The future of UK carbon pricing

UK Government and Devolved Administrations’ response

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Contents

Executive Summary

1. The UK Government and Devolved Administrations consulted on the future of carbon pricing in the UK after EU Exit, receiving over 130 responses from a range of stakeholders, with the majority supporting most of our proposals on the design of a UK ETS.

2. We intend to establish a UK Emissions Trading System with Phase I running from 2021-2030, which could operate as either a linked or standalone system. As stated in 'The UK's Approach to Negotiations' the UK would be open to considering a link between any future UK Emissions Trading System (ETS) and the EU ETS (as Switzerland has done with its ETS), if it suited both sides' interests. As announced at Budget 2020, the UK Government will publish a consultation later this year on the design of a Carbon Emission Tax as an alternative to a UK ETS, to ensure a carbon price remains in place in all scenarios.

3. The UK ETS will apply to energy intensive industries (EIIs), the power generation sector and aviation – covering activities involving combustion of fuels in installations with a total rated thermal input exceeding 20MW (except in installations for the incineration of hazardous or municipal waste) and sectors like refining, heavy industry and manufacturing. The proposed aviation routes include UK domestic flights, flights between the UK and Gibraltar, flights from the UK to EEA states, and flights from the UK to Switzerland once an agreement is reached.

4. In light of the UK's commitment to reaching net-zero emissions by 2050, the UK ETS will show greater climate ambition from the start. As such, the cap will initially be set 5% below the UK's notional share of the EU ETS cap for Phase IV of the EU ETS. The Committee on Climate Change (CCC) will advise later this year on a cost-effective pathway to net-zero, as part of their advice on the Sixth Carbon Budget. We will consult again on what an appropriate trajectory for the UK ETS cap is for the remainder of the first phase within nine months of this advice being published. Our aim is that any changes to the policy to appropriately align the cap with a net zero trajectory will be implemented by 2023 if possible and no later than January 2024, although we would also aim to give the industry at least one year's notice to provide the market with appropriate forewarning.

5. Auctioning will continue to be the primary means of introducing allowances into the market. To safeguard competitiveness in the UK ETS and reduce the risk of carbon leakage, a proportion of allowances will be allocated for free. Some free allowances will also be made available for new stationary entrants to the UK ETS as well as existing operators who increase their activity – these allowances will be accessible through the New Entrants Reserve. Our initial UK ETS free allocation approach will be similar to that of Phase IV in order to ensure a smooth transition for participants for the 2021 launch.

6. However, we recognise the range of views expressed in response to the consultation and the crucial need to take a fair, proportionate and considered approach to potential improvements to free allocation and we will begin a full review of possible future changes in the coming months.

7. In a standalone UK ETS we will introduce a transitional Auction Reserve Price (ARP) of £15 (nominal) to ensure a minimum level of ambition and price continuity during the

initial years of UK ETS. To address concerns around the reactiveness of the UK ETS in managing high price spikes, in years one and two of a UK ETS the Cost Containment Mechanism (CCM) will have lower price and time triggers, providing a mechanism by which the UK Government can decide whether to intervene sooner should very high prices occur. We will revert to the EU ETS CCM design in year three of a UK ETS, or sooner if we link with the EU ETS. We will consult separately on the design of a Supply Adjustment Mechanism (SAM) in a standalone UK ETS if required.

8. We will implement a Small Emitter and Hospital Opt-Out for installations with emissions lower than 25,000t CO2e per annum and a net-rated thermal capacity below 35MW. We will implement an Ultra-Small Emitter Exemption for installations with emissions lower than 2,500t CO2e per annum.

9. International credits will not be permitted in a UK ETS at this time. This is without prejudice to ongoing reviews on how best to implement the UN global offsetting scheme, CORSIA, alongside a UK ETS.

10. The Government will implement two of the three reviews proposed in the consultation document, with the mid-phase review being incorporated into the second whole-system review of the phase. An initial review of the UK ETS to be conducted from 2023 to assess whole system performance during the first half of the phase (2021-2025) with any necessary changes to design features implemented by 2026; a full review from 2028 onwards to assess whole system performance across all of Phase I (2021-2030) with any update to the UK ETS rules implemented for 2031 (Phase II). These reviews are aligned with the EU ETS Phase IV reviews and Paris Agreement Global Stocktake efforts.

11. The UK ETS will play an important role in cross-government efforts to deliver the net zero target as part of a coherent policy package alongside £2 billion to support decarbonisation in a range of sectors, and the £315m Industrial Energy Transformation Fund to support industry to invest in energy efficiency and decarbonisation technologies.

Introduction

12. The UK Government and the Devolved Administrations (DAs) are committed to climate action. The UK was the first major economy to commit to ending its contribution to climate change entirely by 2050. This is set in law through the Climate Change Act 2008, which has been amended for the UK's net zero commitment.

13. Additional legislative frameworks and targets exist in the DAs. The Scottish Government has legislated for net zero targets by 2045, including emissions from international aviation, and the Welsh Government will bring forward legislation in 2020 to cut net emissions at least 95% in 2050, including emissions from international aviation and shipping, in line with the reduction required to meet its fair contribution to a net zero target for the UK. Northern Ireland also contributes towards the UK climate change targets and carbon budgets.

14. Having left the EU, the UK will remain at the forefront of domestic and international action on climate change by committing to go further and faster in our efforts to deliver clean energy and a net zero future.

15. The UK Government are expecting advice from the Committee on Climate Change (CCC) on the Sixth Carbon Budget (emissions for 2033-2037) This will include advice on the cap for the UK Emissions Trading System (UK ETS) in a net zero context, which will go to both the UK Government and DAs. This advice will give the evidence on what is cost-effective and inform the evolution of the UK ETS after its launch.

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

17. The UK has long been an advocate of the development of carbon pricing internationally. The UK established Europe's first emissions trading scheme in 2002, which served as a pilot for the EU Emissions Trading System (EU ETS), and established London as a global centre of carbon trading. Carbon pricing schemes are being established around the world: as of 1 April 2019, 57 carbon pricing initiatives had been established or scheduled for implementation globally, covering around 20% of global greenhouse gas emissions. Of these, 28 are emissions trading systems[1].

18. Last year the UK Government and Devolved Administrations consulted on the future of carbon pricing in the UK after EU Exit[2]. The consultation received over 130 responses, from a range of stakeholders including current EU ETS participants and NGOs, with the majority of respondents to each question supporting the proposal being put forward. Some proposals were more strongly supported than others, and we have presented these views and alternative proposals put forward by respondents against each policy within this document.

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[1] World Bank Group (2019) State and Trends of Carbon Pricing 2019
https://openknowledge.worldbank.org/handle/10986/31755

[2] The future of UK carbon pricing
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/815011/THE_FUTURE_OF_UK_CARBON_PRICING_-_04072019.pdf

19. A large proportion of stakeholders expressed a preference to link a UK ETS to the EU ETS. As stated in 'The UK's Approach to Negotiations'[3] the UK Government would be open to considering a link between any future UK Emissions Trading System (ETS) and the EU ETS (as Switzerland has done with its ETS), if it suited both sides' interests. A linking agreement could:

- provide for mutual recognition of allowances, enabling use in either system;
- establish processes through which relevant information will be exchanged; and
- set out essential criteria that will ensure that each trading system is suitably compatible with the other to enable the link to operate.

20. This document sets out the UK Government and DAs' decisions on the design of the UK ETS, which could operate as either a linked or standalone system, in light of a wide range of evidence gathered in the consultation. As announced at Budget 2020, the UK Government will publish a consultation later this year on the design of a Carbon Emission Tax as an alternative to a UK ETS.

21. The UK played a leading role in the negotiations to agree recent reforms to Phase IV of the EU ETS and the design of the UK ETS reflects the many successful features of that System. This means that the UK ETS will be familiar to operators in many ways and should be compatible with the EU ETS should the UK and EU agree to link emissions trading systems.

22. At the same time, launching a UK ETS will allow us to have autonomy over its design and governance. In some areas, we have taken the opportunity to make the system work better for the UK and will continue to do this as the UK ETS evolves over time.

23. A successful launch of the UK ETS in January 2021 will provide a smooth transition from the EU ETS at the end of the Transition Period and will lay the foundation for effective carbon pricing in the UK after we leave the EU ETS.

