Palace, the 0000 day of 0000 2024

Present,

The King's Most Excellent Majesty in Council

This Order is made in exercise of the powers conferred by sections 44, 54 and 90(3) of, and Schedule 2 and paragraph 9 of Schedule 3 to, the Climate Change Act 2008(a).

In accordance with paragraph 10 of Schedule 3 to that Act, before the recommendation to His Majesty in Council to make this Order was made—

- (a) the advice of the Committee on Climate Change, including on the amount of the limit referred to in section 48(2) of that Act, was obtained and taken into account; and
- (b) such persons likely to be affected by the Order as the Secretary of State, the Department of Agriculture, Environment and Rural Affairs, the Scottish Ministers and the Welsh Ministers considered appropriate were consulted.

In accordance with paragraph 11 of that Schedule, a draft of the instrument containing this Order was laid before Parliament, the Northern Ireland Assembly, the Scottish Parliament and Senedd Cymru and approved by resolution of each House of Parliament, the Northern Ireland Assembly, the Scottish Parliament and Senedd Cymru.

Accordingly, His Majesty, by and with the advice of His Privy Council, makes the following Order:

(a) 2008 c. 27. The amendment made to paragraph 30 of Schedule 2 of that Act by S.I. 2022/500 is not relevant to this Order.

PART 1

Preliminary

Citation

1. This Order may be cited as the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024.

Commencement

2.—(1) The following provisions come into force on the day after the date on which this Order is made—

- (a) this Part;
- (b) article 4;
- (c) articles 6 to 9;
- (d) article 31(1) and (2);
- (e) article 33;
- (f) article 36;
- (g) Part 4.

(2) If this Order is made on or before 30th December 2024—

- (a) articles 44 and 45 come into force at the end of 31st December 2024;
- (b) except as provided in paragraph (1), the rest of this Order comes into force on 1st January 2025.

(3) If this Order is made on or after 31st December 2024—

- (a) articles 44 and 45 come into force at the end of the day before the relevant commencement day;
- (b) except as provided in paragraph (1), the rest of this Order comes into force on the relevant commencement day.

(4) In paragraph (3), “relevant commencement day” means—

- (a) if this Order is made on 31st December 2024, 1st February 2025;
- (b) if this Order is made on or after 1st January 2025, the first day of the month after the month in which this Order is made.

Extent

3. This Order extends to the whole of the United Kingdom.

PART 2

Greenhouse Gas Emissions Trading Scheme Order 2020 amended

Greenhouse Gas Emissions Trading Scheme Order 2020 amended

4. The Greenhouse Gas Emissions Trading Scheme Order 2020(a) is amended in accordance with this Part.

(a) S.I. 2020/1265, amended by S.I. 2020/1557, 2021/1455, 2022/454, 2022/1173, 2023/850, 2023/1267, 2023/1387 and 2024/192. S.I. 2022/1336, which also amended S.I. 2020/1265, is revoked by this Order.

Article 4 amended (interpretation)

5.—(1) Article 4 is amended as follows.

(2) In paragraph (1)—

- (a) in the definition of “full-scope flights” after “Gibraltar” insert “, Switzerland”;
- (b) in the definition of “surrender” after “article 27 or 34” insert “or any other obligation referred to in paragraph (6) of this article”.

(3) After paragraph (4) insert—

“(5) Where an allowance is surrendered in circumstances in which the allowance may be treated as surrendered to comply with more than one obligation referred to in paragraph (6), or with one of those obligations but in respect of more than one scheme year, the regulator may treat the allowance as surrendered to comply with any one of those obligations, or in respect of any one of those scheme years; and consequently any provision of Part 7 under which a deficit notice may be given, or a civil penalty may or must be imposed, in respect of a failure to surrender allowances must be read accordingly.

(6) The obligations are obligations to surrender allowances under any of the following—

- (a) article 27;
- (b) article 34;
- (c) a deficit notice under article 44A;
- (d) a notice under paragraph 10 of Schedule 6;
- (e) a surrender notice under paragraph 11 of that Schedule;
- (f) a revocation notice under paragraph 12 of that Schedule.”.

Article 19 amended (cap for trading period)

6.—(1) Article 19 is amended as follows.

(2) In paragraph (a) for “736,013,432” substitute “633,116,297”.

(3) In paragraph (b) for “630,152,247” substitute “302,924,924”.

Article 20 amended (cap for scheme years)

7.—(1) Article 20 is amended as follows.

(2) In paragraph (1)—

- (a) in the words before sub-paragraph (a) omit “the sum of”;
- (b) in sub-paragraph (a)(ii) omit the “and” at the end of the paragraph;
- (c) omit sub-paragraph (b).

(3) For paragraph (2) substitute—

“(2) But the restriction in paragraph (1) does not apply to the creation of allowances—

- (a) for the flexible reserve (see article 23A);
- (b) for the new entrants’ reserve (see article 34G);
- (c) for allocation under the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021^(a) or any other regulations made under section 96 of the Finance Act 2020^(b).”.

(4) In paragraph (3) for “But such a direction may not override” substitute “Nothing in this article overrides”.

(a) S.I. 2021/484, amended by S.I. 2021/513, 2021/561, 2021/917, 2023/994 and this Order. S.I. 2023/1387 also amends S.I. 2021/484, but the amendments are to a provision revoked by this Order.

(b) 2020 c. 14.

Article 22 amended (cap: base for scheme years)

8.—(1) Article 22 is amended as follows.

(2) In table B in column 2 (base)—

- (a) for “142,968,239” substitute “92,062,882”;
- (b) for “138,733,792” substitute “86,742,014”;
- (c) for “134,499,344” substitute “79,059,690”;
- (d) for “130,264,897” substitute “70,127,996”;
- (e) for “126,030,449” substitute “53,498,502”;
- (f) for “121,796,002” substitute “50,918,572”;
- (g) for “117,561,555” substitute “49,320,164”.

Article 23A inserted

9. After article 23 insert—

“Flexible reserve

23A.—(1) The flexible reserve is a reserve of allowances for the trading period from which allowances may be allocated until the reserve is exhausted.

(2) The flexible reserve consists of the following—

- (a) allowances equal to the sum of the amounts set out in paragraphs (i) and (ii), if the sum is greater than zero—
 - (i) 28,081,237;
 - (ii) the sum of A and C minus 53,294,847, where—
 - (aa) A is 240,342,255 (industry cap for 2021-2025 allocation period) minus B;
 - (bb) B is the final annual number of allowances approved by the UK ETS authority^(a) under Article 16b of the Free Allocation Regulation^(b) (final allocation at installation level for incumbent installations) to be allocated in respect of all installations for all scheme years in the 2021-2025 allocation period;
 - (cc) C is equal to the number of B that are not allocated or, if allocated, subsequently returned;
- (b) allowances equal to the sum of D and F, where—
 - (i) D is—
 - (aa) 121,169,970 (industry cap for 2026-2030 allocation period) minus E; or
 - (bb) if E is greater than 121,169,970, zero;
 - (ii) E is the final annual number of allowances approved by the UK ETS authority under Article 16b of the Free Allocation Regulation to be allocated in respect of all installations for all scheme years in the 2026-2030 allocation period;
 - (iii) F is equal to the number of E that are not allocated or, if allocated, subsequently returned;
- (c) allowances equal to the number of allowances representing aviation free allocation entitlement (within the meaning of Chapter 2 of Part 4A) approved by the UK ETS authority but not allocated or, if allocated, subsequently returned.

(a) See article 14 of S.I. 2020/1265 for “UK ETS authority”.

(b) EUR 2019/331, amended by S.I. 2020/1557, 2021/1455, 2022/1173, 2023/850, 2023/1387, 2024/192 and this Order. See article 4(1) of S.I. 2020/1265 for the definition of “Free Allocation Regulation”.

- (3) For the purposes of paragraph (2)—
- (a) any increase approved by the UK ETS authority under article 20(5) of the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2023^(a) (free allocation for 2024 and 2025 scheme years: lime and malt extract) that in accordance with article 34B(3A) of this Order was required to be added to the amount included in column A of the allocation table for the 2021-2025 allocation period must be treated as if approved under Article 16b of the Free Allocation Regulation;
 - (b) a reference to allowances that are returned is a reference to allowances transferred or returned in accordance with a notice under article 34U or 34V or, in the case of other allowances to which a person is not entitled (as set out in article 34S(3) or 34T(3)), returned voluntarily without the need for such a notice to be given.
- (4) Allowances from the flexible reserve may be used—
- (a) for free allocation in respect of incumbent installations (within the meaning of the Free Allocation Regulation^(b));
 - (b) for allocation under the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 or any other regulations made under section 96 of the Finance Act 2020.”.

Article 34 amended (surrender of allowances by aircraft operators)

10.—(1) Article 34 is amended as follows.

(2) Omit paragraphs (2) and (3).

Article 34G amended (new entrants’ reserve)

11.—(1) Article 34G is amended as follows.

(2) In paragraph (1)—

- (a) for “30,249,066” substitute “20,725,431”;
- (b) after “trading period” insert “from which allowances may be allocated until the reserve is exhausted”.

(3) After paragraph (1) insert—

“(1A) Allowances from the new entrants’ reserve—

- (a) unless used as mentioned in sub-paragraph (b), must be used for allocation in respect of installations in accordance with paragraphs (2) to (5);
- (b) may be used for allocation under the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 or any other regulations made under section 96 of the Finance Act 2020 (even if the allocation exhausts the new entrants’ reserve before the end of the trading period).”.

(4) In paragraph (6) after “article 34U or 34V” insert “or returned voluntarily without the need for such a notice to be given”.

Article 34N amended (aviation allocation table for 2021-2025 allocation period)

12.—(1) Article 34N is amended as follows.

(2) In paragraph (4) after “of certain applicants)” insert “, article 42 of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 or article 34M of this Order (as applied by article 43 of that Order)”.

(a) S.I. 2023/850.

(b) See Article 2(1)(1) of EUR 2019/331 for the definition of “incumbent installation”.

Article 34R amended (errors in aviation allocation table)

13.—(1) Article 34R is amended as follows.

(2) In paragraph (2)—

- (a) in sub-paragraph (a) after “34Q” insert “or under article 43 of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024”;
- (b) in sub-paragraph (b) after “(including under this article)” insert “or article 42 or 43 of the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024”.

Heading of Chapter 1 of Part 7 amended

14. In Part 7 in the heading of Chapter 1 after “Enforcement notices” insert “, deficit notices”.

Article 44A inserted

15. After article 44 insert—

“Deficit notices

44A.—(1) This article applies where—

- (a) the operator of an installation fails to surrender allowances equal to the installation’s reportable emissions in a scheme year (the “relevant scheme year”), contrary to—
 - (i) article 27;
 - (ii) the requirements of a surrender notice under paragraph 11 of Schedule 6 (see paragraph 11(4)(b)(iii));
 - (iii) the requirements of a revocation notice under paragraph 12 of that Schedule (see paragraph 12(5)(b)(iii));
- (b) a person who is an aircraft operator in relation to a scheme year (the “relevant scheme year”) fails to surrender allowances equal to the person’s aviation emissions in that year, contrary to article 34.

(2) The regulator may give a notice (a “deficit notice”) to the operator of the installation or to the person.

(3) The deficit notice must set out—

- (a) the relevant scheme year and the installation’s reportable emissions, or the person’s aviation emissions, in that year;
- (b) the number of allowances (if any) surrendered in compliance with article 27, the requirements of a surrender or revocation notice or article 34 (including any surrendered after the date by which allowances were required to be surrendered);
- (c) the number of allowances representing the difference (the “deficit”) between allowances equal to the installation’s reportable emissions, or the person’s aviation emissions, in the relevant scheme year and the number referred to in sub-paragraph (b);
- (d) the date (the “deficit surrender date”) on or before which the person to whom the notice is given must surrender allowances equal to the deficit;
- (e) information about rights of appeal.

(4) The person to whom a deficit notice is given must surrender allowances equal to the deficit on or before the deficit surrender date.

(5) The regulator may withdraw a deficit notice at any time by giving notice of the withdrawal to the person to whom the deficit notice is given.

(6) A deficit notice may be given in respect of a failure to surrender allowances that arises before as well as after this article comes into force.

(7) In the case of a transfer of a permit under paragraph 9 of Schedule 6 (other than a partial transfer)—

- (a) after the transfer date, a deficit notice may be given to the new operator only, including in respect of a failure to surrender allowances arising before the transfer date;
- (b) where a deficit notice in respect of a failure to surrender allowances is given to the transferring operator before the transfer date and has not been complied with, a new deficit notice may be given to the new operator in respect of the same failure provided that the original notice is first withdrawn.

(8) A deficit notice may not be given—

- (a) to the operator of an installation, if the operator holding account for the installation has been closed under paragraph 27 of Schedule 5A;
- (b) to a person who is an aircraft operator in relation to a scheme year, if the person's aircraft operator holding account has been closed under paragraph 28 of that Schedule;
- (c) in respect of allowances which a transferring operator failed to surrender in a scheme year as a result of an error of the kind referred to in paragraph 10(1) of Schedule 6 (transfer of permits: underreporting discovered after transfer).

(9) In this Article—

“new operator” and “transferring operator” have the meanings given in paragraph 7(1) of Schedule 6;

“transfer date” has the meaning given in paragraph 9(6) of that Schedule.”.

Article 47 amended (penalty notices)

16.—(1) Article 47 is amended as follows.

(2) After paragraph (2)(c) insert—

“(d) article 65A (failure to comply with deficit notice), but the regulator is not required to impose the daily penalty under paragraph (2)(b) of that article.”.

(3) After paragraph (5) insert—

“(5A) Where the person is liable to a civil penalty under article 53 or 65A, an initial notice may not be given until at least 28 days have expired since—

- (a) in the case of a civil penalty under article 53, the day on or before which the person is required to transfer or, as the case may be, surrender allowances;
- (b) in the case of a civil penalty under article 65A, the deficit surrender date set out in the deficit notice (see article 44A(3)(d)).”.

(4) In paragraph (7A) for “article 64A(2)(b)” substitute “article 53(2)(b), 64A(2)(b) or 65A(2)(b)”.

(5) In paragraph (12) in the definition of “daily penalty”—

- (a) after “51(3)(b),” insert “53(2)(b),”;
- (b) after “55(2)(b),” insert “60A(2)(b),”;
- (c) after “65(2)(b)” insert “, 65A(2)(b)”.

Article 48 amended (penalty notices: supplementary)

17.—(1) Article 48 is amended as follows.

(2) After paragraph (3)(c) insert—

“(d) a penalty notice imposing a civil penalty under article 65A, but if the penalty imposed consists of both a non-escalating penalty and a daily penalty, paragraphs (1) and (2) apply to the notice in relation to the daily penalty only.”.

Article 51 amended (installations: failure to comply with conditions of permit, etc.)

18.—(1) Article 51 is amended as follows.

(2) After paragraph (2)(b) insert—

“(c) article 57.”.

Article 52 amended (failure to surrender allowances)

19.—(1) Article 52 is amended as follows.

(2) Omit paragraph (3).

(3) In paragraph (11)—

(a) for “ $(CPI_2 - CPI_1)/CPI_1$ ” substitute “ CPI_2 /CPI_1 ”;

(b) for “most recent March for which the consumer prices index is published when the penalty notice is given” substitute “month preceding the month that includes the day on or before which the allowance was required to be surrendered”.

Article 53 amended (installations: failure to transfer or surrender allowances where underreporting discovered after transfer)

20.—(1) Article 53 is amended as follows.

(2) For paragraphs (2) and (3) substitute—

“(2) The civil penalty is—

(a) $CP \times 1.5$ for each allowance that the person fails to transfer or surrender, where CP is the carbon price for the scheme year after the scheme year to which the report referred to in sub-paragraph (1) of paragraph 10 of Schedule 6 relates; and

(b) a daily penalty at a daily rate of £1,000 for each day that sub-paragraph (3) or, as the case may be, (4) of that paragraph has not been complied with, beginning with the day on which the initial notice is given (see article 47(5)).”.

Article 56 amended (hospitals and small emitters: under-reporting of emissions)

21.—(1) Article 56 is amended as follows.

