

# THE EU EMISSIONS TRADING SYSTEM (EU ETS) EU EXIT REGULATIONS

## NOTIFICATION TO THE SCOTTISH PARLIAMENT

### **Name of the SI(s) (if known) or a title describing the policy area**

The Greenhouse Gas Emissions Trading Scheme (Amendment) (EU Exit) Regulations 2018. This relates to the EU Emissions Trading System which is within the Environment, Climate Change & Land Reform (ECCLR) portfolio.

### **A brief explanation of law that the proposals amend**

This proposal relates to EU Emissions Trading System (EU ETS) which is one of the EU's flagship policies, contributing towards its climate ambition and a key mechanism deliver its Paris Agreement commitments. The EU ETS is a market based mechanism that provides a carbon signal to incentivise the traded sector (energy intensive industry and the power sector) to decarbonise. The EU ETS is one of the largest mechanisms to achieve Scotland's statutory climate change targets, with the around 95 EU ETS participants accounting for 35% of Scotland's CO<sub>2</sub> emissions. EU ETS participants are required to report their emissions annually, and obtain corresponding emissions allowances which are surrendered to the EU Commission. Allowances are auctioned by each Member State, and can be traded between participants. Sectors at risk of carbon leakage (whereby the carbon costs put them at a competitive disadvantage) are allocated a certain proportion of allowances for free. The data collected under the EU ETS is also used in compiling Scotland's greenhouse gas statistics for the industry sector.

The EU ETS is established by over 54 pieces of legislation including an EU Directive that sets out the general principles, and directly applicable EU Regulations that provide detailed rules for participants and regulators operating the system. The implementation of the EU ETS is within the Scottish Ministers' devolved competence. Since the launch of the EU ETS in 2005 Scottish Ministers have agreed to implement it via UK wide arrangements to provide participants with a common approach. Consequently the UK Greenhouse Gas Regulations 2012 (UK Regulations) were made by the UK Government using powers under section 57 of the Scotland Act 1998, with the consent of Scottish Ministers.

### **Summary of the proposals and how these correct deficiencies**

The UK will be excluded from participating in the EU ETS in a no deal scenario and so it becomes fundamentally inoperable as UK participants will no longer have access to the centralised EU Registry to manage their allowances. Therefore, in a no-deal scenario, UK participants will cease to participate in the EU ETS after the 2018 compliance year (after meeting the emission reporting and allowance surrender deadlines in early March 2019). The UK SI seeks to salvage the elements of the EU

ETS that remain operable after EU Exit, by bringing the relevant EU Regulations into UK law with amendments as necessary, and removing the redundant inoperable elements in existing UK Regulations.

The UK SI retains the existing EU ETS emissions monitoring and reporting requirements along with corresponding enforcement provisions, but removes the requirements to obtain and surrender EU ETS emissions allowances. As a result industry will continue to report their emissions (on a calendar year basis with deadlines in the subsequent year) without any gap. This ensures that this data can continue to be used in Scotland's greenhouse gas statistics.

The Scottish Ministers consider that this UK SI is appropriate in the no-deal scenario as it provides a pragmatic solution to the inoperabilities, maintaining emissions reporting whilst a longer term approach can be discussed by the four administrations (further detail provided below).

The UK Government has not yet published its Technical Note relating to EU ETS which describes the approach taken in this UK SI to stakeholders, as part of its wider approach to carbon pricing and climate change.

### **An explanation of why the change is considered necessary**

The UK SI is necessary because the current arrangements for implementing the EU ETS are inoperable in the event of a no deal Brexit, and the UK will cease to participate in it. Allowing the EU ETS obligations to lapse without making changes would have negative impacts on Scottish participants and our wider policy to decarbonise the industry sector to contribute towards delivering Scotland's statutory climate change targets.

The changes are needed to clarify what UK participants' ongoing obligations are under the UK Regulations. The current obligations to obtain and surrender emission allowances will become inoperable such that participants cannot fulfil them, so the UK SI removes these obligations to ensure that participants will not be subject to enforcement action. The UK SI also ensure that the remaining operable obligations, to monitor and report emissions, are still undertaken according to technical rules currently set out in directly applicable EU Regulations by bringing them into UK law.

The changes are also needed in policy terms. If the changes were not made, effectively the EU ETS, would cease to operate in the UK. As the EU ETS is the single largest mechanism to incentivise the traded sector to decarbonise, this would risk the delivery of our statutory climate change targets. Making changes to maintain emissions reporting provides for continued data collection to contribute towards Scotland's climate change statistics.

Furthermore it sends a signal that the policy objective to decarbonise the traded sector remains, despite ceasing to participate in the key delivery mechanism. Maintaining data collection will ensure continuity for stakeholders and facilitate transition into longer term arrangements following discussion between all four administrations. In policy terms, the changes to remove the obligations relating to emission allowances could reduce the trade sectors incentive to decarbonise.

### **Scottish Government categorisation of significance of proposals**

The majority of changes in the UK SI are technical. The Scottish Ministers agree the changes constitute a pragmatic approach to addressing the inoperabilities in the EU ETS arising from EU Exit, and support the continuation of emissions reporting. However on balance it is considered that the proposal falls within category B because it represents a departure from a longstanding emissions trading scheme, only maintaining the reporting requirements but removing any carbon price.