24. The UK ETS will cover a significant proportion of emissions within scope of our carbon budgets (between 2013 and 2020 the EU ETS has covered around a third of UK emissions) and will play an important role in cross-government efforts to deliver the net zero target as part of a policy package which includes £2 billion to support decarbonisation in a range of sectors, and the £315m Industrial Energy Transformation Fund to support industry to invest in energy efficiency and decarbonisation technologies.

25. The overall cap for the UK ETS will determine the limit on total emissions allowances. Our UK ETS cap is set to signal our long-term climate commitments while ensuring our economy remains competitive.

26. The UK Government and the DAs are committed to clean growth. The global shift to a low carbon economy is one of the greatest industrial opportunities of our time, and climate leadership can drive UK competitiveness while securing long term prosperity.

27. We are however aware that UK industry competes in a global market, and operators exposed to international competition may be put at a competitive disadvantage compared to their counterparts in other countries without similar carbon costs. There is

[3] https://www.gov.uk/government/publications/our-approach-to-the-future-relationship-with-the-eu

a risk that this disadvantage could lead to businesses relocating their production, investment and associated emissions abroad - a concept known as carbon leakage.

28. In the EU ETS, operators exposed to international competition are protected through free allocation of allowances. We will replicate these rules when the UK ETS is launched to allow a smooth transition, but we will also review the approach to free allocation across sectors in light of the feedback from the consultation. Getting this right will mean that we effectively protect industries at risk of carbon leakage, while following the ‘polluter pays’ principle.

29. We are on track to deliver a UK ETS and will lay legislation in each of the four legislatures in 2020 so that the UK ETS can launch in January 2021. We have procured a supplier who are building the Registry – the main IT system for the UK ETS.

30. We have included decisions in this document that apply to a UK ETS that could operate as either a linked or standalone system. Where different approaches would apply under a linked or a standalone UK ETS this is highlighted under the relevant sections.

31. However, given inherent uncertainty, it is sensible to have a fallback carbon pricing option; therefore, the UK Government will also consult on a Carbon Emissions Tax which, if needed, will ensure a carbon price remains in place in all scenarios.

32. The Future of UK Carbon Pricing consultation ran prior to the ongoing COVID-19 emergency. We appreciate that some businesses are facing financial difficulties as a result of COVID-19, and we will be working closely across Government and the DAs to respond to difficulties faced by operators. The UK Government has set out a package of temporary, timely and targeted measures to support businesses through this period of disruption caused by COVID-19. A dedicated website helps businesses to find the right support, advice and information to help with the impact of COVID-19[4].

33. Business support is also offered by DAs, with dedicated websites outlining support in Scotland[5], Wales[6] and Northern Ireland[7].

34. We are also mindful of the continuing need to maintain climate ambition, and will continue to put measures in place that enable us to achieve net zero emissions by 2050, whilst balancing this with the need to maintain UK business competitiveness.

[4] https://www.gov.uk/government/publications/support-for-those-affected-by-covid-19/support-for-those-affected-by-covid-19
[5] https://findbusinesssupport.gov.scot/coronavirus-advice
[6] https://businesswales.gov.wales/coronavirus-advice/
[7] https://www.nidirect.gov.uk/articles/coronavirus-covid-19-business-and-employers

Government response

Chapter 1: Design of a UK Emissions Trading System

Summary

35. Chapter 1 sets out the proposals for the main design features of a UK ETS, primarily related to stationary installations. Features of the system which relate solely to aviation are set out in Chapter 3. This chapter explains how we have taken on board the responses we received to the consultation and what this means for design elements specific to stationary installations. Where different proposals would apply under a linked or standalone system, this is highlighted within the relevant sections.

Question 1

a) Are you a current participant of the EU ETS? (Y/N)

b) If you are a participant or a representative of a sector, which sector do you belong to?

Question 2

Does your interest in the ETS relate to the operation of the scheme in a particular geographical area?

a) England

b) Wales

c) Scotland

d) Northern Ireland

e) UK-wide

Summary of responses

36. We received 77 responses to question 1, with 40 respondents (52%) stating they were participants in the EU ETS, and 37 respondents (48%) stating they were not participants.

37. The 40 respondents who were current participants in the EU ETS were from a variety of sectors, including: power (17), fossil fuels (8), cement and materials (8), food and drink (7), chemicals (7), and aviation (6). A further 12 stated that they were from “other” sectors. Note that respondents were able to select multiple sectors.

38. Of the 37 non-participant responders, 6 stated they represented trade bodies, 3 represented NGOs, 1 represented academic institutions, 1 specified representing a consultancy, 5 responses were from individual applicants, and 2 responses from “other”.

39. 55 respondents indicated that they had a UK-wide interest in the operation of the system, whereas 19 indicated England, 8 indicated Scotland, 6 indicated Wales and 2 indicated Northern Ireland. Note that respondents were able to select multiple locations.

40. Alongside the consultation, the UK Government and Devolved Administrations jointly commissioned the CCC for advice on both a linked and standalone UK ETS. The CCC provided their advice on these scenarios on 7 August 2019 and on 20 March 2020, respectively.

Scope

Summary of proposals

41. In the consultation we proposed that energy intensive industries (EIIs), the power generation sector and aviation should be included in the scope of the UK ETS. This means the UK ETS would apply to activities involving combustion of fuels in installations with a total rated thermal input exceeding 20MW (except in installations for the incineration of hazardous or municipal waste) and sectors like refining, heavy industry and manufacturing.

Question 3

a) Do you agree with the proposed scope of a UK ETS? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 4

a) Do you have any suggestions for which sectors might be included in scope in the future? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of responses

42. We received 78 responses to the question (Q3) on the scope of a UK ETS. 61 (78%) respondents agreed that the scope of a UK ETS should include EIIs, the power generation sector and aviation.

43. 14 of the respondents who supported the proposed scope did so because they believed it would facilitate a smooth transition into the UK ETS. Additionally, 17 respondents specifically mentioned the potential for future linkage of the UK ETS and the EU ETS as a key reason for their support of the proposed scope.

44. 17 (22%) respondents disagreed with the proposed scope of a UK ETS. Of these, 12 respondents from a variety of sectors cited a perceived lack of ambition and were of the view that scope should be expanded to ensure that the UK is capable of achieving its net zero target.

45. We received 69 responses to the question (Q4) on sectors to consider including in the future scope of a UK ETS. Of these, 42 (61%) respondents provided suggestions for the inclusion of additional sectors.

46. There was significant variation in proposed sectors across the responses. 9 respondents proposed that the transport sector should be included in the scope of a UK ETS and 7 proposed the inclusion of commercial and residential heating. Respondents noted that these sectors are included in the ETSs of New Zealand, California and Quebec.

47. Additionally, the CCC suggested in its advice that "in the longer-term, an expansion of carbon pricing, and possibly an emissions cap, to a much larger part of, or all of, the economy could be desirable." The CCC later advised that the Government should work to expand the scheme's scope by 2026 and seek to include agriculture and land use

48. Six respondents highlighted their concern that municipal waste incinerators are excluded from the scope. Some suggested that the inclusion of waste incinerators would contribute positively towards the UK's circular economy objectives.

49. Five respondents suggested that consistency in sectoral coverage with the EU ETS was of primary importance. 27 (39%) of respondents did not provide suggestions on the future inclusion of sectors.

UK Government's and Devolved Administrations' response

50. In the light of responses received, we have decided to keep the scope of a UK ETS as proposed in the consultation. This fulfils the UK Government's commitment under the Clean Growth Strategy that any replacement of the EU ETS would be at least as ambitious environmentally and contributes to providing a smooth transition for business. This position was also supported by a majority of respondents to the consultation.

51. We note the arguments that some respondents made for expanding the scope of the system to a number of sectors and installation types. We recognise that there is a case for expanding carbon pricing, especially in the context of a net zero emissions target, and will therefore consider the option of expanding the scope to the most appropriate additional sectors in the first ETS review as per the review process outlined below (see "Phases and Reviews") to enable implementation of any potential changes to scope by no later than 2026.

52. We acknowledge respondents' comments regarding expanding the scope of the scheme to include municipal waste incinerators. The complex environmental requirements placed on municipal waste incinerators, as well as their role in diverting waste from landfill, make it difficult to include them in a UK ETS. We also acknowledge the CCC's advice to expand the scope to include agriculture and land use. While we agree that emissions from these sectors will need to be abated to meet our net zero target, there may be more appropriate measures than the UK ETS for doing so. This will be for the appropriate government departments to consider following the CCC's advice on the Sixth Carbon Budget and a net zero trajectory, however municipal incinerators will not be included within the scope of the UK ETS for the period 2021 - 2025.