(2) In paragraph (2)—

(a) for “ $(UE \times CP)$ ” substitute “ $(UE \times £10 \times \text{the inflation factor})$ ”;

(b) omit “CP is the carbon price for the scheme year”.

(3) After paragraph (2) insert—

“(3) In this article, “inflation factor” has the meaning given in article 52(11), except that CPI_2 is the consumer prices index (as defined in article 52(12)) for the month preceding the month that includes the day on or before which the emissions report was required to be submitted.”.

Article 57 amended (hospitals and small emitters: failure to notify when ceasing to meet criteria)

22.—(1) Article 57 is amended as follows.

(2) In paragraph (3)—

(a) in sub-paragraph (a) for “£5,000” substitute “£2,500”;

(b) for sub-paragraph (b) substitute—

“(b) if there is a penalty year, subject to paragraph (4A), the operator is liable (after the end of the last penalty year), to a civil penalty of the sum of the avoided compliance costs for all penalty years.”.

(3) After paragraph (4) insert—

“(4A) When setting the amount of the civil penalty to be imposed under paragraph (3)(b), the regulator may increase the sum of the avoided compliance costs for all penalty years (before any reduction under article 48) by 10% of the total or £2,500, whichever is higher.”.

Article 60 amended (ultra-small emitters: failure to notify where reportable emissions exceed maximum amount)

23.—(1) Article 60 is amended as follows.

(2) In paragraph (2)—

- (a) in the words before sub-paragraph (a) for “The civil penalty is the sum of” substitute “Subject to paragraph (5), the civil penalty is”;
- (b) omit sub-paragraph (a).

Article 60A inserted

24. After article 60 insert—

“Installations: failure to submit information under article 27A

60A.—(1) The operator of an installation is liable to a civil penalty where the operator fails to comply (or to comply on time) with the requirements of article 27A.

(2) The civil penalty is—

- (a) £5,000; and
- (b) a daily penalty at a daily rate of £500 for each day that the operator fails to comply with the requirements of article 27A, beginning with the day on which the initial notice is given, up to a maximum of £45,000.”.

Article 65A inserted

25. After article 65 insert—

“Failure to comply with deficit notice

65A.—(1) A person is liable to a civil penalty where the person fails to surrender (or to surrender on time) sufficient allowances, contrary to the requirements of a deficit notice given under article 44A.

(2) The civil penalty is—

- (a) $CP \times 1.5$ for each allowance not surrendered on or before the deficit surrender date set out in the deficit notice, where CP is the carbon price for the scheme year after the relevant scheme year set out in the notice; and
- (b) a daily penalty at a daily rate of £1,000 for each day that the requirements of the deficit notice have not been complied with, beginning with the day on which the initial notice is given (see article 47(5)).”.

Article 70 amended (appeals)

26.—(1) Article 70 is amended as follows.

(2) After paragraph (2)(c) insert—

“(ca) article 44A (deficit notices);”.

Schedule 1 amended (aviation activity)

27.—(1) Schedule 1 is amended as follows.

Paragraph 1 amended (aviation activity)

(2) After paragraph 1(1)(a)(iv) insert—

“(v) in Switzerland.”

Schedule 2 amended (meaning of installation and regulated activity)

28.—(1) Schedule 2 is amended as follows.

Paragraph 3 amended (meaning of regulated activity, etc.)

(2) In paragraph 3—

(a) in sub-paragraph (1)—

(i) in the words before paragraph (a) after “means” insert “any of the following”;

(ii) in paragraph (a) omit the “and” at the end of the paragraph;

(iii) after paragraph (b) insert—

“(c) where the activity set out in column 1 of the first row of table C (combustion of fuels, etc.) is carried out on an upstream site, upstream GHG removal on or after the relevant date in any stationary technical unit on the site that results in emissions of carbon dioxide.”;

(b) after sub-paragraph (6) insert—

“(6A) In this paragraph—

“relevant date” means 1st January 2025 or, if the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 is made on or after 16th November 2024, the first day of the fourth month after the month in which that Order is made;

“upstream GHG removal” means the removal of constituent greenhouse gases from petroleum (whether by a chemical or physical process);

“upstream site” means the site of—

(a) a project carried out by virtue of a licence granted under section 2 of the Petroleum (Production) Act 1934(a), section 3 of the Petroleum Act 1998(b) or section 2 of the Petroleum (Production) Act (Northern Ireland) 1964(c);

(b) a facility (other than a liquefied natural gas import or export facility or a facility operated by a gas transporter) where constituent greenhouse gases are removed from petroleum for the purpose of enabling it to be introduced into a pipeline system operated by a gas transporter or to be conveyed to an electricity generating station, a gas storage facility, a liquefied natural gas import or export facility or any place outside the United Kingdom.

(6B) In sub-paragraph (6A)—

“gas storage facility” means a gas storage facility as defined in section 12(6) of the Gas Act 1995(d) or a gas storage facility as defined in Article 3(1) of the Gas (Northern Ireland) Order 1996(e);

(a) 1934 c. 36, repealed by section 51 of, and Schedule 5 to, the Petroleum Act 1998.

(b) 1998 c. 17.

(c) 1964 c. 28 (N.I.).

(d) 1995 c. 45. The definitions of “gas storage facility” and “LNG import or export facility” are inserted by section 92(11)(b) of the Energy Act 2011 (c. 16).

(e) S.I. 1996/275 (N.I. 2). The definition of “gas storage facility” is amended by regulation 4(1)(c) of S.R. 2020 No. 279. The definition of “LNG facility” is inserted by regulation 12(a) of S.R. 2013 No. 92.

“gas transporter” means a gas transporter as defined in section 7(1) of the Gas Act 1986(a) or the holder of a licence under Article 8(1)(a) of the Gas (Northern Ireland) Order 1996;

“liquefied natural gas import or export facility” means an LNG import or export facility as defined in section 12(6) of the Gas Act 1995 or an LNG facility as defined in Article 3(1) of the Gas (Northern Ireland) Order 1996;

“petroleum” has the same meaning as in Part 1 of the Petroleum Act 1998(b) and includes petroleum that has undergone any processing.”.

Schedule 4 amended (Monitoring and Reporting Regulation 2018)

29.—(1) Schedule 4 is amended as follows.

Paragraph 38 amended (Annex 4: activity-specific monitoring methodologies related to installations (Article 20(2))

(2) After paragraph 38(e) insert—

“(f) after section 23 there were inserted—

“24. UPSTREAM GHG REMOVAL AS LISTED IN SCHEDULE 2 TO THE GREENHOUSE GAS EMISSIONS TRADING SCHEME ORDER 2020

A. Scope

The operator shall monitor and report all CO₂ emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order) that are released in a combustion process or as vented emissions without a combustion process.

Where emissions are released in a combustion process, the scope is as set out in section 1 of this Annex. Where emissions are released as vented emissions without a combustion process, the operator shall include at least vents and unlit flares.

B. Specific monitoring rules

Where emissions are released in a combustion process, monitoring shall be carried out in accordance with section 1 of this Annex.

Where emissions are released as vented emissions without a combustion process, if a measurement-based methodology is used, Annex 8 is to be read as if in section 1 in Table 1 (tiers for CEMS (maximum permissible uncertainty for each tier)) for the first row there were substituted:

	Tier 1	Tier 2	Tier 3	Tier 4
“CO ₂ emission sources	± 17.5%	± 12.5%	± 7.5 %	N.A.”.

Where emissions are released as vented emissions without a combustion process, the operator may choose to apply a calculation-based methodology whereby:

- (a) vented emissions released at a vent or unlit flare are to be treated as a “source stream” for the purposes of this Regulation and monitored accordingly;
- (b) venting is to be treated as the process that causes vented emissions;

(a) 1986 c. 44. The term “gas transporter” is substituted by section 76(2) of the Utilities Act 2000 (c. 27).
 (b) See section 1.

- (c) emissions are to be determined by multiplying the activity data related to vented emissions, expressed as tonnes or normal cubic metres, by the corresponding emission factor, expressed as t CO₂/t or t CO₂/Nm³.

Where the methodology referred to in the preceding paragraph is applied, for the purposes of that methodology:

- (a) Article 3 is to be read as if in point (13) (definition of “emission factor”) “assuming complete oxidation for combustion and complete conversion for all other chemical reactions” were omitted;
- (b) Article 27 is to be read as if:
 - (i) paragraph 1(b) were omitted;
 - (ii) paragraph 2 were omitted;
- (c) Article 30 is to be read as if in paragraph 2 in the first subparagraph the reference to fuel included a reference to vented emissions;
- (d) Article 31 is to be read as if in paragraph 1(e) for “batches of the same fuel or material” there were substituted “vented emissions”;
- (e) Article 32 is to be read as if:
 - (i) in paragraph 2 the reference to fuels included a reference to vented emissions;
 - (ii) in paragraph 3 for “delivery period or batch of fuel or material” there were substituted “period of release of vented emissions”;
- (f) Article 33 is to be read as if:
 - (i) in paragraph 1:
 - (aa) in the first subparagraph for “each fuel or material” there were substituted “vented emissions”;
 - (bb) in the second subparagraph for “batch or delivery period” there were substituted “period of release of vented emissions”;
 - (cc) in the second subparagraph for “the respective fuel or material” there were substituted “vented emissions”;
 - (ii) in paragraph 2:
 - (aa) for “the respective fuel or material” there were substituted “vented emissions”;
 - (bb) for “the fuel or material” there were substituted “the vented emissions”;
 - (cc) for “that specific fuel or material” there were substituted “those vented emissions”;
- (g) Article 35 is to be read as if:
 - (i) in paragraph 1 for “relevant fuels or materials” there were substituted “vented emissions”;
 - (ii) in paragraph 2 in the first subparagraph in point (a):
 - (aa) for “the respective fuels or materials” there were substituted “vented emissions”;
 - (bb) for “the respective fuel or material” there were substituted “vented emissions”;
 - (cc) for “the relevant fuel or material” there were substituted “vented emissions”;
 - (iii) in paragraph 2 in the second subparagraph for “Where an installation operates for part of the year only, or where fuels or materials are delivered

in batches that are consumed over more than one calendar year” there were substituted “Where vented emissions are not released continuously”;

(h) Article 36 is to be read as if after paragraph 3 there were inserted:

“4. Emission factors of vented emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order) shall be expressed as t CO₂/t or t CO₂/Nm³.”;

(i) Annex 2 is to be read as if:

(i) in section 1 in Table 1 (tiers for activity data (maximum permissible uncertainty for each tier)) after the last row there were inserted:

<i>Activity/source stream type</i>	<i>Parameter to which the uncertainty is applied</i>	<i>Tier 1</i>	<i>Tier 2</i>	<i>Tier 3</i>
“Vented emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order)	Amount of vented emissions [t] or [Nm ³]	± 17.5%	± 12.5 %	± 7.5%”;

(ii) after section 4 there were inserted:

5. DEFINITION OF TIERS FOR EMISSION FACTORS FOR VENTED EMISSIONS FROM UPSTREAM GHG REMOVAL

Operators shall monitor vented CO₂ emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order) using the tier definitions for emission factors laid down in this section.

Tier 1: The operator shall derive emission factors for vented emissions based on a proxy agreed with the regulator, in combination with an empirical correlation as determined at least once per year in accordance with Articles 32 to 35.

The operator shall ensure that the correlation satisfies the requirements of good engineering practice and that it is applied only to values of the proxy which fall into the range for which it was established.

Tier 2: The operator shall apply one of the following:

- (a) determination of the emission factor in accordance with the relevant provisions of Articles 32 to 35;
- (b) the empirical correlation as specified for Tier 1, where the operator demonstrates to the satisfaction of the regulator that the uncertainty of the empirical correlation does not exceed 1/3 of the uncertainty value to which the operator has to adhere with regard to the activity data determination of the vented emissions.”;
- (j) Annex 5 is to be read as if in Table 1 (minimum tiers to be applied for calculation-based methodologies in the case of category A installations, etc.) after the last row there were inserted:

<i>Activity/Source stream type</i>	<i>Activity data</i>		<i>Composition data</i>			
	<i>Amount of fuel material</i>	<i>Net calorific value</i>	<i>Emission factor</i>	<i>(carbon content)</i>	<i>Oxidation factor</i>	<i>Conversion factor</i>
“Upstream GHG removal						

Vented emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order)	1	n.a.	1	n.a.	n.a.	n.a.”;
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(k) Annex 7 (minimum frequency of analyses) is to be read as if in the table after the last row there were inserted:

<i>Fuel/material</i>	<i>Minimum frequency of analyses</i>
“Vented emissions from upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order)	At least weekly”””.

Schedule 5 amended (Verification Regulation 2018)

30.—(1) Schedule 5 is amended as follows.

Paragraph 54 amended (Annex 1: scope of accreditation for verifiers)

(2) After paragraph 54(b)(ii) insert—

“(iia) after the entry for group 12 (aviation activities) there were inserted—

<i>Activity Group No</i>	<i>Scopes of accreditation</i>
“13	Upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the 2020 Order)””.

Schedule 5A amended (registry)

31.—(1) Schedule 5A is amended as follows.

Paragraph 9 amended (central accounts)

(2) After paragraph 9(1)(h) insert—

“(i) a flexible reserve account (to keep track of the flexible reserve referred to in article 23A).”.

Paragraph 27 amended (closure of operator holding accounts)

(3) In paragraph 27(1)(b) after “operator, etc.)” insert “, any deficit notice given under article 44A or any notice given under paragraph 10 of Schedule 6 (transfer of permits: underreporting discovered after transfer),”.

Paragraph 28 amended (closure of aircraft operator holding accounts)

(4) In paragraph 28(1)(c) after “notice to operator, etc.)” insert “, or any deficit notice given under article 44A,”.

Schedule 6 amended (permits)

32.—(1) Schedule 6 is amended as follows.

Paragraph 4 amended (greenhouse gas emissions permits: content of permit)

(2) In paragraph 4—

- (a) in sub-paragraph (1)(h) for “sub-paragraphs (3) to (5)” substitute “sub-paragraph (3)”;
- (b) omit sub-paragraphs (4) and (5).

Paragraph 11 amended (surrender of permits)

- (3) In paragraph 11—
- (a) in sub-paragraph (4)(b)(iii)—
 - (i) in the words before sub-paragraph (aa) omit “the sum of”;
 - (ii) in sub-paragraph (aa) omit the “and” at the end of the sub-paragraph;
 - (iii) omit sub-paragraph (bb);
 - (b) in sub-paragraph (6)(b) after “surrender notice” insert “, and of any deficit notice given to the operator of the installation under article 44A,”.

Paragraph 12 amended (revocation of permits)

- (4) In paragraph 12—
- (a) in sub-paragraph (5)(b)(iii)—
 - (i) in the words before sub-paragraph (aa) omit “the sum of”;
 - (ii) in sub-paragraph (aa) omit the “and” at the end of the sub-paragraph;
 - (iii) omit sub-paragraph (bb);
 - (b) in sub-paragraph (7)(b) after “revocation notice” insert “, and of any deficit notice given to the operator of the installation under article 44A,”.

PART 3

Free Allocation Regulation amended

Free Allocation Regulation amended

33. Commission Delegated Regulation (EU) 2019/331 is amended in accordance with this Part.

Article 2 amended (definitions)

34.—(1) Article 2 is amended as follows.

(2) After paragraph 1(24) insert—

“(25) “upstream GHG removal” means upstream GHG removal (as defined in paragraph 3(6A) of Schedule 2 to the UK ETS Order) on or after the relevant date (as defined in that sub-paragraph).”.

Article 10 amended (division into sub-installations)

35.—(1) Article 10 is amended as follows.

(2) In paragraph 5(b) after “production of electricity in the installation,” insert “the venting of emissions from upstream GHG removal without a combustion process,”.

Article 16a amended (cross sectoral correction factors)

36.—(1) Article 16a is amended as follows.

(2) In paragraph 2—

- (a) in point (a) for “in the trading period preceding the relevant scheme year” substitute “preceding the relevant scheme year in the same allocation period as the relevant scheme year”;
- (b) in point (b) for “40,984,970 allowances (the flexible share)” substitute “such number of allowances from the flexible reserve under article 23A of the UK ETS Order as the UK ETS authority may determine for the allocation period”;

- (c) in point (c) for “in the trading period preceding the relevant scheme year” substitute “preceding the relevant scheme year in the same allocation period as the relevant scheme year”.