### **Impact on devolved areas**

There are no serious negative impacts on Scottish participants from the UK SI itself. It maintains their existing obligations to monitor their emissions according to current familiar rules and to report them annually to the Scottish Environmental Protection Agency (SEPA). The UK SI does not introduce any new requirements for participants and actually removes their obligations to obtain and surrender the allowances annually, reducing their costs. The UK SI ensures an ongoing role for SEPA to administer and enforce the emissions monitoring and reporting rules in Scotland and so does not impact on its current functions.

There could be an impact on the decarbonisation of the traded sector and its contribution to the delivery of our statutory climate change targets. The Climate Change Plan (Report on Policies and Proposals covering 2017-32) considers that participation in the EU ETS would contribute 17% towards our targets. It is not clear what the approach set out in the UK SI would mean for the rate of decarbonisation from the traded sector.

### **Summary of stakeholder engagement/consultation**

The UK Government's letter states that there is no requirement to consult stakeholders when fixing deficiencies resulting from Brexit using powers in the EU Withdrawal Act 2018. As of 28 September the UK Government has not announced its overall approach to the EU ETS in a no-deal scenario, with the publication of its Technical Notice being delayed.

The Scottish Government has attended industry meetings and informally sought stakeholders' views on future participation in the EU ETS after Brexit. Stakeholders' views have focused on the longer term arrangements rather than no-deal scenario arrangements. The UK Emissions Trading Group (ETG), composed of participants and

other stakeholder involved in the EU ETS, has developed detailed options papers for the long term arrangements. However the ETG is intimately aware of the complications surrounding the EU ETS in a no-deal scenario, and is likely to have anticipated that maintaining emission reporting is the only pragmatic option immediately available to the UK and Devolved Governments.

### **A note of other impact assessments**

An Impact Assessment is not necessary to support the proposals in this UK SI, which continues the existing arrangements for emissions reporting and monitoring. The Scottish Government continues to press the UK Government for Impact Assessments for all future long term arrangement options for EU ETS.

### **Summary of reasons for Scottish Ministers' proposing to consent to UK Ministers legislation**

The Scottish Ministers propose to consent to the UK SI to fix the inoperabilities in the EU ETS because failure to fix the deficiencies would lead to negative impacts for Scottish stakeholders and for the delivery of industrial decarbonisation to contribute towards our statutory climate change targets. The approach set out in the UK SI, retaining emissions reporting but removing the inoperable obligations relating to EU ETS emissions allowances, is realistic, quickly achievable and minimises immediate disruption. It is likely to be the only practicable approach available in the no-deal scenario. It ensures continuity of current arrangements, for both stakeholders and in policy terms, until longer term arrangements can be put in place by all four administrations (the Scottish and Welsh Cabinet Secretaries have pressed for Ministerial discussions on this).

We have long experience of working collaboratively with the UK Government on the EU ETS, agreeing to UK wide arrangements made through UK SI to implement it since its launch in 2005. Maintaining the longstanding UK wide approach is preferable for stakeholders, and the UK and Scottish Governments share policy objectives in relation to emissions reporting to incentivise industrial decarbonisation. Legislating separately would be highly complex due to the mix of competencies in this area between the Scottish Parliament and Westminster and would cause further disruption for stakeholders, potentially introducing transitional issues. Furthermore co-operation with the UK Government is necessary in order to make the fixes in order to give participants sufficient notice of their ongoing obligations. It would not be possible to make separate arrangements in the time available.

### **Detail how Scottish Ministers' have had regard to the guiding principles on animal welfare and the environment**

The Scottish Ministers have had regard to the guiding principles on the environment. The EU ETS is predicated on the polluter pays principle by requiring the traded sector to account for their CO<sub>2</sub> emissions. The approach in the UK SI ensures that the traded sector remains accountable in the event of no-deal, by continuing to monitor and report their emissions.

### **Intended laying date of instruments**

The UK Government has indicated that it intends to lay the instrument on the 14 November, and its consent letter asked for the Scottish Ministers' consent by 29 October 2018.

### **If the Scottish Parliament does not have 28 days to scrutinise Scottish Minister's proposal to consent, why not?**

The UK Government's requested deadline does not allow for 28 days scrutiny when taking the Scottish Parliament October recess into account.

### **Information about any time dependency associated with the proposal**

The EU ETS operates on a calendar year, therefore participants need clarity on their ongoing EU ETS obligations before the end of 2018. Similarly anybody with emissions allowances in the UK (participants and traders) need to know what the implications are of the UK ceasing to participate in the EU ETS and make contingency plans.

### **Any significant financial implications?**

There are no significant new financial implications for the Scottish Government in the UK SI as it maintains the existing arrangements as far as possible. (The UK Government raises around £0.5bn pa from the auctioning of EU ETS allowances, but this is not hypothecated and the Scottish Government does not get a share of the receipts.) The financial implications of this UK SI for Scottish participants are that their costs will reduce (given they no longer require EU ETS emissions allowances).