Cap and Trajectory

Summary of proposals

53. The consultation set out our proposals for the cap in a standalone UK ETS, noting that the cap for a linked system would need to take into account the joint market. In a standalone system, we proposed setting a single cap covering stationary installations and aircraft operators, with all allowances being interchangeable between participating sectors. We also proposed that there should be a trajectory for reducing the total number of allowances in the system each year, enabling UK ETS participants to contribute to the UK's overall decarbonisation goals.

Question 5

a) Do you agree that costs to business alongside climate ambition are the appropriate ones to be considered for the final decision on setting the cap and trajectory? (Y/N)

b) What other factors should be prioritised in the setting of the cap and trajectory?

c) Please expand on your answer and give evidence where possible.

Question 6

What would the implications be for your business if the cap for a standalone UK ETS was set at a tighter level than the UK's anticipated notional share of the EU ETS cap?

Summary of responses

54. Out of 65 respondents, 52 (80%) agreed that the costs to business alongside climate ambition were the appropriate factors to be considered in deciding the level of the cap and trajectory.

55. Four trade bodies and one company from the EIIs sector suggested that the impact on the international competitiveness of UK businesses should be prioritised. Five respondents underlined the importance of accounting for the costs to business, and nine noted the potential for carbon leakage as a key factor for consideration when setting the cap. Four respondents from the energy and steel sectors suggested that providing the conditions for linking with the EU ETS should be a priority, stating the cap should be set at the UK's notional share of the EU ETS cap.

56. Three respondents in the power sector and one respondent in the chemicals sector suggested that the UK's pathway to net zero carbon emissions should be prioritised in setting the cap. Some respondents suggested the cap could be tighter than the UK's notional share of the EU ETS cap, with one company in the power sector suggesting that alignment to the Paris Agreement and future recommendations from the Intergovernmental Panel on Climate Change (IPCC) and CCC should be considered. Four respondents suggested the need to consider future technological progress, such

as deployment of Carbon Capture Usage and Storage (CCUS), which could shape future carbon emissions reductions alongside costs to business and climate ambition.

57. Of those who disagreed (13 out of 65) that costs to business and climate ambition were the appropriate factors, only four respondents offered further detail to support their position. One respondent in the insurance sector suggested that setting the cap and trajectory should be subject to ‘the inclusion of a price floor within the scheme which is not less than the societal cost of carbon’. One respondent from the chemicals industry noted the importance of considering ‘technological readiness’ in setting the cap and trajectory. A further respondent suggested that air quality and health impacts should also be key considerations.

UK Government’s and Devolved Administrations’ response

58. The UK Government and the Devolved Administrations firmly believe that the key considerations in setting the level of the cap are climate ambition balanced with the costs to business. We welcome the support for this approach from the majority of our stakeholders.

59. The UK is committed by law to reducing emissions to net zero by 2050, and the UK ETS will play a key role in decarbonising the power sector, EIIs and aviation. However, it is important that in meeting this commitment the UK Government considers the traded sector’s competitiveness, and other pressures that businesses currently face as a result of our departure from the EU. In addition, the UK ETS will be a new emissions market, whereby any uncertainties around how the market will respond will need to be considered when setting the cap.

60. To balance these objectives, the cap for a UK ETS will initially be set at 5% below the UK’s expected notional share of the EU ETS cap for Phase IV of the EU ETS. Based on the proposed design scope, this equates to around 156 million allowances in 2021. These cap figures include our proposed aviation scope.

61. We note the CCC’s advice from 20 March 2020 on further tightening of our proposed cap for day 1 of the UK ETS, and have considered this advice carefully, particularly in the context of the uncertainties and risks posed by COVID-19. We also note the CCC’s recommendation that the cap for a standalone or linked UK ETS should be set in line with the cost-effective pathway to net zero emissions in 2050. They will be providing more detail on this when they advise on the Sixth Carbon Budget, which is expected in December 2020. It was recommended that the cap should be adjusted to align with this trajectory as soon as possible following receipt of further advice.

62. We intend to consult again on what an appropriate trajectory for the UK ETS cap is for the remainder of the first phase within nine months of this advice being published. Our aim is that any changes to the policy to appropriately align the cap with a net zero trajectory will be implemented by January 2023 if possible and no later than January 2024, although we would also aim to give the industry at least one year’s notice to provide the market with appropriate forewarning.

63. In the interim, particularly given the current uncertainties, we believe it is appropriate to maintain sufficient headroom of allowances for a time-limited period at the start of the UK ETS. We therefore believe that initially tightening the cap by 5% provides the appropriate balance between the UK’s climate ambition in the context of the UK’s net zero commitment and any risks of disproportionate costs to businesses which could

arise in the early years of a UK ETS. The initial cap will be reduced annually by 4.2 million allowances, meaning that the UK ETS cap will remain 5% below where we would have expected the UK's notional share of the Phase IV EU ETS cap to be year on year.

Distribution of Allowance

Summary of proposals

64. The consultation set out our approach to determine the stationary cap split[8] in a UK ETS, with the expected level of free allocation for UK industry to be similar in a UK ETS to what they would expect to receive in Phase IV of the EU ETS.

Summary of responses

65. Whilst we did not directly request responses on how the overall cap should be split between free allocation, the New Entrants Reserve, and auctions, we received a number of responses in this area. Responses broadly focused on two themes: (i) the importance of free allocation, (particularly where sectors are operating in a global marketplace, or where there are limited options for carbon abatement); and (ii) concerns that free allocation fails to adequately incentivise decarbonisation and the implementation of decarbonisation technologies.

UK Government's and Devolved Administrations' response

66. We are committed to delivering an emissions trading system that delivers cost-effective decarbonisation, while minimising the potential carbon leakage impacts of the carbon price on industries in the traded sector. The importance of these objectives were outlined in the responses we received on the distribution of allowances.

67. Auctioning will continue to be the primary means of introducing allowances into the market. This will ensure that a price on emissions is established and the 'polluter pays' principle is reinforced.

68. We recognise, though, that putting a price on carbon risks certain sectors being at a competitive disadvantage. To safeguard competitiveness in a UK ETS, a proportion of allowances will therefore be allocated for free. Free allowances will also be made available for new entrants to the UK ETS as well as existing operators who increase their activity. These allowances will be accessible through the New Entrants Reserve.

69. During the early years of the UK ETS, we will have a total emissions cap equal to our notional share of the Phase IV EU ETS cap minus 5%. This reduction in the overall cap is to be taken from the auction share, with free allowances being broadly the same as they would be if the UK continued participation in Phase IV of the EU ETS. This commits the UK ETS to a steeper trajectory, aiding climate ambition while protecting industries in the traded sector from the risk of carbon leakage.

[8] The distribution of allowances into different 'pots', i.e. auctioned allowances, free allocation allowances, and a ring-fenced number of free allowances for new entrants.

Free Allocation

Summary of proposals

70. The consultation set out our proposals for the allocation of free allowances in a UK ETS. We proposed that eligibility for free allocation would be determined using the same methodology as is proposed for Phase IV of the EU ETS.

Question 7

a) Do you agree with using the EU ETS Phase IV Carbon Leakage List and Benchmarks for determining UK ETS free allocation? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 8

a) Do you agree with using the Phase IV approach to the Carbon Leakage Exposure Factor for a UK ETS? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 9

a) Do you agree with the process and measures to mitigate the risk of a Cross-Sectoral Correction Factor being applied? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of responses

71. Out of 58 respondents for Question 7, 52% supported the approach. Of those disagreeing with the proposal, many called for a UK-specific CLL. Several responses from industries and their trade associations stated that the UK should set benchmarks based on an industry's ability to decarbonise; for example, until technologies such as CCUS become commercially viable.

72. Another common point made was the need to consider circumstances in the UK that increase the risk of carbon leakage relative to the same industries in the EU. We received comments from multiple industries on the appropriateness of NACE (Nomenclature of Economic Activities) code[9] classifications, such as whether oil and

[9] NACE Classification Codes are an industry standard classification system for classifying business activities.

gas extraction should be treated separately. One sector noted that the UK may not have enough sites to create UK specific benchmarks for some industries.

73. We also received responses, largely from non-eligible sectors or non-participants, suggesting we should not offer free allowances at all as they disincentivise decarbonisation.