(3) In paragraph 5 in the words before point (a) after “allocation period” insert “the number of allowances determined as FS under paragraph 2(b) and”.

(4) In paragraph 6 in table A in column 2 (industry cap)—

- (a) for “53,107,152” substitute “36,825,153”;
- (b) for “51,524,012” substitute “34,696,806”;
- (c) for “49,940,872” substitute “31,623,876”;
- (d) for “48,357,732” substitute “28,051,198”;
- (e) for “46,774,592” substitute “21,399,401”;
- (f) for “45,191,452” substitute “20,367,429”;
- (g) for “43,608,312” substitute “19,728,066”.

Article 17 amended (historical activity level for new entrants)

37.—(1) Article 17 is amended as follows.

(2) In paragraph 1(e) after “process emissions of the process unit” insert “other than emissions from upstream GHG removal vented without a combustion process”.

Annex 7 amended (data monitoring methods)

38.—(1) Annex 7 is amended as follows.

Section 10 amended (rules for determining emissions at sub-installation level for the purpose of updating benchmark values)

(2) In section 10.2 (attributed emissions to sub-installations) in the third paragraph after “used for electricity production,” insert “for the venting of emissions from upstream GHG removal without a combustion process,”.

PART 4

Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 amended

Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 amended

39. The Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021 are amended in accordance with this Part.

Regulation 10 amended (adjustments of the auction calendar)

40.—(1) Regulation 10 is amended as follows.

(2) In paragraph (1)(d) after “Trading Scheme Order” insert “or in the flexible reserve provided for in article 23A of that Order”.

Regulation 12 amended (cost containment mechanism)

41.—(1) Regulation 12 is amended as follows.

(2) In paragraph (1)(b)—

- (a) omit paragraph (iv);
- (b) in paragraph (v) for “up to 28,081,237 allowances” substitute “allowances from the flexible reserve provided for in article 23A of the Trading Scheme Order”.

- (3) Omit paragraphs (1A) to (1D).

PART 5

Other

Flights from Northern Ireland to Switzerland: further provision

Flights from Northern Ireland to Switzerland: recalculation of aviation free allocation entitlement for 2025 scheme year

42.—(1) As soon as reasonably practicable after this article comes into force, the regulator must recalculate the aviation free allocation entitlement for the 2025 scheme year of every person (an “applicant”) who made an application under article 34L of the UK ETS Order, applying article 34M(2) to (6) of that Order and taking into account any historical aviation activity level (“relevant historical aviation activity level”) attributable to the applicant immediately before 1st January 2021 due to aviation activity consisting of flights departing from an aerodrome situated in Northern Ireland and arriving in an aerodrome situated in Switzerland.

(2) If this Order is made on or after 31st December 2024, for the purpose of this article, any relevant historical aviation activity level must be multiplied by $X/12$, where X is the number of months in 2025 after the “relevant commencement day” referred to in article 2(4) (including the month in which the relevant commencement day falls).

(3) The regulator may by notice to the applicant request the applicant to provide such information specified in the notice, within such period specified in the notice, as the regulator considers necessary for the recalculation.

(4) The regulator must as soon as reasonably practicable submit the recalculation and any relevant information that the regulator holds to the UK ETS authority.

(5) Paragraph (4) does not apply if the applicant fails, without reasonable excuse, to provide any information requested under paragraph (3) within the period specified in the notice or such later period as may be agreed with the regulator.

(6) The UK ETS authority must—

(a) approve the applicant’s aviation free allocation entitlement for the 2025 scheme year, making any corrections to the recalculation that the UK ETS authority considers appropriate;

(b) inform the regulator accordingly.

(7) This article and article 43 must be interpreted as if they were part of Chapter 2 of Part 4A of the UK ETS Order.

(8) In this article and article 43, “UK ETS Order” means the Greenhouse Gas Emissions Trading Scheme Order 2020.

Flights from Northern Ireland to Switzerland: application for aviation free allocation entitlement for 2025 scheme year

43.—(1) A person who did not submit an application for an aviation free allocation entitlement under article 34L of the UK ETS Order may apply for an aviation free allocation entitlement for the 2025 scheme year, but in reliance on any historical aviation activity level (“relevant historical aviation activity level”) due to aviation activity consisting only of flights departing from an aerodrome situated in Northern Ireland and arriving in an aerodrome situated in Switzerland.

(2) If this Order is made on or after 31st December 2024, for the purpose of this article, any relevant historical aviation activity level must be multiplied by $X/12$, where X is the number of months in 2025 after the “relevant commencement day” referred to in article 2(4) (including the month in which the relevant commencement day falls).

(3) An application must be submitted to the regulator on or before the later of—

- (a) 30th April 2025; and
- (b) the last day of the second month after the month in which the relevant commencement day falls.

(4) Articles 34L and 34M of the UK ETS Order apply to an application under this article as they apply to an application under article 34L with the following modifications—

- (a) references to historical aviation activity levels must be read as references to relevant historical aviation activity level;
- (b) article 34M(1)(b) must be read as if for “each scheme year in the 2021-2025 allocation period” there were substituted “the 2025 scheme year”.

Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022 revoked

44. The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022(a) is revoked.

Provision for carbon capture, transport and storage, etc. extended to Northern Ireland

Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 amended

45.—(1) The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023(b) is amended as follows.

(2) In article 3 (extent) for “England and Wales and to Scotland” substitute “the whole of the United Kingdom”.

Name
Clerk of the Privy Council

EXPLANATORY NOTE

(This note is not part of the Order)

The United Kingdom Emissions Trading Scheme (the “UK ETS”) was established by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the “UK ETS Order”). The UK ETS runs for a “trading period” consisting of 10 “scheme years” beginning with 2021, split into two 5-year “allocation periods”. Operators of certain industrial installations and certain aircraft operators are required to monitor, report on, and surrender “allowances” equivalent to, their greenhouse gas emissions in each scheme year. Allowances (which are tradable) are held in accounts in the UK ETS registry, and there is a cap on the number of allowances that may be created. Allowances are sold at auction, but some participants receive an allocation of allowances free of charge.

This Order amends *inter alia* the UK ETS Order and Commission Delegated Regulation (EU) 2019/331 (the “Free Allocation Regulation”). Articles 24 and 25 of the UK ETS Order provide that Commission Implementing Regulation (EU) 2018/2066 (the “Monitoring and Reporting Regulation 2018”) and Commission Implementing Regulation (EU) 2018/2067 (the “Verification Regulation 2018”) have effect for the purposes of the UK ETS, with modifications set out in Schedules 4 and 5 to the UK ETS Order, and this Order makes further modifications.

The main changes made by this Order are as follows.

- The number of allowances that may be created, and the number available for free allocation for installations, is reduced (see amendments to articles 19, 20, 22 and 34G of the UK ETS Order and to Article 16a of the Free Allocation Regulation).
- A “flexible reserve” of allowances is created, which may be used to top up free allocation for “incumbent” installations in the 2026-2030 allocation period before the application of

(a) S.I. 2022/1336.

(b) S.I. 2023/1387.

a cross-sectoral correction factor or for auction (see new article 23A of the UK ETS Order and amendments to Article 16a of the Free Allocation Regulation). Consequential amendments are made to the Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021.

- The UK ETS is expanded to include (a) flights from Northern Ireland to Switzerland (see amendments to article 4 of, and Schedule 1 to, the UK ETS Order) and (b) the venting of carbon dioxide emissions released without a combustion process from installations in the “upstream” oil and gas sector that are required to participate in the UK ETS in any event by reason of combustion activities (see amendments to Schedule 2 to the UK ETS Order and further modifications to the Monitoring and Reporting Regulation 2018 and the Verification Regulation 2018). There is no free allocation for vented emissions (see amendments to the Free Allocation Regulation (other than to Article 16a)).
- The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 is extended to Northern Ireland (see article 45 of this Order). That Order provides for aircraft operators whose free allocation exceeds their emissions to be required to return any excess allowances and makes provision in relation to carbon capture, transport and storage and free allocation for “electricity generators”.
- There is an additional means of enforcing the obligation to surrender allowances – a “deficit notice” – and an associated civil penalty (see new articles 44A and 65A of the UK ETS Order).
- There is a new civil penalty to enforce the requirement in article 27A of the UK ETS Order to provide information (see new article 60A of the UK ETS Order), and changes are made to the amount of the civil penalty that may be imposed under articles 52, 53, 56, 57 and 60 of the UK ETS Order.

This Order also makes a number of corrections and clarifications.

An impact assessment covering some of the policy given effect to by this Order is available from the Industrial Decarbonisation and Emissions Trading Directorate, Department for Energy Security and Net Zero, 3-8 Whitehall Place, London SW1A 2JP and is available alongside this Order on www.legislation.gov.uk.

Annexe B: Scottish Government Policy Note

POLICY NOTE

THE GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT) (No. 2) ORDER 2024

SI 2024/XXXX

The above instrument is to be made in exercise of the powers conferred by sections 44, 54 and 90(3) of, and Schedule 2 and paragraph 9 of Schedule 3 to the Climate Change Act 2008. The instrument is subject to affirmative procedure.

Summary Box

This instrument makes various changes to the UK Emissions Trading Scheme (the “UK ETS”) including expanding the scope of the scheme to carbon dioxide venting in the upstream oil and gas sector, introducing a new type of enforcement notice called a ‘deficit notice’, and making technical changes to the scheme’s penalties.

In addition, this instrument will ensure legislative consistency by implementing changes that were previously unable to be made on a UK-wide basis under the Climate Change Act 2008 (CCA) in the absence of a sitting Northern Ireland Assembly. It will bring the scheme’s cap, as set in legislation, in line with net zero trajectories (already partially effected by changes to the Greenhouse Gas Emissions Trading Auctioning Regulations 2021 (the “Auctioning Regulations”) made in late 2023 which reduced the number of allowances to be auctioned from 2024).

This instrument will also implement the announced reduction in the total number of allowances available for free allocation (as part of that same process of aligning the UK ETS with net zero trajectories), expand the scope of the scheme to flights from Northern Ireland to Switzerland, and extend legislation to Northern Ireland that currently only extends to England, Wales and Scotland. For further information on the UK ETS, see the Policy Note accompanying the 2020 Order ¹.

Policy Objectives

The UK ETS was established under the Climate Change Act 2008 by the 2020 Order as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions which will contribute to the UK’s emissions reduction targets and net zero goal. 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 for 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. This scheme replaced the UK’s participation in the EU Emissions Trading System (EU ETS), and the 2020 Order applied EU ETS rules on the monitoring, reporting and verification of emissions with modifications to ensure that they work for the UK ETS.

¹ [Draft Greenhouse Gas Emissions Trading Scheme Order \(legislation.gov.uk\)](https://legislation.gov.uk)

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 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.

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.

This instrument will make changes to free allocation policy in the UK ETS. The main changes made by this instrument are in relation to:

- *Carbon dioxide venting in the upstream oil and gas sector:* In the initial phases of oil and gas production, installations may be required to carry out localised processing to remove excess CO₂ from hydrocarbon oil and gas. These controlled processes are essential for safety purposes and are also used in situations where the hydrocarbon oil and gas are unable to be used, exported, or re-injected without the CO₂ being removed. The removed CO₂ can then be released in the processes of flaring, where waste gas including the stripped-out CO₂ as well as combustible elements is ignited, and venting, where unignited gas is released through a vent. In 2020, 2.81Mt of CO₂ was released during flaring. We estimate 0.4Mt of CO₂ is vented and thus in scope of this legislation.

Under current legislation, CO₂ released through flaring is included in the UK ETS as it is within the scope of the regulated activity of combustion (whether that is "combustion of fuels on a site where combustion with a maximum total rated thermal input exceeding 20 megawatts" or the combustion of fuels in a combustion unit operated on a site carrying out any other regulated activity; therefore, carbon emitted through flaring is already subject to the carbon price. In contrast, venting is not a regulated activity within the UK ETS and, as a result, operators have a perverse incentive to vent gas containing carbon dioxide that, if flared, would constitute reportable emissions for the purposes of the Scheme. This instrument introduces CO₂ venting into the scope of the UK ETS for installations already covered by the scheme because they exceed the combustion threshold, thereby removing this perverse incentive.

- *Enforcement:* The Regulators are responsible for enforcing compliance, including operational functions such as issuing penalties. This instrument introduces two new penalties, and makes several changes to existing penalties in order to ensure that a proportionate and consistent approach is maintained across the UK ETS.
- *Deficit notice and penalty:* Where installations and aircraft operators fail to surrender allowances to cover their reportable or aviation emissions by the relevant deadline, this instrument provides for a "deficit notice" to be issued by their UK ETS regulator as an additional means of enforcing the obligation. Should the operator not comply with the deficit notice, they will be liable to a penalty equivalent to the carbon price for each

allowance they are in deficit for, multiplied by a factor of 1.5. Operators who continue to not pay this may be liable for a daily penalty.

- *Penalty to enforce article 27A:* This instrument provides a new penalty whereby operators who fail to submit information in line with the notification requirements in article 27A will, at the discretion of the regulator, be liable to a penalty of £5,000 in addition to a daily penalty if they continue to fail to comply. Article 27A applies to operators of installations in scope of the scheme that have not submitted applications to become an HSE, a USE or for free allocation for the 2026-2030 allocation period.
- *Amendments to penalties in articles 53, 56, 57 and 60:* The article 53 penalty (for failure to transfer or surrender allowances where under-reporting of allowances is discovered after a permit transfer) is amended to make it consistent with the newly introduced deficit penalty, as outlined in section 5.7.

The article 56 penalty (for HSEs who have under-reported their emissions) is amended to make it more consistent and proportionate with article 52, which is an equivalent penalty for main scheme participants.

The article 57 penalty (for HSEs who fail to notify when they cease to meet the HSE criteria) and article 60 penalty (for USEs that fail to notify the regulator where their reportable emissions exceed the maximum amount) are amended to make them more consistent and proportionate with the article 50 penalty (for operators carrying out a regulated activity without a permit).

- *Amendments to the cap:* The UK ETS cap sets a limit on how many allowances can be created over the trading period and in each year (subject to certain exceptions); this level reduces over time to drive down total emissions. This legislation implements the decisions taken in the Developing the UK ETS Authority response to reset the cap for the trading period, which runs from 2021-2030, in line with the top of the net zero consistent range. The number of allowances auctioned from 2024 onwards has already been reduced in line with this new cap through amendments made to Auctioning Regulations in late 2023. This reduction of around 30% in the cap for the trading period supports a smooth transition for the scheme's participants whilst sending a strong signal to decarbonise.
- *Amendments to the industry cap and creating a flexible reserve:* The amendments made by this instrument reduce the industry cap (the total number of allowances which can be made available to incumbent installations for free). Accounting for the reduction in the overall cap for the trading period, the share of allowances set aside for this purpose will increase from 37% to 40%. Making a higher proportion of a reduced cap's allowances available for free allocation mitigates carbon leakage risk across participating sectors while still maintaining an effective incentive to decarbonise. The amendments also create a flexible reserve of allowances stocked with allowances specifically created for flexible reserve purposes. Unallocated free allowances from the industry cap and designated free allowances that are returned by operators due to changes in participant eligibility or activity level reductions will also flow into the flexible reserve. This instrument provides for the flexible reserve to be used for the Cost Containment Mechanism (a discretionary market stability intervention available to the UK ETS Authority when certain conditions are met), to increase the volume of

allowances that are auctioned, or to mitigate the Cross Sectoral Correction Factor (a mechanism which can apply a uniform reduction to incumbent participants’ free allocation entitlements in the event that the eligibility for free allocation in an allocation period exceeds the industry cap).

- *Expanding the scope to flights from Northern Ireland to Switzerland:* After our departure from the European Union, flights between the UK and Switzerland were not covered in either the UK ETS or the Swiss Emissions Trading System. In 2022, a memorandum of understanding between the UK Government and the Swiss Government was signed, setting out the intention to include flights from the UK to Switzerland in the UK ETS. Flights from Great Britain to Switzerland were brought into the UK ETS scope on 1st January 2023 by the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 3) Order 2022. This instrument extends the scope of the UK ETS to cover flights departing from an aerodrome in Northern Ireland and arriving to an aerodrome in Switzerland. This requires the recalculation of entitlements to free allocation of UK allowances for aircraft operators to take account of this new category of historic aviation activity. Aircraft operators who have not previously applied for free allocation will be entitled to make an application on the basis of this new category of historic aviation activity. The inclusion of flights from Northern Ireland to Switzerland will bring an additional 100 flights per year into the scope of the UK ETS (rounded to the nearest 10 flights), covering 1250 tCO₂e of emissions per year (rounded to the nearest 10tCO₂e).
- *Extending other amendments to Northern Ireland:* In line with the original policy intention, this instrument extends legislative amendments made by the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 to Northern Ireland. The effect of this instrument is to ensure that the policy implementation is the same across all jurisdictions. Those amendments include capping aviation free allocation at 100% of emissions, clarifying the treatment of Carbon Capture and Storage (CCS) plants and amendments to free allocation rules for electricity generation. The full policy detail can be found in the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023 Policy Note.
- *Corrections:* This instrument makes a number of corrections and clarifications. An amendment to article 52(11) of the 2020 Order corrects the inflation factor for the purpose of calculating the relevant civil penalty. The penalty in article 51 (for installations failing to comply with the conditions of a permit) is corrected to add the article 57 penalty, referred to in section 5.9 to its exclusions list, since the obligation is already covered by permit conditions.

EU Alignment Consideration

The UK ETS was established under the Climate Change Act 2008 by the Greenhouse Gas Emissions Trading Scheme Order 2020 (the “2020 Order”) as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions which will contribute to the UK’s emissions reduction targets and net zero goal. 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 UK ETS replaces the UK membership of the EU Emissions Trading Scheme

following the UK's exit from the EU. Directive 2003/87/EC (as amended) established the EU emissions trading scheme, which created a European Union market in greenhouse gas emissions allowances. The 2020 Order applied EU ETS rules on the monitoring, reporting and verification of emissions with modifications to ensure that they work for the UK ETS.

This instrument is part of a package of legislation to implement the policy decisions in the main joint Government Response to the 'Developing the UK ETS' consultation, published in July 2023, and in the joint Government Response to a targeted penalties consultation, published in September 2024. Overall, this instrument aligns in intent with EU ETS policy and is not expected to have any impact on any wider interactions with the EU. That is because all the changes in this instrument match or exceed ambitions and commitments of the EU ETS. This is also the case for the other provisions in this instrument.

Consultation

The UK ETS Authority –formed by the Scottish Government delivered, together with the UK Government, Welsh Government and the Department for Agriculture, Environment and Rural Affairs for Northern Ireland– ran a public consultation “Developing the UK Emissions Trading Scheme” between 25 March and 17 June 2022.

As part of the consultation process, and aiming to gather as much feedback as possible, the Authority carried out 47 UK-wide stakeholder engagement sessions with current and future UK ETS participants, cross-sector business groups, trade associations, thinktanks, academics and eNGOs. These sessions included high-level summaries of the consultation and topic-specific workshops, which covered proposals on the cap, free allocation changes, aviation, GGRs and the inclusion of waste and maritime, among others. Approximately, 350 stakeholders attended these engagement sessions, including Scottish stakeholders.

A total of 300 stakeholders responded to the consultation, out of which around 120 were identified as relevant for Scotland by policy teams across the Scottish Government². The Authority has reported on the findings from this consultation in the joint Government Response: [Developing the UK Emissions Trading Scheme: main government response \(publishing.service.gov.uk\)](#)

The responses to this public consultation included a variety of stakeholders, including those from the aviation, chemical, oil and gas, refining, transport, manufacturing, power, food and drink, and steel sectors, as well as other trade associations, local authorities, consultancies, think tanks, academics and NGOs, and other sectors.

As a result of that consultation the key decisions have been made regarding the cap trajectory, industry cap, unallocated allowances and scope expansion. There were other more operational and technical changes consulted upon, such as the changes CO₂ venting being implemented by this SI, which are needed for the correct functioning of the ETS. Guidance will be updated as required to address these changes.

² This was defined as those who operate in Scotland or who are key to Scottish supply chains.

The Authority also delivered a targeted consultation in February 2024 covering several further minor amendments to penalties and deficit notice.

Impact Assessments

The Government Response to the consultation has a UK-wide impact assessment on the decisions made by the Authority outlined in the Government Response document: [Developing the UK ETS: impact assessment \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)

The Scottish Government has completed a Business and Regulatory Impact Assessment and an Island Communities Impact Assessment on all the changes the the UK ETS Authority agreed on and which were published in the final Government Response to the “Developing the UK ETS” consultation. Both impact assessments are attached and will be published in the coming months.

Financial Effects

A Business and Regulatory Impact Assessment (BRIA) has been completed and is attached. The BRIA focuses on the costs and benefits of the following proposed changes in the UK:

- Setting the UK ETS cap to be consistent with a goal of reaching net zero. The net zero consistent cap will reset the total cap for the first phase of the UK ETS (2021 – 2030).
- Setting the Industry Cap (the proportion of allowances that are given for free to industries at risk of carbon leakage) at 40% of the overall cap.
- Smoothing the transition to the new net zero consistent cap through releasing 53.5 million additional allowances (which are currently unallocated) to the market between 2024-2027.
- Retaining 29.5 million of the unallocated allowances. This is equivalent to approximately 3% of the overall cap.
- Phasing-out of aviation free allocation.

The Government Response to the ETS consultation also sets out a number of more technical policy changes, such as the ones introduced by this affirmative instrument. Officials have assessed these and deem their impact on business to be low; they are therefore not considered in detail in the BRIA.

Scottish Government
Energy and Climate Change Directorate

October 2024

UK Emissions Trading Scheme: Business and Regulatory Impact Assessment

UK Emissions Trading Scheme: Business and Regulatory Impact Assessment (BRIA)

1. Title of Proposal

Development of UK Emissions Trading Scheme ("ETS"): Impacts in Scotland.

2. Purpose and Intended Effect

2.1 Background

The UK Emissions Trading Scheme (UK ETS) was established on 1 January 2021 by the UK ETS Authority (the "Authority") –formed by the Scottish, UK and Welsh Governments and the Department of Agriculture, Environment and Rural Affairs in Northern Ireland (DAERA) for Northern Ireland. When it was established, the Authority committed to increasing the climate ambition of the scheme and last year the Authority consulted on a number of proposals to strengthen the UK ETS and align it with net zero targets.

In August 2022, the Authority published an initial Government Response to the consultation covering proposals which had to be implemented by 2023¹. On 3 July 2023 the Authority published a final Government Response and associated impact assessment covering the remaining and more substantive policy changes.² These documents considered stakeholders' views throughout. This Business and Regulatory Impact Assessment (BRIA) builds on the UK Government's Impact Assessment to provide an assessment of the impact of these changes on Scottish businesses.

This document is designed to be considered alongside the "*Developing the UK Emissions Trading Scheme: Main Response*" (referred to as 'Government Response') and its associated impact assessment (referred to as the "UK ETS Impact Assessment").

In summary, the proposed changes in the UK will:

- Set the UK ETS cap to be consistent with a goal of reaching net zero. The net zero consistent cap will reset the total cap for the first phase of the UK ETS (2021 – 2030). This supports Scottish Government climate change plans and targets, and it goes further in reducing emissions than the previous cap.
- Set the Industry Cap (the proportion of allowances that are given for free to industries at risk of carbon leakage) at 40% of the overall cap.

¹ [Developing the UK Emissions Trading Scheme \(UK ETS\) Consultation \(2022\) and associated documents.](#)

² [Main Response and associated impact assessment to the Developing the UK ETS Consultation.](#)

- Smooth the transition to the new net zero consistent cap through releasing 53.5 million additional allowances (which are currently unallocated) to the market between 2024-2027.
- Retain 29.5 million of the unallocated allowances. This is equivalent to approximately 3% of the overall cap.
- Phase-out aviation free allocation.
- Expand the scope of the UK ETS to include the maritime, waste incineration and energy from waste sectors, as well as new activities within the traded sector³ (see Annexes A and B for more detail on these proposals).

These changes are set out in detail in the Government Response, along with definitions for some of the terms used in this document.

The Government Response to the UK ETS consultation also sets out a number of more technical policy changes. The Scottish Government has assessed these and deems their impact on business to be low; they are therefore not considered in detail in this document. See Annex A for more detail on each policy decision.

Lastly, a few policy positions outlined in the Government Response are subject to further consultation (see Annex B for more detail). The Authority will produce impact assessments as appropriate following consultations on these policy issues. The Scottish Government will also consider what Scottish specific impact assessments may be appropriate to support policy development.

2.2 Objectives

The changes to the UK ETS set out in the Government Response support Scotland's decarbonisation objectives. The UK ETS plays an important role in meeting Scotland's ambitious net zero target by incentivising emissions reductions in the power, oil and gas, heavy industry and short-haul aviation⁴ sectors of the economy. Together Scottish ETS emissions account for 18% of Scotland's 2021 greenhouse gas (GHG) emissions⁵. By setting a market-led price for carbon, the UK ETS incentivises least cost decarbonisation in these high-emitting sectors, whilst also mitigating risks of carbon leakage during the transition to net zero.

This section summarises the objectives of the policy changes covered in this BRIA:

1. **Net zero consistent cap** : The cap refers to the total number of allowances created within the scheme, which can be broken down by year. A lower cap represents a smaller number of emissions and greater climate ambition. The

³ Traded sector refers to those sectors already covered by the UK ETS, which include energy-intensive industry (including manufacturing, upstream and downstream oil and gas, construction and steel), non-renewable power sector and some aviation.

⁴ The UK ETS currently includes domestic flights within the UK, flights between the UK and the European Economic Area and those between Great Britain and Switzerland.

⁵ [Scottish Greenhouse Gas Statistics 2021](#).

objective behind the new cap trajectory is to therefore support the decarbonisation of the ‘traded sectors’ (including industry, power and short haul aviation) in order to meet our net zero targets. The cap must be set appropriately to ensure the carbon price signal provided by the UK ETS is consistent with the level of traded sector ambition needed to meet our targets⁶. If the cap is set too high (i.e. allows a greater number of emission allowances to enter the market), it is less likely the UK ETS price will incentivise sufficient decarbonisation. Similarly, if it is set too low, it will not align with a credible and low-cost decarbonisation pathway. We believe that the net zero consistent cap trajectory strikes the balance between incentivising decarbonisation and enabling industry to transition to net zero fairly, in line with our Just Transition objectives.

2. **Industry cap:** The industry cap is the upper limit on the number of free allowances that can be issued each year to sites that are at risk of carbon leakage. The objective for setting the industry cap at 40% is to mitigate the risk of carbon leakage as the traded sector decarbonises and lower the risk of triggering the cross-sectional correction factor (CSCF)⁷. It also gives the Authority more flexibility for reviewing the scheme’s approach to free allocation distribution in the upcoming phase 2 Free Allocation Review. This is aligned with the Climate Change Committee (CCC) advice to the Authority on the industry cap⁸.
3. **Unallocated allowances:** In previous years, the number of free allowances allocated to industries was below the industry cap. The gap between the amount allocated and the cap has resulted in unallocated allowances that have no route to market. The objective for bringing some of these unallocated allowances to market is to smooth the transition to the net zero consistent cap. This supports Scotland’s Just Transition objectives by supporting businesses to plan for a managed transition to net zero.
4. **Phase out aviation free allocation:** Free allocation for the aviation sector will not be extended for the 2026-2030 allocation period as research has found that there is a minimal risk of carbon leakage for the aviation sector.⁹ Free allocations are used to mitigate against carbon leakage, therefore, continuing to allocate free allowances to the sector goes against the policy intent.

⁶ For further details on how the UK ETS incentivises decarbonisation, see the [analytical annex to the consultation](#).

⁷ CSCF is a process by which a reduction in all free allocations is applied and occurs when the total amount of required free allocation is greater than allowances in the industry cap, and no additional allowances are available.

⁸ [Climate Change Committee \(2022\) Letter: Development of the UK Emissions Trading Scheme \(UK ETS\)](#). Letter from Lord Deben, Chair of the Climate Change Committee, to Graham Stuart MP, Minister of State at the Department for Business, Energy and Industrial Strategy, copying in the portfolio Ministers of the devolved administrations.

⁹ The methodology for free allocations for aviation is different from those of stationary installations and is therefore considered separately.

2.3 Rationale for Government intervention

Climate change targets: Both the UK Government and the Scottish Government have legislated ambitious net zero targets. One of the primary policy objectives in reforming the UK ETS was to align the UK ETS Cap to the UK's legally binding net zero targets by implementing a revised net zero consistent cap trajectory from 2024. The net zero consistent cap will reset the total cap for the first phase of the UK ETS (2021 – 2030). The CCC have stated that the proposed cap “ is appropriate, given the pathway set out in the [UK] Net Zero Strategy.”

Scotland's greenhouse gas emissions reduction targets are set out in the Climate Change (Scotland) Act 2009¹⁰, and subsequently amended in the Climate Change (Emissions Reduction Targets) (Scotland) Act 2019.¹¹ Scotland's net zero target is consistent with the overall UK target and is based on advice from the CCC. The new cap goes beyond the level of reductions set by the previous cap, thereby providing greater support for Scotland's net zero targets.

Negative Externalities: The rationale for Government intervention is that there are a number of negative externalities associated with climate change, whereby the global costs of greenhouse gas emissions are not factored into the decision making of emitters and hence emissions will be too high. These externalities represent market failures, and as such warrant Government intervention in the market to correct them.

Alignment with National Performance Framework (NPF). These changes to the ETS support alignment with the National Performance Framework (NPF).¹² The UK ETS contributes positively to four of the National Outcomes:

- We value, enjoy, protect, and enhance our environment;
- We have a globally competitive, entrepreneurial, inclusive, and sustainable economy;
- We are open, connected and make a positive contribution internationally; and
- We have thriving and innovative businesses, with quality jobs and fair work for everyone

¹⁰ [Climate Change \(Scotland\) Act 2009](#)

¹¹ [Climate Change \(Emissions Reduction Targets\) \(Scotland\) Act 2019](#)

¹² [Scottish Government: National Performance Framework](#)

3. Consultation

3.1 Within Government

The following government agencies and departments have been consulted by the Scottish Government in the Authority consultation and the preparation of this BRIA between June 2022 and April 2023:

- The Division of Energy Industries, Food and Drink Division, Strategic Commercial Assets Division and Industrial Transformation and the Office of the Chief Scientific Advisor in the Scottish Government have provided advice in relation to issues on industrial decarbonisation, Greenhouse Gas Removals (GGRs) and/or expansion within the traded sector;
- Transport Scotland in the Scottish Government advised on issues on the maritime inclusion in the UK ETS and aviation free allocations;
- The Circular Economy Division in the Scottish Government advised on the inclusion of waste incineration activities in the UK ETS;
- The Onshore Electricity, Strategy and Consents Division in the Scottish Government provided advice in relation to issues on biomass and combined heat and power (CHP) policies;
- The Agriculture Policy Division in the Scottish Government has provided advice in relation to issues on agriculture and land use;
- The Scottish Government Legal Directorate has provided advice on the legal issues raised in this consultation;
- The Authority members and other government departments (Department for Transport and His Majesty's Treasury); and
- Scottish Environment Protection Agency (SEPA).

3.2 Public Consultation

The Authority delivered the public consultation “*Developing the UK Emissions Trading Scheme*” between 25 March and 17 June 2022. As part of the consultation process, and aiming to gather as much feedback as possible, the Authority carried out 47 UK-wide stakeholder engagement sessions with current and future UK ETS participants, cross-sector business groups, trade associations, thinktanks, academics and eNGOs. These sessions included high-level summaries of the consultation and topic-specific workshops, which covered proposals on the cap, free allocation changes, aviation, GGRs and the inclusion of waste and maritime, among others. Approximately, 350 stakeholders attended these engagement sessions, including Scottish stakeholders.