74. Support for the CLEF proposal was high, with 67% of 52 respondents agreeing with the proposal. Support was shown for the importance of equivalence to the EU ETS in preventing carbon leakage between the UK and the EU. Key comments by those who disagreed related to tailoring the CLEF to UK-specific circumstances, for instance the chemicals sector suggesting introducing tiering (where sectors receive free allowances proportionate to their relative risk of carbon leakage). The chemicals sector and the oil and gas sector proposed using 'higher quality' data to underpin it.

75. We received responses arguing for additional protections against the risk of negative competitiveness impacts and carbon leakage, warning of risks to inward investment in the UK where unilaterally developing a policy could potentially be more expensive compared to the EU and other regions in which UK companies compete.

76. There was an even split in responses to the question about the approach to mitigating the risk of the Cross-Sectoral Correction Factor (CSCF) reduction being applied or its impact, with 53% supporting the approach and 47% against. The main item raised by those who disagreed related to the application of a CSCF reduction itself rather than the proposed mitigation measures. Several sectors stated that application of a CSCF reduction could result in loss of competitiveness for industry and could potentially result in a larger impact than if triggered in the EU owing to the additional potential risk for carbon leakage towards the EU for UK ETS participants.

77. The main alternative to a CSCF reduction put forward that would maintain the overall cap is to reduce the number of allowances that are auctioned.

UK Government's and Devolved Administrations' response

78. Free allocation of allowances will be the main policy instrument through which carbon leakage risk and competitiveness impacts are addressed in a UK ETS. Our initial UK ETS free allocation approach will be similar to that of Phase IV in order to ensure a smooth transition for participants for the 2021 launch.

79. A UK ETS will use the following preliminary free allocation calculation to give an indication of an installation's entitlement to free allowances:

    Historical Activity Level (HAL) x Benchmark x Carbon Leakage Exposure Factor (CLEF)

80. In a UK ETS, an installation's HAL will be based on data from the EU ETS Phase IV 2019 National Implementation Measures (NIMs) exercise, the EU ETS Phase IV benchmarks and CLEF. The Phase IV Carbon Leakage List (CLL) will be used to determine which CLEF would apply to an installation.

81. The final free allocation calculation will also consider the limit on the total number of free allowances available for free allocation – the industry cap. This will initially be set at the UK's notional share of the EU ETS industry cap for Phase IV of the EU ETS. This equates to around 58 million allowances in 2021 and will reduce annually by around 1.6 million allowances. If the total volume of calculated preliminary free allocation made to

eligible scheme participants breaches the industry cap, any unallocated allowances from the industry cap in previous years and (if needed) allowances from the flexible share will be used to 'top up' the industry cap (see below). If this is still insufficient, a uniform reduction using the Cross-Sectoral Correction Factor (CSCF) will be applied as a last resort. This would proportionately reduce any preliminary free allocation entitlement above the industry cap across all eligible recipients.

82. Two measures will be used to mitigate the risk of the CSCF reduction being applied or its impact if it was:

- For any year in which the sum of UK preliminary free allocation does not exceed the industry cap, the difference would be used to offset any future year that the industry cap is breached and the CSCF would otherwise be triggered.
- Where the CSCF would still be triggered, up to 3% of allowances from the stationary portion of the cap, originally earmarked for auction, would be made available to further offset its impact. Any remaining preliminary free allocation above the industry cap after these steps are taken would then be removed by the CSCF.

83. However, we recognise the range of views expressed in response to the consultation and the crucial need to take a fair, proportionate and considered approach to potential improvements to free allocation and we will begin a full review of possible future changes in the coming months.

84. This targeted review will take place outside the 2023 substantive review mentioned in the Phases and Reviews section. We will aim to coordinate this review with other targeted reviews. To minimise disruption, when the review is launched we will set out a timeline for changes to give as much policy certainty as we can. We will consult on any proposed changes resulting from the review.

85. The review should cover:

- the methodology for determining preliminary and final free allocation, including consideration of benchmarks and how carbon leakage risk is assessed, and the NER,
- alternative approaches to free allocation for mitigating potential negative competitiveness risks; and
- New Entrants Reserve rules on thresholds and treatment of new entrants and existing installations.

86. Any conclusions from the review and decisions about when to implement any changes will take account of wider considerations, such as:

- the transition of the UK ETS cap to a trajectory consistent with our net zero commitment,
- the revision of the free allocation calculation for the second allocation period, and
- work undertaken by others (for example, the EU Commission-led Florence Process that, amongst other things, looks at benchmarks in carbon markets globally, and best practice).

87. Our plan is to use Phase IV benchmarks for the first allocation period irrespective of whether data from UK installations is included. This will ensure that benchmarks are

based on sufficiently broad sets of data, and ensuring free allocation is awarded on a comparable basis to their EU counterparts, while presenting minimal impact on the profitability of affected businesses. We will be looking at possible future changes to these benchmarks, including the possibility of having bespoke UK benchmarks, as part of the free allocation review described above.

88. We will also implement the two proposed measures to mitigate the risk of a CSCF reduction being applied. We remain convinced of the need to have a CSCF as a means of ensuring that auctioning remains the primary way to distribute allowances, thereby supporting the 'polluter pays' principle, as well as protecting the overall UK ETS cap.

New Entrants Reserve (NER)

Summary of proposals

89. In the consultation we proposed that a ring-fenced reserve of free allowances (the NER) would be set aside for installations that become eligible for participation during the phase and for existing installations that significantly adjust their activity level.

90. The specific number of free allowances new entrants would receive upon application would be calculated using the same free allocation calculation methodology described above. For the purpose of the calculation, a new entrant's HAL would be based on the first full calendar year of normal operation.

91. A representative amount of free allowances from the NER would be made available to existing participants who increase their activity level by 15% or more. Existing participants who decrease their activity level by 15% or more, or who ceased to operate would have their entitlement to free allowances reduced. For both increases and decreases, the 15% would be based on a rolling average of two years.

92. Further details of the EU ETS Phase IV approach to adjusting free allocation due to activity level changes were published in 2019[10]. We will apply similar rules for the start of a UK ETS.

Question 10

Do you agree with the operation of the UK ETS New Entrants Reserve, including for production increases and decreases? (Y/N)

Please expand on your answer and give evidence where possible.

Summary of responses

93. Of the 52 respondents, 39 (75%) agreed with the proposals for the operation of a UK ETS NER, including for dealing with activity level changes.

94. Several of those who agreed with the proposals cited the need to have equivalence of support with the EU ETS to avoid competitive distortion.

[10] https://ec.europa.eu/clima/news/adoption-regulation-adjustments-free-allocation-emission-allowances-due-activity-level-changes_en

95. Suggested changes included the allocation of free allowances being adjusted proportionally to the scale of the change in activity. Some respondents highlighted the potential for a two-year delay in receiving allowances for increases in activity level.

UK Government's and Devolved Administrations' response

96. Following consideration of stakeholder responses, which were broadly supportive of our position, a UK ETS will implement a NER as per the proposals in our consultation. The UK ETS will initially apply production change thresholds of 15% based on 2 year rolling average. A UK ETS Linear Reduction Factor (LRF) would also apply to the NER.

97. New entrants will have their free allowances entitlement calculated using the free allocation calculation:

    Benchmark x HAL* x CLEF

    * A new entrant's HAL will be based on data covering the first full calendar year of normal operation.

98. We will apply the approach as outlined above in the summary of proposals.

99. The review of free allocation mentioned above will consider aspects of the approach dealing with changes in activity level.

Question 11

Do you have any further comments regarding our approach to free allocation? (Y/N)

Please expand on your answer and give evidence where possible.

Summary of responses

100. We received further comments regarding the proposed approach to free allocation from 31 respondents.

101. Five respondents supported using free allowances as a method of maintaining competitiveness and limiting the risk of carbon leakage. However, two respondents from the insurance and consultancy sectors disagreed and suggested that free allocation should be removed, stating that it is too generous and would result in a downward pressure on the price of allowances.

102. A respondent from the steel industry suggested permitting international offsets.

103. One respondent from the chemicals sector displayed concerns that free allocation applies a penalty regime where industry is not able to further reduce emissions, i.e. through lack of CCUS infrastructure 'despite government not providing the essential infrastructure for us to mitigate against it'. The respondent also suggested that a national infrastructure plan is necessary to drive decarbonisation.

UK Government's and Devolved Administrations' response

104. A separate consultation outlining the UK Government's approach to business models for CCUS ran from July to September 2019 with the UK Government's response to be published in due course.