A total of 300 stakeholders responded to the consultation, out of which around 120 were identified as relevant for Scotland by policy teams across the Scottish Government¹³. The Authority has reported on the findings from this consultation in the joint Government Response.

¹³ This was defined as those who operate in Scotland or who are key to Scottish supply chains.

The responses to this public consultation included a variety of stakeholders, including those from the aviation, chemical, oil and gas, refining, transport, manufacturing, power, food and drink, and steel sectors, as well as other trade associations, local authorities, consultancies, think tanks, academics and NGOs, and other sectors.

3.3 Business

Businesses were primarily consulted through the public consultation “*Developing the UK Emissions Trading Scheme*” set out above. Scottish Government officials identified responses most relevant to Scotland – including all UK ETS operators in Scotland who responded to the consultation. Scottish businesses and UK ETS operators also participated in the workshops and roundtables hosted by the Authority during the consultation.

4. Options

4.1 Options Development

The Authority examined a range of options for each of the policy proposals set out in the consultation. Full details are set out in the “*Developing the UK Emissions Trading Scheme*” consultation, the Authority Government Response to the consultation and the UK ETS Impact Assessment.

4.1.1 Net zero consistent cap

The Authority considered three options when deciding on the cap trajectory:

- i) Do nothing.
- ii) A Net Zero Strategy consistent cap.
- iii) Follow the CCC’s recommendations for the UK ETS cap.

Option i) was used as our counterfactual for these changes. It was ruled out as the current UK ETS cap is inconsistent with net zero targets (i.e. It allows for a higher level of traded sector emissions than would align with a pathway to our net zero targets).

Option ii) is the preferred approach as it incentivises the largest reduction in emissions, and therefore more likely to provide a greater contribution to Scotland’s climate change targets. This option presents a range for a ‘net zero consistent’ cap which would result in the total cap for the first phase (2021-2030) of between 887 million allowances and 936 million allowances, a reduction of 30-35% on the current legislated cap. Under these options by 2030 the cap would be 50 MtCO_{2e}.

Option iii) was ruled out as it required lower emission reductions than option ii) and would place more pressure on the non-traded sector for the achievement of SG climate change targets. The CCC recommended that emissions should result in the

total cap for the first phase of around 996 million allowances, with a cap of 59.3 MtCO_{2e} in 2030.¹⁴

The Authority considered how to drive maximum climate ambition while enabling the market to function and UK ETS operators to decarbonise in a managed way. In combination with the other factors set out below, the Authority decided to set the cap at the top of the consulted range, which represents a reduction of 30% compared to what is currently legislated.

4.1.2 Unallocated Allowances

The Authority considered three options for the unallocated allowances:

- i) Do nothing.
- ii) Auction unallocated allowances to smooth the transition to the new cap.
- iii) Retain unallocated allowances in contingency pots for later use.

Option i) was ruled out as the Authority deemed it important to support the transition to the net zero cap through bringing some unallocated allowances to auction.

The Authority therefore decided to combine options ii) and iii) to ensure that there are sufficient allowances to support the adjustment to the lower cap from 2024 whilst also retaining enough allowances in reserve for future market stability purposes and CSCF mitigation.

4.1.3 Industry Cap

The Authority considered two options for the setting of the industry cap:

- i) Do nothing.
- ii) Reset the industry cap to make up a percentage of the overall cap.

Under current rules the industry cap is set at the UK's notional share of the EU ETS industry cap for Phase IV of the EU ETS. This means that the industry cap is currently legislated as fixed numbers of allowances based on the previous cap levels and will not automatically change with any changes to the cap. Option i) was therefore ruled out as it would mean that the proportion of allowances allocated for free would increase relative to the size of the revised cap. This was seen as potentially being detrimental to market functioning, stability and liquidity.

Option ii) is the preferred option as it enables the level of free allocations available to be set at a level which allows the overall cap to be distributed in a balanced way between free allocation and auction share.

¹⁴ [Climate Change Committee \(2021\) Letter: UK Emissions Trading Scheme and CORSIA](#). Letter from Lord Deben, Chair of the Climate Change Committee, to Anne-Marie Trevelyan MP, Minister of State at the Department for Business, Energy and Industrial Strategy, copying in the portfolio Ministers of the devolved administrations.

The Authority decided to set the industry cap at 40% of overall cap. This is higher than retaining the current share of the cap of 37%. This enables the Authority to balance the requirements for a net zero consistent cap with support for businesses at risk of carbon leakage. It will also enable effective market functioning and allow sufficient allowances for auction.

This higher cap will also provide flexibility for the future decisions on the distribution of free allowances as part of the phase 2 Free Allocation Review. Further impact assessments will be undertaken as appropriate to assess the impact of any recommendations from this review. The Authority also committed to maintain free allocations at current levels, subject to activity level changes, until 2026 to further support the transition to the net zero consistent cap.

4.1.4 Aviation Free Allocation Phase out

The Authority examined the Aviation Free Allocation (AFA) phase out from two perspectives, namely the timing of a phase out and the speed/trajectory at which the AFA would be reduced. Under current legislation AFA are due to decline annually by 2.2% until 2026 at which point they are removed.

Three options were considered for the timing of the phase out:

- Option 1: Early phase-out: the rate at which free allocation entitlement reduces will increase so that full auctioning will apply from 2026.
- Option 2: Intermediate phase-out: the rate at which free allocation entitlement reduces will increase so that full auctioning will apply no later than 2028.
- Option 3: Later phase-out: The rate at which free allocation entitlement reduces will increase so that full auctioning will apply from the start of 2031.

Four options were considered for the speed/trajectory of the phase out:

- Option A: Linear: AFA entitlement decreases by a constant amount every year.
- Option B: Smooth backloaded: AFA entitlement decreases by an exponentially increasing amount each year.
- Option C: Sharp backloaded: half of the original AFA entitlement is phased-out linearly, the remaining half is phased-out in the final year.
- Option D: Sharp backload 2: AFA entitlement follows the business as usual trajectory (aviation free allocation annual reduction rate of 2.2%) until all the remaining AFA is removed in the final year.

Taking these options together the Authority considered the 12 phase-out trajectories. These comprised of four trajectories (options A to D) for each phase-out year 2026, 2028 and 2031 (options 1, 2 and 3,). These were assessed against the following criteria (more detail on which is available in Annex 4 of the IA):

- Cost;

- Revenue;
- UK ETS design and Objectives;
- Impact on competition and market distortion;
- Commercial viability and air connectivity; and
- Operational delivery.

The Authority has decided, following assessment of the options, that free allocation for the aviation sector will not be extended for the 2026-2030 allocation period but will follow a trajectory of a 2.2% annual reduction until all remaining AFAs are removed in 2026 (Option 1D). This option was chosen as it aligns with the overall policy objectives of the UK ETS, given the minimal risk of carbon leakage for the aviation sector.

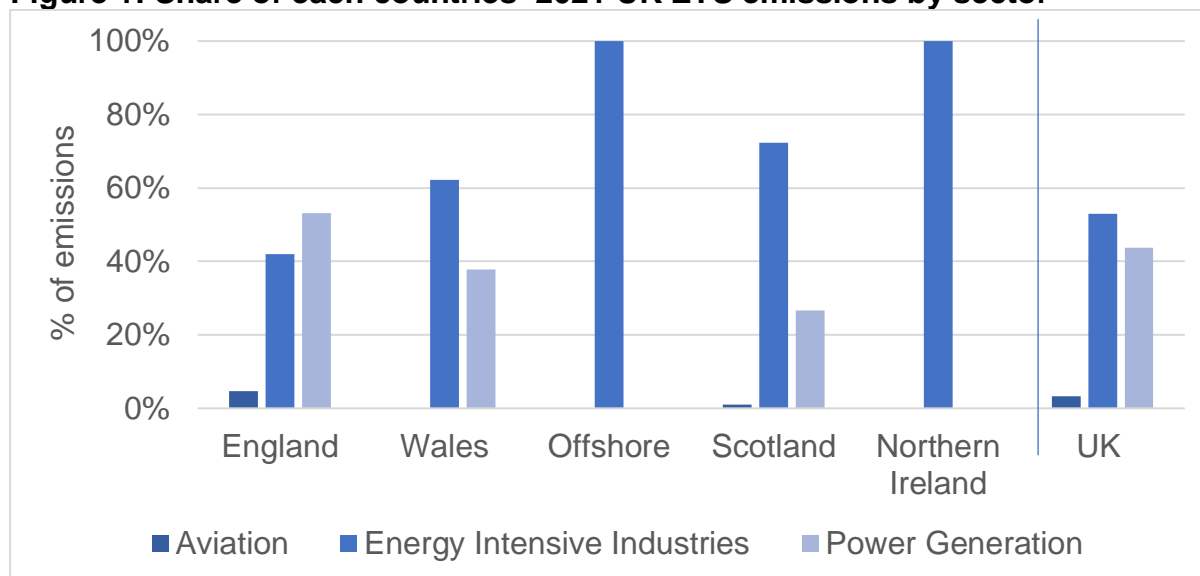
4.2 Sectors and groups affected

The proposed changes to the UK ETS will primarily affect the sites and businesses which operate within the scheme. The UK ETS focuses on energy intensive industries, power generation and aviation. Scotland accounted for around 6.9% of the traded sector emissions in the UK ETS in 2021 (excluding those covered by the Hospital and Small Emitter (HSE) opt out scheme¹⁵). The emission profiles vary across the regions with Scotland having a higher concentration of emissions in the energy intensive industries (around 72% of emissions) compared to the UK as a whole (around 42%), Figure 1.¹⁶

¹⁵ Hospital and Small Emitter (HSE) Opt-out scheme accounts for around a quarter of sites in Scotland that are participating in the UK ETS but only accounted for 4% (0.3 MtCO₂e) of total emissions for Scottish sites in the UK ETS in 2021. These installations are given an allocation of emissions which are included towards the overall cap, but they are not able to participate in the purchasing of additional allowances. These have been excluded from our analysis

¹⁶ Data is presented for each country based on their regulator, for static installations the emissions will occur in the region that it is located. The exception is for aviation where emissions are reported to the regulator where the airline is registered rather than where the emissions occur.

Figure 1: Share of each countries' 2021 UK ETS emissions by sector



Source: Scottish Government analysis of main scheme activity as published in the UK ETS Registry data¹⁷

Notes to figure: Offshore activities are regulated by Offshore Petroleum Regulator for Environment and Decommissioning (OPRED) and are included in total UK ETS emissions.

In 2021 aggregated total emissions were approximately 73MtCO_{2e} in England, 16.6 MtCO_{2e} in Wales, 7.4MtCO_{2e} in Scotland, 0.6MtCO_{2e} in Northern Ireland and 10.1 MtCO_{2e} for offshore sites.

By design, the UK ETS legislation applies across the whole of the UK to the same sectors (with the exception of power in Northern Ireland which remains under the EU ETS). This means that there is no specific Scottish cap, or specific cap for any of the four nations in the United Kingdom.

This presents challenges when assessing the impact and costs of the UK ETS changes at the regional level. Abatement opportunities, such as access to decarbonisation technologies, carbon capture and storage and fuel switching, will vary across and within sectors and regions and depend on often site-specific key infrastructure and technological solutions being available. In addition, Scotland’s industrial profile is different from the UK when taken as a whole and, as a result, the solutions required in Scotland may be different from those in the rest of the UK. Abatement solutions will also not be available or delivered symmetrically across the UK. Overall the rate of decarbonisation is therefore likely to differ across the UK nations. While we can draw some high level and aggregate conclusions around likely impacts, business responses to the proposed changes will be made on site-or organisation-specific commercial decisions which are difficult to predict on the basis of national or sector-level data and targets.

In addition to the sites and businesses which operate within the scheme, we expect that the proposed changes have the potential to have indirect and second order impacts on:

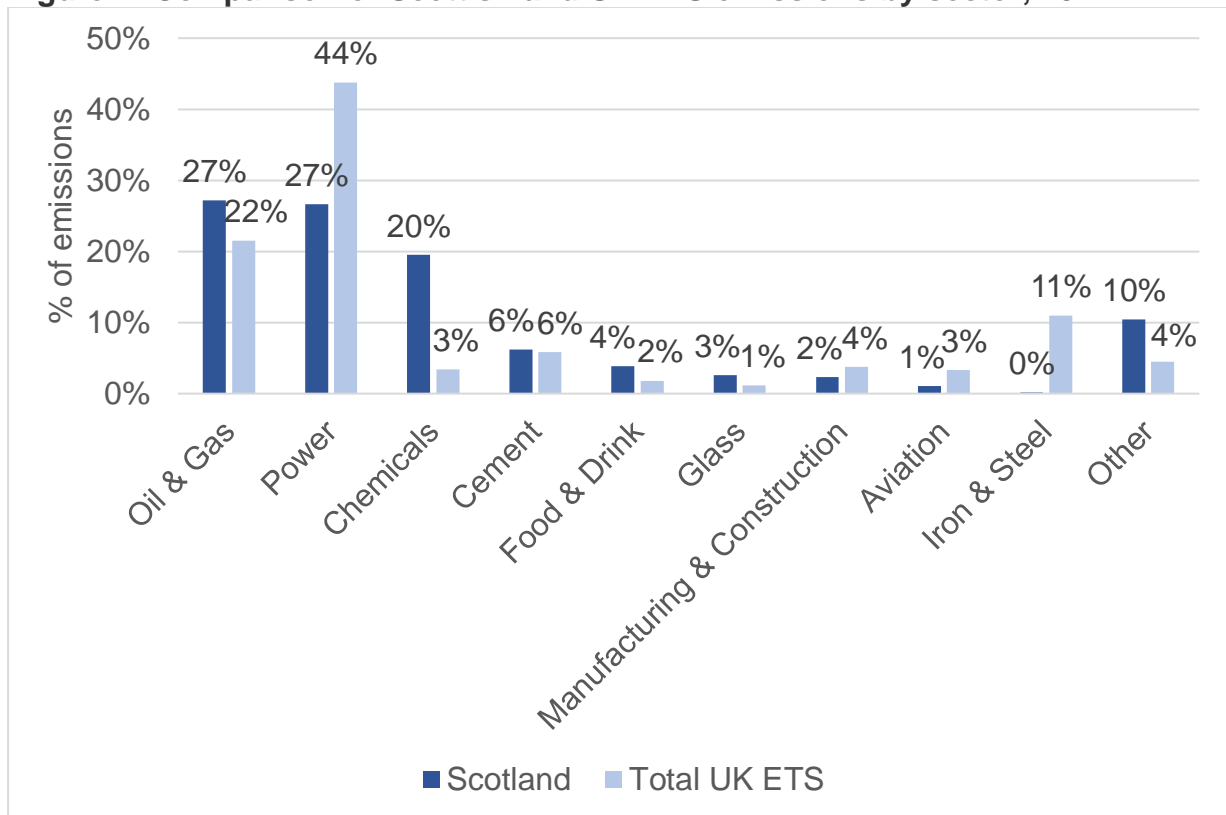
¹⁷ [UK ETS Public Reports](#)

- Scottish businesses operating within the supply chain of those directly affected firms or businesses purchasing and using the products of firms within the UK ETS
- Scottish households which consume products produced by affected firms
- Central and local government and other public bodies which either participate directly in the UK ETS (i.e. hospitals via the HSE scheme) or which purchase products produced by firms within the UK ETS.
- Individuals who live and work in close proximity to sites within the UK ETS may experience positive air quality impacts as a result of a move towards clean energy sources.

4.2.1 Overall impact of Cap, Industry Cap and Unallocated Allowances

The overall impact on Scottish businesses is likely to be broadly in line with what is happening at the UK level. However, it should be noted that there are variations in the sectoral composition of the scheme across the regions. Emissions from the Scottish traded sector, excluding HSE, in 2021 were concentrated in three sectors; power (27%), oil and gas (27%) and chemicals (20%), Figure 2. This is different from the traded sector in the UK as a whole, as emissions are more concentrated in the power sector (44%), oil and gas (22%) and iron and steel (11%).

Figure 2: Comparison of Scottish and UK ETS emissions by sector, 2021



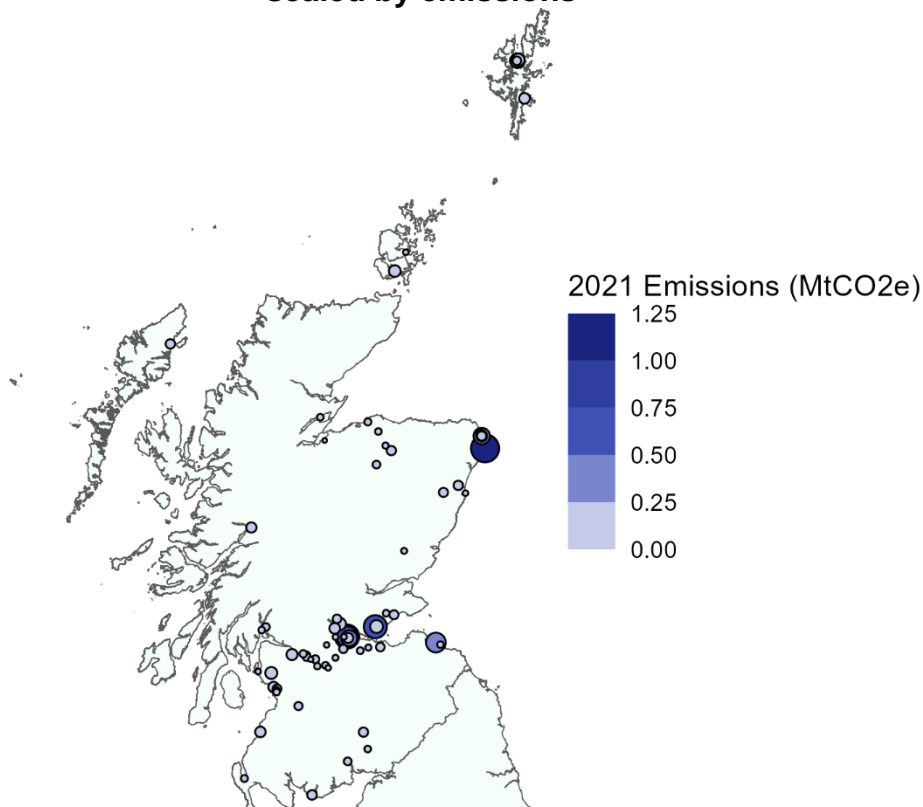
Source: Scottish Government analysis of UK ETS registry data

Scotland’s emissions are also highly concentrated in a few sites, with the top ten emitters accounting for 73% of Scotland’s traded sector emissions in 2021. The

impact the UK ETS has on these sectors will depend on their decarbonisation pathways, including access to decarbonisation technology.

The impact of the UK ETS on Scottish regions will also vary, as different regions are home to different numbers, and types, of UK ETS sites. Figure 3 highlights that the largest concentration of emissions and sites occurs in the central belt and Aberdeenshire.

Figure 3: Location of Main Scheme UK ETS participants in Scotland in 2021, scaled by emissions

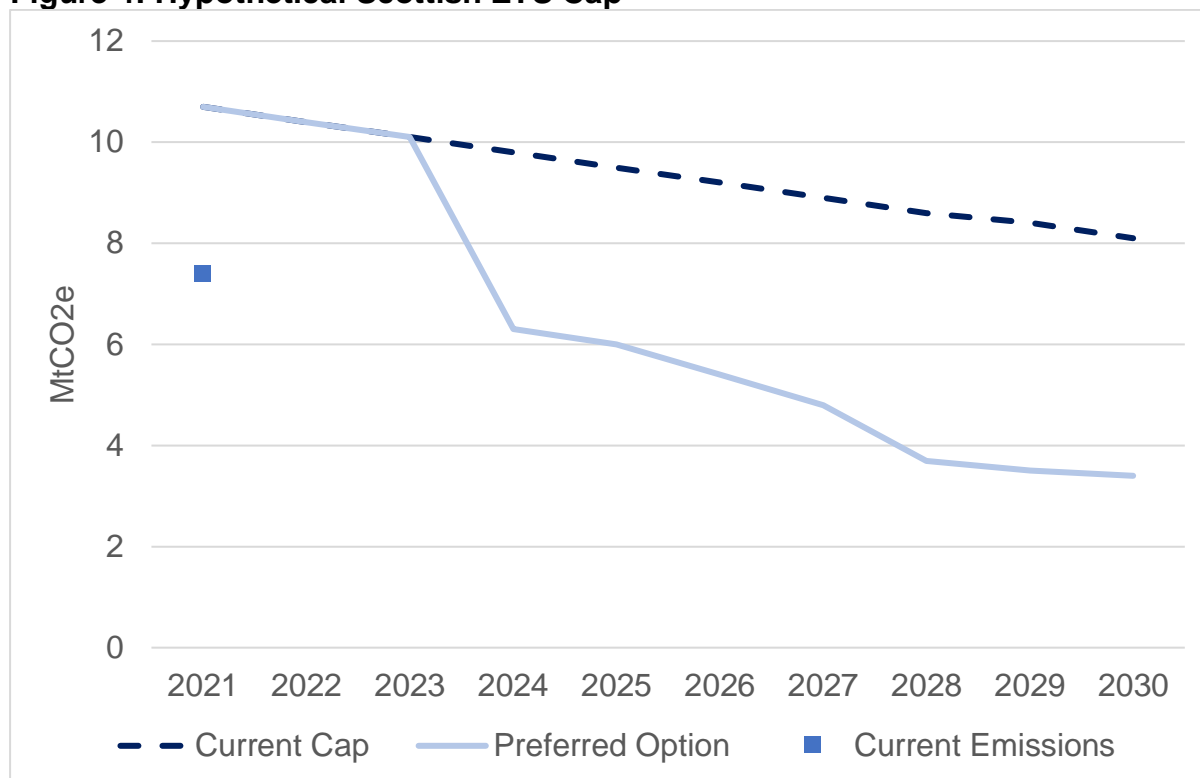


Source: Scottish Government analysis of UK ETS registry data and SEPA data

The proposals to reset the cap will affect all sectors operating in the UK ETS. It will intentionally limit the number of allowances available, thereby creating an incentive to invest in decarbonisation. Likewise, the decisions around the auctioning of unallocated allowances will impact all UK ETS operators as these will be available to all UK ETS operators (under the main scheme) to buy.

To assess the potential impact of the changes in the UK ETS cap on Scotland we used Scotland’s 2021 share of main UK ETS emissions (6.9%) to produce a hypothetical “Scottish Share” of the UK ETS cap over the period to 2030. (Figure 4). This has been used as a proxy to estimate how Scottish industries may be impacted by the Cap and implies that Scottish ETS emitters decarbonise on average at the same rate as the UK as a whole. As discussed above, the actual rate at which Scottish emitters decarbonise may well be faster or slower than the overall decline in the UK cap and will depend on a variety of site-specific factors related to costs and the technological and process options available.

Figure 4: Hypothetical Scottish ETS Cap



Source: Scottish UK Government Analysis

Scottish Operators who are exposed to the risk of carbon leakage¹⁸ are eligible for free allowances. The decision to set the ‘Industry Cap’ at 40% of the cap is designed to mitigate that risk of carbon leakage and support those industries to invest in decarbonisation. Scottish ETS sites account for 7.7% of all free allowances which cover 44% of Scottish ETS emissions. This is slightly higher than the UK as a whole where 39% of UK ETS emissions were covered by free allowances in 2021, however this will be influenced by the lower proportion of emissions from power in Scotland.

The Authority is due to review the Free Allocation (phase 2) in the coming years ahead of the next free allocation phase (from 2026). Further impact assessments will be undertaken as appropriate to assess the impact of any recommendations from this review.

4.2.2 Impact of the aviation phase out

The phase out of free allocation for aviation will impact a number of airlines operating across the UK, including those operating routes in Scotland. In 2021 there was only one airline which was regulated by SEPA which participated in the UK ETS - 14% of its emissions were covered by free allowances. As SEPA regulates only one airline it would not be appropriate for government to speculate on the impacts on an

¹⁸ Carbon leakage refers to 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. As a result of carbon leakage, the objective of decarbonisation efforts – to reduce global emissions – would be undermined.

individual business. We have, however, considered the potential impact on island connectivity specific to Scotland, in our Island Communities Impact Assessment¹⁹.

As a large number of other airlines operate in Scotland (whilst being regulated by the appropriate organisations in England or Wales) it is useful to consider the impact on the aviation sector as a whole. As part of the Authority's review of the future of aviation free allowances, external economic research was commissioned by the Department for Transport and the Department for Business, Energy and Industrial Strategy (BEIS).²⁰ This suggests that the withdrawal of free allowances poses minimal risk of carbon leakage for aviation. However, this analysis does highlight that withdrawal of free allowances may lead to a reduction in airlines' capacity. Further, the UK ETS Impact Assessment highlights that "we expect that the withdrawal of free allocation may lead to small impacts on regional airports except where an Aircraft Operator leaves a market and there is a subsequent sustained reduction in capacity, there may be knock on impacts on small regional airports, particularly if they are reliant on one carrier or limited routes".

4.3 Benefits

There are a number of benefits associated with these policy changes to the UK ETS. The primary benefit of this policy is the reduction in GHG emissions reductions arising from the tightened cap. This will support delivery of our statutory climate change targets. Relative to the counterfactual we expect a significant reduction in traded sector emissions.

It is expected that the price signal from the UK ETS will increase the incentive for firms to invest and deploy clean technologies and processes by making them better value for money than higher emissions alternatives. It will also incentivise firms to drive improvements in their energy efficiency as using less fuel input per unit of output would reduce their exposure to the carbon price. This increased investment in decarbonisation technologies can have long term positive spillovers, with reduced costs and accelerated future abatement. The development and implementation of these decarbonisation technologies will also support jobs and investment within the green economy in Scotland and across the rest of the UK which is key to Scotland's objectives for a Just Transition to net zero.

Any movement away from fossil fuels and other fuels such as biofuels can yield improvements to air quality, which can significantly improve health outcomes. In their *Sustainable Health Equity: Achieving a Net Zero* report to the CCC The UK Health Expert Advisory Group highlighted that the move to clean energy sources and a move away from fossil fuels in the power generation and industry sectors is a key component of improving health outcomes.²¹

¹⁹ [Island Communities Impact Assessment - UK Emissions Trading Scheme](#)

²⁰ [Frontier Economics \(2022\) Economic research on the impacts of carbon pricing on the UK aviation sector.](#)

²¹ [UK Health Expert Advisory Group \(2020\), Sustainable Health Equity: Achieving a Net Zero UK](#)

4.4 Costs

There are two main costs to Scottish businesses as a result of this policy: the costs associated with investment in decarbonisation technologies, and the costs associated with purchasing of allowances.

The primary objective of the UK ETS is to encourage firms to invest in decarbonising technologies and processes. The higher the UK ETS allowance price the higher the costs to firms of unabated emissions. In theory we would expect abatement to occur up to the point where the marginal cost (i.e., the cost of abating an additional unit of emissions) is less than or equal to the allowance price in the system. The available decarbonisation options and associated costs will be diverse and determined on a site-specific basis. Options could range from fuel saving and energy efficiency measures, fuel switching and electrification, process redesign and Carbon Capture and Storage.

There are also costs associated with the purchasing of allowances. This can be done via auction, where the allowances are purchased directly from the Authority, or via the secondary market. The reduction in free allowances, and greater abatement required by the cap, means there may be more operator engagement in primary and secondary allowance markets in order to buy and sell allowances.

From the primary auctions in 2021 alone, Scottish businesses are estimated to have spent in the region of £215m to comply²². Estimates suggest that industry in Scotland spent in the region of £110m, Power £100m and aviation £5m in 2021. By the same token free allowances can be considered a benefit to business with free allowances issued in 2021 being valued at around £170m, with nearly all of this in the industry sector. It is estimated in the UK ETS Impact Assessment that across the whole of the UK the direct cost to business of the preferred option is £2.4bn, assuming that the UK Government policies under the high policy scenario, such as Carbon Capture, Usage and Storage (CCUS) and hydrogen, are delivered. This is primarily driven via the purchasing of allowances via the markets by participants.

4.5 Overall costs and benefits associated with the UK ETS changes

As highlighted above there are a number of challenges to analysing the impact of the changes to the cap on Scottish Businesses. As the Authority agrees a shared approach to UK ETS changes it is appropriate for the costs and benefits of this policy to be examined at a UK-level. This analysis was undertaken by the Department of Energy Security and Net Zero (DESNZ) and full details can be found in the UK ETS Impact Assessment attached to the Government Response.

The UK ETS Impact Assessment provides the overall economic impact across the UK of these changes. The UK ETS Impact Assessment discounts and sums the flow of costs and benefits over time to derive a net present value, a measure of the overall economic impact of the policy changes. It suggests that for the preferred option there is a high Net Present Value (NPV) of £10.1bn along with a high Benefit to Cost Ratio (BCR) of 7.1, assuming that there is other UK Government Support for

²² This is based on an average price of £52 from the primary auctions as reported on the [ICE website](#).

decarbonisation alongside UK ETS under the high policy baseline. A key element of this decarbonisation support in Scotland will be the decision around whether or not we are awarded the Track 2 Cluster for CCUS, which will impact our ability to decarbonise. Whilst the analysis in the impact assessment is done at a UK level, we would expect the level of overall impact for the individual UK nations should also remain high and positive. This is because the same mechanisms that drive the overall NPV and BCR would also apply to the Devolved Administrations.

5. Regulatory and EU Alignment Impacts

5.1 Intra-UK Trade

We do not expect these policy changes to impact on intra-UK trade as it has been produced in conjunction with the UK Government and other Devolved Administrations via the Authority. We will continue to assess the impact of these changes including unintended regional impacts and act accordingly. The upcoming phase 2 Free Allocation Review will also consider regional variations in terms of the impact of free allocations and how they might impact competitiveness. We will continue to assess the potential impact for Scottish businesses and intra-UK trade as part of this.

5.2 International Trade

The measures covered by this BRIA aim to incentivise business to decarbonise in a cost-efficient way, including by improving efficiency which could result in increased competitiveness in global markets. Where companies are deemed at risk of carbon leakage, they receive a proportion of their allowances for free. This will be reviewed through the upcoming second phase of the Free Allocation Review.

5.3 EU Alignment

The Scottish Government continues to favour consideration of alignment between the UK ETS and the EU ETS.

6. Scottish Firms Impact Test

Across all elements of the UK ETS there were around 100 sites/installations regulated by SEPA in Scotland. Collectively they emitted around 7.6 MtCO_{2e} in 2021. Of these, there are 71 sites in Scotland in the UK ETS main scheme that will be affected by these changes. These are split across the sectors with industry accounting for 56 sites, power 14 sites and one aviation operator. If we break this down further we can see that nearly 70% of all sites are concentrated across four areas, these are oil and gas (15 sites), power generation (14 sites), food & drink (12 sites) and manufacturing and construction (8 sites). The remaining sites come under the Hospital and Small Emitter opt-out scheme. These sites have a different approach to compliance where an emissions target is set for each year, if the target is exceeded a penalty is paid to cover the difference between the target and the reported emissions. They are not required to purchase allowances to comply as with

the main scheme. These sites will see an impact on the calculation of their targets, which will be reduced, as a result of the changes to the cap, which may impact on their ability to comply with tighter targets set.

Businesses were primarily informed the development of this policy through the Authority consultation. Scottish Government also worked with sector teams who regularly engage business to understand specific issues and concerns to inform the analysis and policy development.

A total of 300 stakeholders responded to the UK ETS consultation. The Authority included a summary of responses as part of the Government Response . The following high-level summary considers the views of the from over 120 stakeholder organisations identified as relevant for Scotland by policy colleagues across the Scottish Government.

A summary of consultation responses in relation to the cap trajectory, industry cap and unallocated allowances which were considered relevant to Scotland are summarised below.

Cap trajectory (or Net Zero cap)

- Out of 52 Scottish stakeholder responses to the cap trajectory questions, 23 (44%), agreed and 23 (44%) disagreed with the cap range, while 6 (10%) did not state a clear position. However, around a quarter of those that agreed also highlighted concerns with the proposal. These included issues on impact on carbon markets, rate of decarbonisation, access to technologies and interaction with other decarbonisation policy.