105. Offsets are addressed in the section on Evolution of the Emissions Trading System.

Market Stability

Supply Adjustment Mechanism (SAM)

Summary of proposals

106. The consultation set out proposals to introduce a Supply Adjustment Mechanism (SAM) broadly based on the EU ETS Market Stability Reserve (MSR). The SAM would adjust the number of allowances to be auctioned in certain years if predefined volume surplus triggers were activated. The intention would be to maintain a supply-demand balance which facilitates long-term cost-effective decarbonisation.

107. In a standalone UK ETS, a SAM based on the EU ETS MSR could not be operational immediately due to the SAM making adjustments based on the total number of allowances in circulation at the end of the previous year, therefore we did not propose implementing a SAM from day one but instead stated we would reconsult should we decide to implement a SAM.

Question 12

a) Do you agree with the concept of introducing a SAM, similar in function to the EU ETS MSR, for a UK ETS? Noting that in a standalone system, a SAM could not be operational immediately and we will consult on the specific details at a later date. (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 13

What factors should be considered when setting the thresholds for a standalone UK ETS SAM?

Question 14

What factors should be considered in determining at what point in Phase I of a standalone UK ETS a SAM should be introduced?

Summary of responses

108. Out of 54 respondents, 35 (65%) agreed with the proposal to introduce a UK ETS SAM (Q12) based broadly on that of the MSR in the EU ETS. Six respondents indicated a UK SAM should replicate the function of the MSR in the EU ETS.

109. 13 respondents from a range of sectors saw the SAM as a mechanism to reduce risk and market volatility, though they stated that the mechanism should only be used in extreme circumstances and not for political motivation. 11 respondents saw the value of a sustained carbon price that did not drop too low, with seven of these stating the SAM would facilitate decarbonisation and spur investment in low carbon technologies. Nine respondents from various sectors explicitly stated that a high, stable carbon price was a desirable outcome and that a SAM would help achieve this.

110. Those in favour included a broad range of parties such as energy companies, academics, carbon intensive industries, oil and gas producers, renewable energy organisations and environmental NGOs. Some highlighted that the SAM should be designed in a way to deal with extreme and/or unexpected circumstances.

111. 19 out of 54 (35%) did not support a sustained high carbon price and included carbon intensive industries including cement and minerals, ceramics, chemicals, paper and steel. There were a range of comments to support this view. Some indicated artificially inflating the carbon price would reduce the competitiveness of UK industry, stating that markets were most effective when left to run on their own. Some stated that a low carbon price was not, in and of itself, a bad thing and a high price was contrary to the idea of lowest cost abatement.

112. Others noted that a decision on the SAM should wait until the 2021 EU ETS MSR review has concluded and reported the findings.

113. The 23 respondents to Question 13 indicated five key factors which should be considered when setting the threshold for a standalone UK ETS SAM:

- the EU's approach to market stability through the MSR;
- the current cap and trajectory which will inform the number of allowances in the system;
- the stability of the UK ETS market;
- market certainty determined by minimising frequency of intervention by the mechanism; and,
- flexibility of the mechanism to respond to economic shocks and rapid price spikes.

114. Respondents to Question 14 highlighted three timeframes for the introduction of a SAM in a standalone UK ETS. Eight respondents from a variety of sectors preferred a SAM to be introduced immediately. Seven respondents from a variety of sectors preferred the introduction of the SAM to occur after two years to allow the market to be observed and understood. Four respondents from carbon intensive industries said their preference was to use Phase I of the UK ETS to study the market and then determine whether a SAM should be introduced in Phase II.

115. In addition to timeframes, six factors were presented as key considerations for determining when a SAM should be introduced:

- market stability;
- sector demand for allowances;
- desired rate of carbon emission reduction;

- clarity and detail of the scheme;
- impact complimentary policies will have on overall demand; and,
- impact free allocation of allowances will have on overall demand.

UK Government's and Devolved Administrations' response

116. In a standalone UK ETS, a SAM cannot be operational until approximately mid-2022 at the earliest due to the requirement for at least one year of verified UK emissions data on which to base adjustments to auction volumes. The implementation of a SAM would need to be considered in the context of future announcements on the cap (as described in the cap section above) and some specific adaptations would be required to aid effective functioning in a UK context. For example, bespoke trigger thresholds and withdrawal and return rates will be required.

117. Given we cannot introduce a SAM straightaway due to data requirements, an Auction Reserve Price (ARP) would be implemented in a standalone UK ETS. As set out in the consultation proposal, this will mitigate against any start up issues and will ensure minimum price continuity in the transitional period of the scheme. Further detail on the ARP, including the level we will set it at, is detailed below in response to Question 16.

118. As set out in the consultation, we will consult separately on the design of a standalone SAM if required in due course.

Cost Containment Mechanism (CCM)

Summary of proposals

119. The consultation proposed the introduction of a Cost Containment Mechanism (CCM) mirroring the design of the EU ETS CCM. In the EU ETS the CCM is triggered if, for more than six consecutive months, the allowance price is more than three times the average price of allowances during the two preceding years on the European carbon market. The resultant action is for the Commission to convene a meeting of the Committee to establish what action, if any, to take.

120. The purpose of the CCM is to provide a process to address significant price spikes through the auctioning of additional allowances from within the cap.

Question 15

a) Do you agree that the proposed CCM strikes the appropriate balance between effectively addressing in-year price spikes without responding too frequently to shorter term upward price fluctuations – thereby avoiding market disruption? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of responses

121. 28 out of 48 (58%) of respondents agreed that the proposed CCM strikes the appropriate balance between effectively addressing in-year price spikes without

responding too frequently to shorter term upward price fluctuations. Respondents who supported the proposal thought it would reduce volatility within the market and improve the competitiveness of carbon intensive industries, especially against European countries, in a standalone system.

122. 20 out of 48 (42%) of respondents were not in favour of the proposed CCM. Of the 20 respondents not in in favour, 15 out of 20 (75%) believed the current CCM was not reactive enough to address in-year price spikes. This view was also expressed by some of those who supported the proposed CCM.

123. Some respondents viewed the CCM as a mechanism to intervene in the market and expressed concerns about this undermining market fundamentals. Their preference was for the market to set the price and believed the CCM could undermine market stability. Respondents who disagreed with the CCM came from carbon intensive industries including the chemicals, minerals, tarmac and paper sectors. They suggested that the CCM is not reactive enough to the risk of high prices.

124. Four respondents from the oil and gas and ceramic industry did not express a view on the proposed CCM, instead suggesting that a cap and collar might be a better way to achieve the desired outcome.

UK Government's and Devolved Administrations' response

125. In response to concerns around the reactiveness of the EU ETS design of the CCM, we propose to amend the CCM design in a standalone UK ETS for the early years of the scheme. In years one and two of a UK ETS, the CCM will have lower price and time triggers, providing a mechanism by which the government can decide whether to intervene sooner. We will revert to the EU ETS CCM design, as set out under Article 29a of Directive 2003/87/EC[11], in year three of a standalone UK ETS, or sooner, if we link to the EU ETS. In a standalone UK ETS, the CCM will be triggered if the carbon price is:

- Two times the average carbon price in effect in the UK in the two preceding years, for three consecutive months, in year one;
- Two and a half times the carbon price in effect in the UK in the two preceding years, for three consecutive months, in year two; and,
- Three times the carbon price in effect in the UK in the two preceding years, for six months, from year three onwards.

126. In all years, the CCM will only be triggered if the price evolution does not correspond to changing market fundamentals.

127. If the CCM is triggered, the relevant decision makers will convene a meeting between officials from the UK Government and the Devolved Administrations to consider what intervention, if any, to make. If it is agreed that action should be taken, additional allowances from within the cap can be added to subsequent auctions in one or more of three ways:

[11] Consolidated text: Directive 2003/87/EC of the European Parliament and of the Council of 13 October 2003 establishing a system for greenhouse gas emission allowance trading within the Union and amending Council Directive 96/61/EC

- auctioning allowances from the UK's allowance reserve[12];
- bringing forward a quantity of allowances from future auctions;
- auctioning up to 25% of the remaining allowances in the NER.

Transitional Auction Reserve Price

Summary of proposals

128. The consultation proposed the introduction of a transitional ARP in a standalone system which would be removed once the SAM becomes operational. The ARP would establish a minimum price for which allowances can be sold at auction, enabling the market to continue to function smoothly during the transition.