Industry Cap

- Out of 43 Scottish stakeholder responses, just over half (22 respondents) disagreed with the minded position in the consultation to reset the industry cap in line with the overall cap. However, the majority, 65% (20 out of 31 respondents) believed this proportion should be higher than the 37% industry cap proposed by the Authority.
- The main reasons for these preferences were that reducing the availability of free allocation by significantly reducing the industry cap would:
 - Increase carbon leakage risk and disadvantage the UK industry compared to international competitors; and
 - Reduce investment in decarbonisation initiatives and increase carbon prices and compliance costs –which raised again the need for further government support for industrial decarbonisation
- Of the respondents 70% (26 out of 37 respondents), agreed with the proposed future changes to the free allocation policy, which includes evaluating the methodology (phase 2 Free Allocation Review). While 11 respondents (30%), did not agree with this proposal, including one respondent who suggested that the methodology should be the same as the EU ETS.

Unallocated Allowances

- Out of 34 Scottish stakeholder responses, over 70%, agreed with auctioning a portion of the unallocated allowances or flexible share to smooth the transition to a tighter cap and to mitigate against the application of a cross-sectoral correction factor (Additionally, 58% (of 31 respondents) believed that unallocated allowances should be used for supporting market liquidity before 2024.

For Aviation it is more appropriate to examine what has been said as a sector as a whole, further details of which can be found in Chapter 4 of the Government Response.

- As highlighted in the Government Response the majority of respondents 74% (of 23 respondents) agreed that the risk of carbon leakage is minimal for the UK aviation sector under the current scope of the UK ETS. Additionally, 60% (of 30 respondents) agreed that if there are minimal risks of carbon leakage for the aviation sector, free allocation should be withdrawn or phased-out. While 17% of respondents disagreed, and 23% did not directly respond to the question.

7. Competition Assessment

The impact of these changes on business competitiveness is hard to quantify as the carbon price is just one factor of many impacting on competitiveness. It is not thought that these measures will directly impact competition in terms of limiting the range or numbers of businesses operating in the market. None of the wider proposals are deemed to risk limiting the range or numbers of suppliers.

We have not identified any impact on competition associated with these changes.

8. Consumer assessment

The impact of these changes on consumers is hard to quantify. For the firms involved, the carbon price is one of a number of factors which will impact the price of their products. The costs associated with decarbonisation, as well as the cost of allowances and the proportion of their allowances received for free, will vary across sectors. This is particularly true when examining industry.

For the power sector, the UK ETS compliance costs could be passed on to consumers. While electricity generation in Scotland is primarily driven by renewables, 57% in comparison to only 36.2% in England in Wales in 2021, the costs to Scottish consumers of electricity are determined by the GB electricity market.²³ As a result of the national pricing model for electricity, UK ETS compliance costs and the mix of power generation will be one of many factors determining the end price. It has therefore not been possible to determine the exact scale of the impact of UK ETS compliance costs on wholesale prices but it is expected to be

²³ Data from the [electricity generation section of the Scottish Energy Statistics Hub](#).

minimal given the current costs associated with fossil fuels. In general, a higher carbon price would be expected to increase the marginal cost of electricity generation from fossil fuel generators. In the short-term, these higher costs may be passed onto consumers' energy bills. However, the medium and long-term, energy bills may be decreased where the UK ETS contributes to faster power sector decarbonisation.

Aviation is recognised as a sector that is harder to decarbonise relative to the other UK ETS participants. Aircraft operators could respond to a higher carbon price by investing in sustainable aviation fuel, technological and operational efficiencies. While UK ETS compliance costs may be passed onto consumers via higher airfares, compliance costs will be one of many factors determining airfares, including the costs of aviation fuel and other operational costs. It is therefore not possible to model exactly how they may be passed onto consumers.

9. Test Run of Business Forms

This process does not require new forms as it is built on top of existing practices and procedures and is a matter for SEPA to make operational.

10. Digital Impact Test

No impact identified. The UK ETS is already administered digitally, and these proposals do not make any changes to this.

11. Legal Aid Impact Test

No impact identified. The amendments to the UK ETS will not create a new procedure or right of appeal to a court or tribunal, any change in such a procedure or right of appeal, or any change of policy or practice which may lead people to consult a solicitor.

12. Enforcement, Sanctions and Monitoring

This policy does not change the current enforcement, sanctions or monitoring processes already in place for the UK ETS. These processes are built on top of existing practices and procedures, and it is a matter for SEPA to make operational.

13. Implementation and Delivery Plan

This policy does not change the current implementation or delivery processes already in place for the UK ETS. These processes are built on top of existing practices and procedures, and it is a matter for SEPA to make operational.

14. Post-implementation Review

As previously highlighted, there is a range of forthcoming consultations on various aspects of the UK ETS. These are further highlighted in Annex B.

We will deliver additional impact assessments as appropriate following further consultations. We will also keep under review the possible impacts that any changes to the free allocation policy, as part of the phase 2 Free Allocation Review process, could have on Scottish operators.

There is also a wider programme of evaluation being undertaken by DESNZ/UK ETS Authority over the years 2022-2026. This will look retrospectively at the UK ETS and aims to: evaluate the implementation of the scheme and possible impacts that it might have on delivery; assess the impacts of the scheme and inform the first whole system review of the UK ETS (scheduled for 2023).

The evaluation includes a review of the cap, free allocation, and market stability mechanisms. Data will be collected from both primary and secondary sources, with interviews and surveys of stakeholders taking place for the primary data collection. Future changes to the scheme will be evaluated in line with the 2028 statutory review and stakeholder engagement in the form of interviews and surveys will be used as the primary means of evaluating future changes, building on the evaluation programme, to be completed in 2026.

15. Summary and Recommendation

Changes to the UK ETS will increase costs for participating businesses through the costs associated with investment in decarbonisation technologies and the costs associated with purchasing of allowances. However, these costs are associated with reductions in emissions and will therefore support our ambitious climate targets. The proposed changes presented in the Government Response and resulting costs to businesses are deemed to be proportionate given the importance of our national climate targets.

Summary costs and benefits table

Total benefit per annum: - economic, environmental, social

Total cost per annum: - economic, environmental, social - policy and administrative

Reduction in GHG Emissions: The primary benefit of this policy is the incentivisation of firms to decarbonise and reduce their GHG emissions reductions. This will support delivery of our statutory climate change targets.

Investment in decarbonising technologies: The available decarbonisation options and associated costs to business are diverse and are determined on a site specific basis.

Improve health outcomes: The movement away from fossil fuels towards clean energy sources can yield improvements to air quality which has a positive impact on health outcomes.

Purchasing of allowances: In 2021 Scottish businesses are estimated to have spent in the region of £215m to comply via the primary auctions. The UK ETS Impact Assessment suggests that across the whole of the UK the direct cost to business of the preferred option is £2.4bn which is primarily derived from the purchasing of allowances.

Wider economy spillovers and increased investment in decarbonisation technologies: It is expected that increased investment, development and implementation of decarbonisation technologies will also support jobs and investment within the green economy in Scotland which is key to Scotland’s objectives for a Just Transition to net zero. The UK ETS Impact Assessment suggests that the NPV of the preferred option for the UK as a whole is £10.1bn.

Costs to consumers: Some of the compliance costs could be passed onto consumers in the form of higher prices, although the extent of this is hard to quantify.

16. Declaration and Publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

Signed:

Date:

Minister's name: Màiri McAllan

Minister's title: Cabinet Secretary for Transport, Net Zero and Just Transition

Scottish Government Contact point: emissions.trading@gov.scot

Annex A: Description of technical changes not covered by this BRIA

The Authority decisions covered in this annex are not included in this BRIA as:

- these were calls for evidence and any final proposals are subject to further consultation;
- the proposed change is minor and the impact on operators has been estimated not to be significant; or
- it is a temporary solution in response to an unequal treatment of some UK ETS participants identified by the Authority or raised by operators.

A description of each technical change covered in the Government Response to the UK ETS consultation, and the chapter in which they appear, are provided below. Please refer to the Government Response for further information on the rationale of the decisions.

Chapter 2: Free Allocation Review – Technical Changes

No amendment to the Activity Level Changes (ALCs) for turn-off of activity due to maintenance/planned downtime

- Currently, operators could see a reduction in their free allocations if they turned off their activity for maintenance or improvement work. As this is part of normal operation, no changes will be made to the distribution of free allocations to consider the turn-off of activity. Operators can plan for the turn-off of activity and should be encouraged to do so as efficiently as possible.

Putting current benchmark values into UK law

- Bringing the current benchmark values into UK law, by direct inclusion in UK ETS legislation.

Not changing the treatment of existing vs new sub-installations

- Changes will be made to the electricity generator definition to consider electricity exports in the baseline period, rather than electricity exports since 2005 (this proposal would not apply for the 2021-2025 free allocation period, as the definition is already determined for these years in the current legislation).

Amending the electricity generator definition to only consider electricity exports in the baseline period

- The Authority proposed to amend the electricity generator definition to consider electricity exports in the baseline period, rather than electricity exports since 2005 (this proposal would not apply for the 2021-2025 free allocation period, as the definition is already determined for these years in current legislation).

Amending the combined Heat and Power (CHP) plants and electricity generator definition

- The Authority will amend the electricity generator classification to exclude installations that have produced electricity for sale to third parties, if that electricity was produced by means of a Combined Heat and Power Quality Assurance (CHPQA) certified plant, operating as part of an operator's industrial activity.

Amending electricity generators

- Changes will be made to allow electricity generators who have not exported measurable heat produced by means of high-efficiency cogeneration in the "relevant period" but start to do so in the following scheme years, to be eligible for free allowances once they can demonstrate they meet the eligibility criteria.

Amending the Covid 2021 ALCs

- The Authority will amend the ALCs Regulation to provide for the optional recalculation of the 2021 free allocations omitting the 2020 COVID year, for those operators who can demonstrate significant discrepancies between reductions in activity and emissions.

Amending benchmarks and the carbon leakage list category

- Effecting temporary changes to the lime benchmark and the carbon leakage classification of malt extract production for the 2024 and 2025 scheme years. This decision is based on substantive and evidenced claims from these sectors.

Chapter 4: Aviation

Effecting a cap to aviation free allocations

- The Authority has decided to cap the total amount of aviation free allocation that operators are eligible to receive. This change aims to ensure that aviation operators do not get more free allocations than their verified emissions.

Aviation calls for evidence

- Sustainable aviation fuels (SAF): The Authority signals the intention to continue developing proposals on how SAF is treated in the UK ETS.
- Non-CO2 climate impacts: The Authority will consider how to bring non-CO2 emissions into the scope of the scheme
- International cooperation: The Authority will consider how international cooperation on aviation emissions could be increased

Chapter 5: Expanding UK ETS Coverage within Covered Sectors

Inclusion of upstream CO₂ venting

- The Authority will include process emissions from carbon dioxide venting from the upstream oil and gas sector in the UK ETS.

Carbon capture and storage (CCS) transportation

- To expand the transportation of CO₂ through other forms of non-pipeline transport (i.e., shipping, rail, and road) by including them as a regulated activity under the UK ETS by the mid-2020s, in addition to the existing transport via pipeline.

Expanding UK ETS coverage within covered sectors calls for evidence

- Methane emissions: The Authority will further review the possible expansion of the UK ETS to cover methane emissions from upstream oil and gas and other traded sectors. Any changes will be consulted in due course.
- Safety venting and flaring: There is no intention to include safety and flaring in the UK ETS at this stage. The Authority will review this policy in the coming months and reconsult in due course.
- Remaining upstream oil and gas emissions: The Authority is not proposing any changes at this point, but we will review this policy in the coming months and reconsult in due course.
- 20MWth threshold and 3MW aggregation: The Authority will review the thresholds and to consult further if changes are considered.

Chapter 7: Calls for evidence on greenhouse gas removals and agriculture and land use emissions

Agriculture and Land Use

- Continued exploration of the monitoring, reporting and verification (MRV) of emissions from agriculture. The consultation called for evidence to better understand the MRV in land use and agriculture sector. There is no plan to include this sector within the scope of the UK ETS.

Chapter 8: Operational Amendments to the UK ETS

Appeal routes

- Not implementing appeal routes to UK ETS decisions at this stage.

Penalties

- The Authority will introduce a new penalty and enforcement notice to those operators that fail to submit information requested by Regulators.

Annex B: Description and rationale of proposals that require further consultation

The Authority decisions covered in this annex are not included in this BRIA as:

- these were calls for evidence and any final proposals are subject to further consultation;
- further consultation is required given insufficient data for making a final decision; or
- further consultation is required to finalise the proposal.

A description of each non-technical proposal covered in the Government Response to the UK ETS consultation, and the chapter in which they appear, are provided below. Please refer to the Government Response for further information on the rationale of the decisions.

Chapter 3: Call for Evidence on Future Markets Policy

The Authority agreed to signalling a future consultation on policy relating to the functioning of the UK ETS market, with the aim to build understanding and evidence on potential drivers of evolving market conditions, objectives for market stability policy as the UK ETS evolves and evaluation of existing market mechanisms.

Chapter 5: Expanding UK ETS Coverage within Covered Sectors

Biomass

The Authority agreed to implementing sustainability criteria for all forms of biomass in the UK ETS by 2025 at the earliest.

The objective for implementing sustainability criteria for all forms of biomass in the UK ETS is its importance in delivering effective decarbonisation. This will financially incentivise operators to ensure that all forms (solid, liquid, and gaseous) of biomass combusted at UK ETS installations adhere to a common sustainability standard. Any unsustainable forms of biomass that fail to meet the criteria, therefore, should be exposed to a carbon price. This is expected to be implemented by 2025 at the earliest.

Chapter 6: Expanding the UK ETS to New Sectors

Domestic Maritime

The Authority agreed to expand the UK ETS to include domestic maritime activities from large vessels (over 5000GT), subject to further consultation. The rationale is to overcome a key barrier to decarbonising the sector, which is that maritime fuels do not reflect their environmental costs. This inclusion could strengthen the incentive to adopt low carbon fuels, support deployment of fuel-efficient technologies and introduce more efficient operating practices.

In Scotland, we would expect the sectors impacted to include:

- regular freight feeder services from large English ports (i.e. Felixstowe, Immingham or Liverpool) to Grangemouth or Greenock;
- cruise vessels on UK-only excursions; and
- some larger vessels operating in the oil and gas sector, mainly from Aberdeen.

As both the UK and EU ETS will include vessels over 5000GT on eligible journeys, its impact is expected to be minimal for the Scottish fleet.

We also expect for 11 lifeline ferries services to island communities to be included under the UK ETS. We have also published an Island Communities Impact Assessment on the possible impact to island communities and mitigation strategies²⁴.

Waste Incineration and Energy from Waste (EfW)

The Authority agreed to signal the inclusion of waste incineration and EfW in the UK ETS from 2028, preceded by a 2-year phasing period from 2026-2028. The objective of this inclusion is the mitigation of emissions from the sector.

The CCC noted that waste is increasingly being diverted to incinerators and EfW plants - from which emissions continue to rise and has previously highlighted this increase in emissions as an issue to be addressed with urgency. In addition, the Independent Review of the Role of Incineration in Scotland's Waste Hierarchy recommended that the Scottish Government should support inclusion of incineration (with or without energy recovery) in the UK ETS as one important decarbonisation policy tool. The Scottish Government accepted this recommendation and, subject to further consultation of the details of implementation, we are supportive of expanding the UK ETS to cover waste incineration and energy from waste emissions.

Chapter 7: Calls for evidence on greenhouse gas removals and agriculture and land use emissions

Greenhouse Gas Removals (GGRs)

The Authority will signal that the UK ETS is an appropriate long-term market for GGRs, subject to further consultation. The rationale for this signalling, is to incentivise investment in GGRs, provide a source of demand for GGRs from polluting sectors and futureproof the UK ETS so it continues to play a key role in delivering net zero.