129. We stated that the level of the ARP would be set taking into account EU ETS prices from 2013 where allowance price was £3.79 (using the average annual exchange rate and secondary market front-month price) and 2018 where it was £14.07. In addition, we would take into consideration the fact that the price of EU Allowances (EUA) has increased substantially since the middle of 2017.

130. For details on how the ARP would work within the auction process, see the Auctioning and Market Rules section (Chapter 2).

Question 16

a) Should a standalone UK ETS implement a Transitional Auction Reserve Price to smooth the market operation? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of responses

131. 39 out of 62 (68%) respondents agreed that a transitional ARP should be introduced in a standalone UK ETS. Typically, those in agreement are from the power sector as well as those seeking to invest in, or benefit from, a low carbon transition. Respondents who supported the consultation proposal did so as it would support market stability and protect against a sustained low carbon price.

132. Respondents from the power sector stated that the ARP range (£4.70 to £13.70) outlined in the consultation was too low to be effective and would be exacerbated if the current carbon price floor is reduced from the current level. It was also expressed that the ARP should be replaced by a SAM when it is feasible to do so.

133. 19 out of 62 (32%) respondents were not in favour of a transitional ARP. Respondents not in favour were predominantly from carbon intensive industries such as the cement and minerals, ceramics, chemicals, paper and steel sectors. The majority of

[12] For details on how the Reserve would work in the auction process, see the Auctioning and Market Rules section (Chapter 2)

those who did not support the consultation proposal stated the need for the market to set the price and function without market intervention.

134. Some respondents expressed their concern for an ARP based on the EU allowance price range in the consultation. They stated the risk to the competitiveness of UK industries relative to the EU, as the EU ETS has no lower price management mechanism and could therefore fall below the level of the ARP.

UK Government’s and Devolved Administrations’ response

135. In order to ensure a minimum level of ambition in a standalone UK ETS and to minimise the potential for a significant fall in the UK carbon price in a transition to a standalone UK ETS, we plan to introduce a transitional ARP of £15. This will reduce the severity or possibility of a large difference between the EU ETS price and the price in a standalone UK ETS.

136. We are tightening the cap compared to the UK’s expected notional share of the EU ETS cap for Phase IV. There remains a risk that prices in a standalone UK ETS could be very low in the early years. Low prices will undermine our climate ambition, confidence in the market and remove the investment signal necessary to drive innovation in low carbon technologies. A £15 ARP will mitigate against these risks and maintain a level of climate ambition until we are able to reassess the level of the cap in terms of our net zero commitment, following further advice from the CCC.

137. As set out in the consultation, the ARP will be to facilitate the transition from a EU ETS to a standalone UK ETS, and we will review it alongside a subsequent consultation on the cap (as set out in the cap section above). This may take place outside the whole-system reviews mentioned in the Phases and Reviews section. We will aim to coordinate this review with other targeted reviews.

138. Stakeholders expressed concerns around competitiveness should the EU ETS price fall below the level of the ARP. While this risk is likely to be somewhat increased due to the effects of COVID-19, we believe that an ARP of £15 strikes the appropriate balance between climate ambition and business competitiveness. This price will be kept under review however given the full implications of COVID-19 are, as yet, uncertain. Free allocation of allowances also exists to protect those most exposed to the risk of a negative price disparity between UK and EU allowance prices.

139. We would not implement an ARP in a UK ETS fully linked to the EU ETS, as we would expect to see price convergence between the two markets.

Phases and Reviews

Summary of proposals

140. In the consultation we proposed that an initial first phase of a UK ETS should run from January 2021 to December 2030. In a standalone UK ETS, we proposed that we carry out three reviews during the first Phase. If we negotiate a linked UK ETS, we said we may need to reconsider the review points to ensure they work effectively with those planned for the EU ETS.

Question 17

a) Do you agree with the proposed approach to phases? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 18

a) Do you agree with the proposed approach to reviews? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of responses

141. We received 59 responses to Question 17 on phases. Among them, 56 (95%) of respondents agreed with the proposal to have a first phase of a UK ETS from January 2021 to December 2030. Respondents said that as this approach would be the same as the EU ETS phases, this could support an effective link to Phase IV of the EU ETS, and provide participants more business continuity and certainty over a longer period.

142. Three (5%) respondents did not support the proposed approach of a 10-year initial phase. They suggested that a 5-year phase would be more suitable, to enable necessary adjustments to be made to key design features, such as targets, or to deal with unintended outcomes.

143. We received 59 responses to Question 18 on reviews. Among them, 36 (61%) of respondents supported the proposal to hold three reviews within the 10-year initial first phase of a UK ETS. They perceived a regular review process as essential to maintaining the effectiveness of the UK ETS.

144. Several respondents who supported the proposed approach also suggested that review points and review areas should be coordinated with the EU ETS phases to support an effective link. Also, a small number of respondents suggested that organisations should not be required to provide additional or duplicated data for reviews.

145. 21 of the 23 respondents that disagreed with the proposed approach to reviews suggested that three reviews seemed excessive and would not leave sufficient time to implement any amendments to the UK ETS. In addition, one respondent suggested that the proposed number of reviews would ‘reduce confidence in the market as participants await the next intervention’. Five respondents suggested that one or two reviews would suffice, and one respondent stated that an additional review relative to the EU ETS will add administrative burden to industry.

146. The preferred timing of the reviews varied between respondents. Some respondents suggested that an initial review in 2023 would suffice, while others preferred a mid-phase review for assessing progress, or a review in 2028 to address both system performance and ambition. In addition, one respondent suggested that, should significant market instability arise, the government should consider carrying out an early review and intervene in the market if necessary, to support market stability.

UK Government's and Devolved Administrations' response

147. We have decided to implement a UK ETS with Phase I running from 2021-2030. This matches the EU ETS Phase IV length and is supported by the views of most respondents.

148. Although many respondents supported our proposal for three review points within the initial phase of a UK ETS, we also note the concerns expressed by those who felt that three reviews may be too many.

149. Having considered the arguments mentioned by the respondents above, such as the need for reasonable certainty in the policy framework for investments and reduction of business costs, we have decided to implement two of the three whole-system reviews proposed in the consultation document:

- The first whole-system review of the UK ETS to be conducted from 2023 to assess performance during the first half of the phase (2021-2025) with any necessary changes to design features implemented by 2026;
- The second whole-system review will be from 2028 onwards to assess performance across all of Phase I (2021-2030) with any update to the UK ETS rules implemented for 2031 (Phase II).

150. These reviews are exactly in line with the EU ETS Phase IV reviews and the Paris Agreement Global Stocktake efforts. The mid-phase (2024-2027) review will not be introduced.

151. We feel this position – a 10-year initial phase plus two whole-system review points – provides the right balance between market certainty and flexibility to adjust the market rules to ensure it functions effectively. Aligning the review points with the Global Stocktake dates ensures that a UK ETS remains aligned with our global ambitions on carbon.

152. The whole-system reviews will be complemented by targeted reviews to look at specific elements of UK ETS policy, and will take place separately. These include targeted reviews of free allocation for stationary installations and aviation, in response to the future advice from the CCC on the cost-effective pathway to net zero, and changes required to align with international aviation decarbonisation efforts through CORSIA. This is in addition to any necessary changes resulting from linking with the EU ETS. These targeted reviews may consider related aspects of the scheme as required in order to achieve their objectives.

Small and Ultra-Small Emitters: Reducing the Regulatory Burden

Small Emitter and Hospital Opt-Out Scheme

Summary of proposals

153. In Phase III of the EU ETS, the UK implemented a "Small Emitter and Hospitals Opt-Out Scheme." This allowed installations emitting less than 25,000t CO2e[13] per year and having a net-rated thermal input below 35MW to enter a simplified scheme. Installations in the Small Emitter opt-out had to monitor and report their emissions and meet annual emission reduction targets.

154. The consultation proposed continuing to offer an opt-out scheme in a UK ETS. We proposed that this opt-out scheme should have the same eligibility as currently under the Small Emitter Opt-Out scheme in the EU ETS regarding emissions and thermal capacity. In addition, we also proposed that, changes proposed for Phase IV of EU ETS implementation would be introduced in a UK ETS. These included:

- providing two points of entry into the scheme at the start of each allocation period
- allowing "banking" of overachievement against reduction targets only within allocation periods,
- providing only a single route to calculating emission reduction targets through the historical emissions methodology; and
- making fines for breaching reduction targets mandatory without discretion.

Question 19

a) Do you support the implementation of a Small Emitter and Hospitals Opt-Out Scheme in a UK ETS for installations emitting less than 25,000t CO2e p.a. and having a thermal input less than 35MW with the same design as the Article 27 Scheme proposed by the UK under the EU ETS for Phase IV? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 20

a) Do you have any other comments on our proposals for a Small Emitter and Hospitals Opt-Out Scheme in a UK ETS, not covered by your responses to questions in Chapter 4? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of Responses

155. We received 59 responses to the question (Q19) on the implementation of a Small Emitter and Hospital Opt-Out Scheme, hereinafter the Small Emitter Opt-Out, in a

[13] Carbon dioxide equivalent.

UK ETS. 37 (63%) of respondents were supportive of the implementation of this Opt-Out.

156. Of the 20 (37%) respondents who disagreed with having the Small Emitter Opt-Out, one suggested that 2% of UK ETS emissions falling under such a scheme was significant and one suggested that an opt-out should only apply to public service institutions.

157. In response to Q19 and Q20, 18 (31%) of respondents suggested that the Small Emitter Opt-Out should have a higher threshold for eligibility. They suggested that the additional emissions covered by an opt-out with an increased threshold of 50,000t CO2e would not be significant when compared with the total emissions of a UK ETS and that the monitoring, reporting and verification costs for installations of up to 50,000t CO2e per annum are disproportionately high compared with their level of emissions.

158. Additionally, six respondents proposed removing the thermal capacity threshold.

159. Respondents were mostly supportive of the proposals put forward for improvements to the Article 27 scheme in Chapter 4: Continued UK Membership of the EU ETS for Phase IV. The area that received significant feedback from respondents was the proposed approach for "banking" of overachievement against emissions targets between allocation periods.

UK Government's and Devolved Administrations' response

160. We will implement a Small Emitter and Hospital Opt-Out for installations with emissions lower than 25,000t CO2e per annum and a net-rated thermal capacity below 35MW which follows the approach in Phase IV. We recognise that raising the threshold has the potential to reduce the administrative burden for a further number of installations. However, the UK Government and Devolved Administrations believe that current thresholds support our net zero emissions targets while striking the right balance between reducing the administrative burden on installations and aligning with carbon budgets.

161. Changing the emissions or thermal threshold could put our ability to meet carbon budgets at risk. Emissions from installations in the Opt-Out count towards the total emissions of the non-traded sector. This risks the ability for the non-traded sector to meet its carbon budget (the legislated limit of UK emissions).[14] This risk is demonstrated by the fact that in 2017, 120 of 279 installations in the Small Emitter Opt-Out failed to meet their emission reduction targets.

162. Having more installations in the Opt-Out reduces the incentives to abate in the system as a whole. Installations in the main scheme will financially benefit from reducing their emissions below their targets by selling excess allowances. Installations in the Opt-Out do not have the same incentive to abate and therefore changing the thresholds does not align with our target for net zero emissions by 2050.

163. In addition, having a thermal capacity threshold ensures the environmental integrity of the scheme by providing an upper limit on potential emissions. We acknowledge a small number of respondents' concerns around the inclusion of small-

[14] The Committee on Climate Change noted in its 2019 Progress Report to Parliament that "there has been a shift from emissions covered by the EU emissions trading system (i.e. the 'traded' sector) towards non-traded sectors…this has increased the projected shortfall in meeting the fourth and fifth carbon budgets."

grid connected electricity generators in the Opt-Out. Considering the role of some generators as providing operational security to the sites they are placed on, we will at present maintain the scope of the Opt-Out scheme.

164. With regards to responses to this area for Phase IV, the UK Government and Devolved Administrations acknowledge the concerns raised around the decision to not allow banking between allocation periods, however, on balance we believe that at present it should not be adopted. All other proposals put forward for improvements to the Article 27 scheme in Chapter 4 will also be implemented in the UK ETS. Please see our separate response to Chapter 4 for a more detailed response[15].

Ultra-Small Emitter Exemption

Summary of proposals

165. In the consultation, we proposed to offer an exemption for installations emitting less than 2,500t CO2e per annum. We proposed that these installations with ultra-small emissions could be exempt from all aspects of a UK ETS except a requirement to monitor emissions and notify the regulator if emissions exceed this threshold. These installations face the most disproportionate compliance costs per tCO2e but together emit less than 0.1% of UK ETS emissions from stationary installations.

Question 21

a) Do you support an Ultra-Small Emitter Exemption for installations emitting less than 2,500t CO2e per annum? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 22

a) Do you have any other comments on our proposals for an Ultra-Small Emitters Exemption in a UK ETS? (Y/N)

b) Please expand on your answer and give evidence where possible.

Summary of Responses

166. We received 46 responses to this question, from which 72% support an Ultra-Small Emitters Exemption for installations emitting less than 2,500t CO2e per annum. 81% of current EU ETS participants who responded, and 69% of non-participants who responded, support this proposal. For those that disagreed, some stated that emissions covered from eligible installations were still significant, one stated that all installations should be cutting emissions.

15 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/843603/continued-uk-membership-euets-phase-iv-response.pdf

167. In addition, 14% of respondents expressed support for a higher threshold, suggesting alternatives ranging from 5,000t to 50,000t CO_2e.

168. Respondents were mostly supportive of the proposals put forward for the Article 27a scheme outlined in Chapter 4: Continued UK Membership of the EU ETS for Phase IV. The areas that received significant feedback from respondents were the process for an installation's entry onto the Article 27a scheme (requiring three years of third-party verified data) and the proposed approach to not implement the Article 27a operating hours provision on reserve or backup generators.

UK Government's and Devolved Administrations' response

169. We will implement an Ultra-Small Emitter Exemptions for installations with emissions lower than 2,500t CO_2e per annum and this position was supported by the majority of respondents. This scheme will have a design as outlined for the Article 27a scheme in the government response to Chapter 4 of the consultation.

170. The 111 UK operators that applied to participate in the Phase IV Article 27a scheme would collectively represent less than 0.1% of UK EU ETS emissions. The scheme therefore reduces cost and administrative burden for a large number of installations without any significant impact on UK emission reduction targets. Many of these installations, for example data centres, use back-up generators which only run irregularly and therefore emit below 2,500t per annum.

171. Considering the very hands-off approach of the scheme which requires no reporting or verification, we do not consider it appropriate for installations with emissions higher than 2,500t. Doing so could reduce climate ambition significantly as these installations face no obligations to reduce emissions.

172. We recognise the concerns raised by respondents on the inclusion of small grid-connected electricity generators in Ultra-Small Emitters Exemption. Considering that many generators that fall into this category only run irregularly as back-up generators, we will at present maintain the scope of this exemption.

173. We recognise the administrative challenge of requiring third party verified data, but we also note that it is essential to allow for the hands-off approach of the scheme. Due to the positive response from stakeholders in responding to the Article 27a provision set out in Chapter 4, we will implement those proposals in the UK ETS. Please see our separate response to Chapter 4 for a more detailed response[16].

Entry and Exit of the Small Emitter and Ultra-Small Emitter Schemes in a UK ETS

Summary of proposals

174. In the consultation, we proposed mirroring the EU ETS approach to adjusting the overall cap for those installations entering the Small Emitter Opt-Out or Ultra-Small Emitter Exemption schemes. The system-wide quantity of allowances for the allocation periods could be adjusted to reflect installations choosing to opt-out or be exempt by

[16] https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing - Continued membership of the EU ETS for Phase IV

subtracting their average annual verified emissions in the periods from 2016-2018 and 2021-2023 respectively, adjusted by the trajectory of a UK ETS cap.

175. We also sought views and suggestions from stakeholders on a potential method whereby adequate certainty over likely emissions and targets for a new installation could be determined, to allow them to enter the relevant scheme immediately without first having to enter the main trading system.

Question 23

a) Do you agree with the proposed mechanism for recalculating the system-wide number of allowances to be issued at the start of the phase and at the mid-point of the phase? (Y/N)

b) Please expand on your answer and give evidence where possible.

Question 24

In the absence of historical emissions data, how could the regulator make an environmentally robust assessment of the eligibility and emissions target of a new entrant for the Small Emitter Opt-Out or the Ultra-Small Emitter Exemption, without undermining the environmental integrity of the system?

Summary of responses

176. From the 38 responses received on question 23, 63% agreed with the proposed mechanism for recalculating the cap to account for installations entering the Small Emitter Opt-Out or Ultra-Small Emitter Exemption schemes.