²⁴ [Island Communities Impact Assessment - UK Emissions Trading Scheme](#)



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UK Emissions Trading Scheme: Island Communities Impact Assessment (ICIA)

UK Emissions Trading Scheme: Island Communities Impact Assessment (ICIA)

1. Purpose

The Islands (Scotland) Act 2018 introduced a requirement for Scottish public authorities to undertake an Island Communities Impact Assessment (ICIA) to determine the impacts that policies, strategies, or services which, in the authority's opinion, are likely to have an effect on an island community which are significantly different from the effect on other communities (including other island communities) in the area in which the authority exercises its functions. This duty is often referred to as 'Island Proofing'.

The Scottish Government has, therefore, produced a full ICIA covering changes to the aviation and maritime sectors under the UK Emissions Trading Scheme (UK ETS), as described in the Government Response¹ to the "Developing the UK ETS" consultation.²

This full ICIA is structured following the steps set out in the Scottish Government's ICIA guidance,³

- Step one – Develop a clear understanding of the objectives.
- Step two – Gather data and identify stakeholders.
- Step three – Consultation.
- Step four – Assessment.
- Step five – Preparing the ICIA.
- Step six – Making adjustments.

The Scottish Government will update this ICIA with any further information and analysis as required.

2. Step one - Develop a clear understanding of the objectives

2.1 Policy objectives and possible impact on island communities

The UK ETS was established on 1 January 2021 by the UK ETS Authority (the "Authority") –formed by the Scottish, UK and Welsh Governments and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland.

The UK ETS aims to incentivise cost-effective decarbonisation across energy-intensive industries, the non-renewable power sector, and aviation⁴ to support ambitious climate targets across the UK. When establishing the UK ETS, the

¹ [Government Response to the Developing the UK ETS consultation](#)

² [Developing the UK ETS consultation](#)

³ [Island Communities Impact Assessment: guidance and toolkit](#)

⁴ Domestic flights, flights from the UK to EEA countries, the UK to Gibraltar and Great Britain to Switzerland flights. The return flights are covered by the EU and Swiss ETS schemes.

Authority committed to increasing the climate ambition of the scheme and therefore published the “Developing the UK ETS” consultation with proposals to further develop and strengthen the UK ETS, including through better alignment with net-zero targets.⁵ The Authority has published two Government Responses and associated impact assessments setting out its policy intentions in response to that consultation.⁶

This ICIA covers policy changes included in the final Government Response, published in July 2023, which may have an effect on island communities or impact these differently compared to other communities.

The changes to the UK ETS that have the potential to impact island communities differently are:

- **The phasing out of aviation free allocation (AFA) of allowances by 2026:** Companies in the scope of the UK ETS are required to purchase an allowance for each unit of emissions they produce. The Authority auctions most of these allowances every scheme year, but some are given for free to industries at risk of carbon leakage.⁷ Aircraft operators are among the participants that receive a percentage of the allowances for free. Under current UK ETS legislation, free allocations can only be used for mitigating carbon leakage.⁸ However, independent research commissioned by the UK Government showed that for aviation there is a limited risk of carbon leakage under the current scope of the UK ETS.⁹ Therefore, after thorough consideration, the Authority considered it disproportionate to maintain free allocations for the aviation sector. Ensuring free allocations are used where most needed for mitigating carbon leakage is essential as we are reducing the number of free allowances in line with the new net zero cap trajectory. This decision means that aircraft operators will have to start buying all their UK ETS allowances instead of receiving a percentage for free, which has the potential to impact operators’ costs, including those operators providing some services to island communities (some operators and island services are not currently in the scope of the UK ETS, as shown later in this document).
- **The inclusion of domestic maritime in the UK ETS from 2026 for vessels over 5000GT:** The UK ETS represents one part of a wider policy mix necessary to address barriers to maritime decarbonisation. The UK ETS could incentivise the adoption of low-carbon fuels, support the deployment of fuel-efficient technologies and introduce more efficient operating practices. Therefore, the Authority is including the maritime sector in the UK ETS from 2026, with the intention for this to apply to vessels over 5000GT. That threshold will capture some of the lifeline ferry services to island communities, meaning that they, along with other maritime operators under the UK ETS, will

⁵ [Developing the UK ETS consultation - March to June 2022](#)

⁶ [Government Response to the Developing the UK ETS consultation](#)

⁷ ‘Carbon leakage’ is defined as “where production and associated greenhouse gas emissions are displaced in ways that would not have happened if the pricing of emissions across jurisdictions was implemented in an equivalent way.”

⁸ [The Greenhouse Gas Emissions Trading Scheme Order 2020 \(legislation.gov.uk\)](#)

⁹ <https://www.gov.uk/government/publications/impacts-of-carbon-pricing-on-the-uk-aviation-sector>

need to either reduce their emissions or purchase allowances to cover their vessels' emissions, which could impact their operating costs. The Authority will be consulting further on the implementation of the UK ETS for domestic maritime, to finalise remaining policy details.

These UK ETS changes have the potential to impact operators providing services to island and mainland communities. Given the absence of road and rail transport options to most of the island communities, air and maritime routes play a more important role in ensuring their connectivity and viability. That means these UK ETS changes may impact some island communities differently, compared to other communities across the UK (including other island communities).

Though neither of the changes noted above will directly impact island communities, they are likely to impact operators who serve those communities. That may influence those operators' commercial decisions, which could, in turn, impact Scottish island communities. Cabinet Secretary for Transport, Net Zero and Just Transition, Màiri McAllan, wrote to her counterpart Ministers across the UK to secure commitment that the Authority would work together to mitigate any negative outcomes to island communities due to UK ETS policy changes. All nations replied, acknowledged this risk, and agreed for the Authority to identify and address any negative impacts on these communities. The Scottish Government will therefore work with the rest of the Authority and the Department for Transport on this risk and share possible mitigations in due course.

The Scottish Government does not believe any other changes to the UK ETS would have a different effect on island communities. Therefore, this ICIA does not cover any other decisions in the Government Response. For maritime, this ICIA focuses only on the potential impact on lifeline ferry services to island communities. We have not identified any areas where the inclusion of the wider maritime sector (above 5000GT) could impact island communities differently to other communities.

Please refer to the UK ETS Business and Regulatory Impact Assessment (BRIA) for an analysis of the impact on businesses of the changes to the UK ETS outlined in the Government Response.¹⁰

3. Step two – Gather data and identify stakeholders

3.1 Phase-out of AFA by 2026

3.1.1 Data available on current situation and stakeholders

The phase-out of AFA will capture operators that provide services to the Highlands and Islands. Hence, there is potential for this decision (alongside the maritime changes below) to negatively impact island communities, especially as there are no alternative modes of transport available (i.e., road and rail) for most of these communities compared to other regions in the UK.

¹⁰ [UK ETS Business and Regulatory Impact Assessment \(BRIA\)](#)

The Authority and the Scottish Environment Protection Agency (SEPA) have data about the compliance obligations and the impact of free allocations for the one aircraft operator regulated in Scotland under the UK ETS. The Scottish Government has not published any of this data or analysis as it is commercially sensitive information for that one operator. The Scottish Government does not hold any information about businesses' commercial decisions or other factors impacting them.

3.1.2 Ways the public sector currently supports aviation across island communities

The Authority has already ensured that flights performed by an aircraft with a certified maximum take-off mass of less than 5,700 Kg are exempt from the UK ETS. Based on public information on operators' websites, the following scheduled passenger flights to island communities are currently exempt under this requirement. The UK ETS therefore does not currently impose any costs on airlines for operating these services:

- Tingwall-Fair Isle
- Tingwall-Foula
- Kirkwall-Papa Westray
- Kirkwall-North Ronaldsay
- Kirkwall-Westray
- Kirkwall-Sanday
- Kirkwall-Stronsay
- Kirkwall-Eday
- Oban-Coll
- Oban-Tiree
- Oban-Colonsay
- Coll-Tiree
- Oban-Islay (service due to stop in September 2023)
- Glasgow-Tiree
- Glasgow-Barra

Additionally, the following support is already provided for the associated costs of some island services:

- **Public Service Obligations (PSOs):** Government can use PSOs to subsidise the provision of an air service under certain circumstances. Currently the Scottish Government funds PSOs between Glasgow and Tiree/Barra. Local authorities fund other PSOs, including Benbecula-Stornoway and those within the Shetland and Orkney archipelagos. All the services currently operated under PSOs to and from Scottish islands use aircraft under the 5700kg exemption limit, meaning they are exempt from the UK ETS (with the exception of the Benbecula-Stornoway service).
- **Air Passenger Duty (APD):** All scheduled passenger services departing from airports in the Highlands and Islands are exempt from paying APD, which is set by the UK Government.

- Highlands and Islands Air Discount Scheme (ADS):** The Scottish Government funds the ADS, which provides residents of Shetland, Orkney, the Western Isles, Islay, Jura, Colonsay, Caithness, and north-west Sutherland with a 50% discount on the core airfare on eligible services. The scheme aims to tackle high airfares and improve social inclusion in the most peripheral parts of the Highlands and Islands.

3.2 Inclusion of domestic maritime in the UK ETS

3.2.1 Data available on current situation and stakeholders

This scope expansion would capture 11 vessels currently operating in Scotland, which provide an essential lifeline service for island connectivity.

As of the publication of this ICIA, the operating lifeline ferries that would be covered by this inclusion are:

Motor Vessel Name:	Gross Tonnage:
Hjaltland	11,720
Hrossey	11,720
Hamnavoe	8,780
Loch Seaforth	8,680
Helliar	7,606
Hildasay	7,606
Isle of Lewis	6,753
Finlaggan	5,626
Hebrides	5,506
Clansman	5,499
Caledonian Isles	5,221

3.2.2 Ways the public sector currently supports maritime transport across island communities

Most island ferry services in Scotland are provided under public service contracts, or similar, and adequate service and fare levels are dependent on high levels of support from the Scottish Government and local authorities. One example of the existing support is the freezing of fare levels on the Northern Isles and the Clyde and Hebrides ferry networks - now extended for a further six months from October 2023 until the end of March 2024 - and supported directly by Scottish Ministers. This policy follows an initial freeze introduced for the first three months of 2023.

The Scottish Government is aware that UK ETS policy changes to the aviation and maritime sectors increase risks to island communities. Therefore, we are establishing, with the rest of the Authority and the Department for Transport, a working group to identify adequate mitigation strategies either with policies within or outside of the UK ETS, including changes to the existing support models to ensure island communities are not put at a disadvantage from these changes.

4. Step three – Consultation

4.1 Developing the UK ETS consultation

The Authority delivered the public consultation “Developing the UK ETS” between 25 March and 17 June 2022.¹¹ As part of the consultation process, and aiming to gather as much feedback as possible, the Authority delivered 47 UK-wide stakeholder engagement sessions with current and future UK ETS participants, cross-sector business groups, trade associations, think tanks, academics, and environmental NGOs. These sessions included high-level summaries of the consultation and topic-specific workshops, which covered proposals on AFAs and the inclusion of maritime in the UK ETS, among others. Approximately 350 stakeholders attended these engagement sessions, including Scottish stakeholders.

A total of 300 stakeholders responded to the consultation, of which around 120 were identified as particularly relevant for Scotland by policy teams across the Scottish Government.

The responses to this public consultation included a variety of stakeholders, including those from the aviation, chemical, oil and gas, refining, transport, manufacturing, power, food and drink, and steel sectors, as well as other trade associations, local authorities, consultancies, think tanks, academics, and environmental NGOs.

The Authority has produced and published an [early and final Government Response](#) to the consultation.

While the “Developing the UK ETS” consultation was open to everyone to contribute, the Scottish Government did not directly consult with island communities at that stage, as changes to the UK ETS are technical and directly impact commercial operators, who did engage in the consultation, rather than members of island communities. Any impacts on island communities will be a result of commercial decisions taken by those operators.

5. Step four – Assessment

As set out above, the aviation and maritime sectors might face additional financial pressures as:

¹¹ [Developing the UK ETS consultation document](#)

- For the aviation sector, the phase out of AFA will require operators to purchase all their UK ETS allowances for their verified emissions instead of receiving a percentage for free; and
- For the maritime sector, the inclusion of vessels over 5000GT in the UK ETS means that those lifeline ferry operators that meet the threshold will have to start complying with the UK ETS (i.e., by purchasing allowances equivalent to their verified emissions).

5.1 Impacts on flight services

Flight services are decided and operated on a commercial basis, and any possible changes to services in the short to medium term will be influenced by a range of commercial factors, which could include UK ETS compliance costs. The Scottish Government has no visibility or control over such commercial decision-making, and it would be inappropriate to speculate on how operators will react to the changes.

It is therefore not possible to assess the exact impact due to the phase-out of the AFA but, in general, operators respond to increased operating costs by:

- Seeking to reduce their UK ETS compliance costs, by lowering their emissions through investment in sustainable aviation fuel and technological and operational efficiencies.
- Absorbing the costs without changing their operations.
- Changing the frequency, timings, ticket pricing or operations of certain services.

The Scottish Government, together with the rest of the Authority and the Department for Transport, will continue to monitor any changes that the phase out of AFA could have on service availability and pricing and will implement mitigation strategies as appropriate. Further analysis of the impacts on the aviation sector can be found in the Scottish Government BRIA on the UK ETS (see footnote 7) and the Authority's impact assessment on the back of the Government Response publication.¹²

5.2 Impacts on ferry services

Regarding the changes to the maritime sectors, the operators of Scotland's publicly funded lifeline ferry services are decoupled from commercial considerations, given the high level of government subsidy support in place to enable these services. The contractual arrangements between the ferry operators and Scottish Ministers mean that all additional costs to lifeline ferry operators arising from the UK ETS would be passed on to the Scottish Government. A range of measures would require consideration in order to cover the additional costs, such as raising fares above the standard CPI-linked measure, or potential cuts to ferry services.

5.3 Assessment conclusions

¹² [Developing the UK ETS: impact assessment \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)

Given the above, it is difficult to conclusively assess the impact of these UK ETS changes on island communities. This is because the primary impact is on operators, and the impact on communities would depend on commercial decisions those operators take. Those decisions will be influenced by a range of factors wider than these policy decisions.

However, due to the potential effect on island communities, the Scottish Government has raised with the Authority the possible risks to these communities. As such, the Authority has agreed to establish a working group to identify adequate mitigation strategies within and outside of the UK ETS to protect island connectivity, besides the existing policies and programmes in place that support the island communities more broadly.

Should the Scottish Government become aware of any significant effects, consideration will be taken on whether this ICIA can be reviewed and updated, or a further ICIA will need to be produced.

6. Step five – Preparing the ICIA

6.1 Future possible mitigations

Màiri McAllan, Cabinet Secretary for Transport, Net Zero and Just Transition for the Scottish Government, has raised the potential risk to regional connectivity and the Authority has agreed to work with the relevant parts of the UK Government to address any possible negative impacts to island communities due to UK ETS policies.

6.2 Phase out of AFA by 2026

In the final Government Response, the Authority acknowledged the possible risk to island communities from the AFA phase-out and agreed to consider which policies could be put in place to mitigate these risks. This could include further exemptions within the UK ETS or adopting policies outside of the UK ETS such as expanding the existing government support to the aviation sector (described earlier in this ICIA). The Scottish Government, as well as the Authority, will share more information on these as soon as practicable.

6.3 Inclusion of domestic maritime in the UK ETS

As the Authority has not yet finalised detailed implementation of this policy, the Scottish Government will continue to work with the other UK nations and departments to explore mitigation strategies for the island connectivity risk posed by this scope expansion. The Authority acknowledged in the Government Response the risk this policy could have on crucial services to the areas of the UK that depend on these services and to consider how to address these risks in the second maritime consultation.

The Scottish Government will update this ICIA with any agreed mitigations on either of the policies or any further information as required.

7. Step six – Making adjustments

7.1 Future steps and adjustments

Different island communities rely on air and ferry services to different extents. Additionally, different services are impacted by the UK ETS in different ways (for example, because some services on both modes of transport are below the weight threshold for inclusion in the UK ETS). This means the impact of these policies, and policies to mitigate those impacts, may vary between communities.

Specific island circumstances have been discussed across the Authority; and any possible mitigations will be developed through the Authority working group to identify and address any negative impacts on island communities due to these UK ETS changes.

We will continue to assess if any changes to the UK ETS may impact island communities differently and will engage with these communities as necessary.



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