177. Of those who agreed, 29% indicated that this was based on a preference to be able to link to the EU ETS. Five respondents stated that the level of emissions associated with these emitters is too low to justify a recalculation of allowances.

178. 24 respondents submitted various suggestions for how to assess eligibility and targets for new entrants for the Small and Ultra-Small Emitter Schemes. These included using existing data on emissions intensity for specific technology types, using published emissions factors and calorific value data or using data from other environmental programmes such as the Energy Savings Opportunity Scheme[17]

UK Government's and Devolved Administrations' response

179. We will implement the proposal as set out in the consultation. We also note that most respondents agree with this approach.

180. On assessing eligibility and targets for new entrants into the Small Emitter Opt-Out in the absence of 3 years of historical emissions data, we will allow regulators to make an assessment of eligibility before the UK Government and Devolved Administrations take a decision. Initial targets will be based on an environmental robust estimation of emissions. Targets will then be re-adjusted based on actual verified emissions data from the first years of operation. This will allow installations who have a

[17] https://www.gov.uk/guidance/energy-savings-opportunity-scheme-esos

large degree of certainty over likely emissions to enter directly into the Opt-Out scheme at the beginning of each allocation period while ensuring the regulator is able to reach an environmentally robust assessment. However, considering the very hands-off approach of the Ultra-Small Emitter Exemption with no reporting requirements, we will in all cases, require 3 years' of historical emissions data to ensure confidence in likely emission levels.

Potential Fund for Industrial Decarbonisation

Summary of proposals

181. In the consultation, we sought views on the option of replicating a similar fund structure to the Innovation Fund. Like the Innovation Fund, a potential fund for industrial decarbonisation could fill a funding gap for viable industrial decarbonisation projects, which lack secure funding streams due to a variety of economic and technological barriers to private action.

Question 25

Do you consider that we should create a fund for industrial decarbonisation under a linked or standalone UK ETS?

Please expand on your answer and give evidence where possible.

Question 26

What lessons and improvements can be drawn from your experience of EU ETS funds, and other forms of financial support for industrial decarbonisation, in order to maximise impact of any funding?

Question 27

How can a fund be best designed to overcome barriers to investment in decarbonisation? Please comment on:

i. What the focus of support should be

ii. Length of financial support

iii. Level of financial support

iv. Type of financial support

v. Which types of financial expenditure to focus spending on? (e.g. Capex, Opex)

Question 28

What issues do you anticipate in the creation of such a fund? Would other support structures deliver the objectives of a fund more effectively? Please expand on your answer.

Question 29

If a fund for industrial decarbonisation is created, what are your views on the sources of allowances for the fund?

Question 30

What are your views on re-directing a proportion of free allowances for auctioning and creating the fund out of the revenue generated by those free allowances?

Question 31

Are there further options for sources of allowances we should be considering?

Summary of responses

182. Nearly all respondents (62 out of 67) said that an industrial decarbonisation fund should be created. The main justifications given were that it would enable UK industry to decarbonise, it is important to maintain UK competitiveness and that existing funds (for e.g. Industrial Strategy Challenge Fund and Industrial Energy Transformation Fund) would not provide sufficient support to deliver the UK's climate targets, while maintaining UK competitiveness. Nine stakeholders highlighted the importance of a fund in helping to realise the government's target to bring all greenhouse gas emissions to net zero by 2050. Of the five respondents who did not support the creation of a decarbonisation fund, one gave the reason that there is a greater need to stimulate decarbonisation in sectors of the economy not covered by the UK ETS.

183. Drawing on lessons learnt from previous experience of the EU ETS and other funding mechanisms, nine respondents warned about making the funding eligibility criteria too narrow and suggested that it should be kept as flexible as possible to prevent excluding sectors and technologies. Five stakeholders indicated that the funding application process should be streamlined to minimise administrative burdens and incentivise participation. Eight respondents suggested that any UK fund should learn from issues faced by the EU ETS Phase III fund (NER300). One such issue was that the NER300 did not achieve the intended progress in supporting a wider range of innovative renewable energy technologies.

184. On the design of a potential UK fund:

- Fourteen respondents suggested that any additional government funding should be solely focused on delivering decarbonisation, whereas two suggested that energy efficiency was a more appropriate focus. Four felt that the funding would be more accessible if it were open to both.
- Eighteen stakeholders also made suggestions for the measures and technologies that the potential support should focus on. The most common were Carbon Capture, Utilisation and Storage, followed by fuel-switching and other infrastructure improvements.
- Suggestions on the length of government support for individual projects ranged from 3-30 years, with the most common length being 10-20 years. Some did not state a number of years, with three stakeholders suggesting it should run for the lifetime of the asset and three stating it should be 'ongoing' or run beyond 2050.
- On the type of financial support, 19 respondents suggested grant funding was a necessity, with seven indicating that grants would help accelerate deployment of

technologies faster than loans. Two respondents stated that grants were a necessity for funding Front End Engineering Design (FEED) studies.

- On types of expenditure, 16 out of 25 respondents suggested both capex and opex support would be required, while nine respondents solely referenced capex. Regarding issues anticipated in the creation of a fund, 13 out of 30 respondents raised the need for the applications assessment process to effectively ensure that all sectors have equal opportunity to secure funding. Seven suggested that a key obstacle with creating new funding is ensuring that eligible installations are aware of the funding and know how to apply.

- On sources of funding, sourcing the allowances from the auction pot only (Option A) was the most popular option, suggested by 23 respondents. Eight respondents suggested that allowances from both auction volume and free allowances should be used (Option C). Twenty-eight respondents did not support the use of free allowances for the purpose of generating funds for decarbonisation (Option B), with half of those suggesting this would increase the risk of carbon leakage. Six respondents suggested that towards the end of each phase, unallocated allowances from the New Entrants Reserve (NER) could be a source of funds.

UK Government's and Devolved Administrations' response

185. The UK has taken a lead role in combating climate change by being the first major industrial nation to commit to a target of net zero carbon emissions by 2050. The Government is committed to achieving this target in a way that allows us to grow our economy in the most sustainable way while maximising the opportunities created by 'green growth'. To do this we need to embark on a 'decade of decarbonisation' across all our industries.

186. The UK Government and Devolved Administrations commit to exploring long-term options for accelerating the decarbonisation of industry to support the operational use of technology, while maintaining UK competitiveness. In addition to carbon pricing, these options include a long-term decarbonisation funding stream that comes from a share of a UK ETS, international agreements and product certification, demand-side measures, and other direct fiscal support. We would look to have an appropriate mechanism in place in the early 2020s.

Evolution of the Emissions Trading System

Summary of proposals

187. The consultation proposed that offsets, such as Kyoto Protocol units, should not be used in a UK ETS when the system launches, without prejudice to UK implementation of CORSIA18. However, we stated that the inclusion of domestic or international offsets is a possibility for the long-term evolution of a UK ETS.

Question 32

[18] Carbon Offsetting and Reduction Scheme for International Aviation – see aviation section for more details.

Do you think there is potential for the use of offsets by operators to meet their compliance obligations in the UK ETS?

Question 33

How could a UK ETS evolve over the coming years in order to ensure the system delivers for future challenges and encourages innovation within business?

Summary of responses

188. Respondents expressed a range of opinions on the use of offsets and Greenhouse Gas Removal (GGRs) technologies. Some supported their use, citing the fact that climate change is a global problem and that it could provide a better way to comply for those industries with fewer abatement opportunities. Others disagreed with their use, citing potential adverse impacts globally such as double counting, and concerns with the quality of offsets that have been available in the past. Fifteen respondents raised concerns about the quality of offsets, especially around monitoring, reporting and verification.

189. Some respondents preferred domestic offsets as this would better meet the CCC's recommendation for a net zero target and could encourage the use of bioenergy with carbon capture and storage (BECCS) and afforestation domestically. Others made the case for international offsets as this could give a strong signal for increased international cooperation and could fit within the framework of Article 6 of the Paris Agreement.

190. Some respondents argued that the use of offsets was important for hard to decarbonise sectors while others argued that transformative changes such as implementing Carbon Capture Usage and Storage (CCUS) would be disincentivised by using offsets.

191. 47 respondents also provided suggestions as to how a UK ETS can evolve over time. 11 supported an expansion in scope of the UK ETS; 19 supported linking a UK ETS to other systems, with several suggesting linking a UK ETS to international carbon markets beyond the EU ETS. Several respondents stressed the positive potential for using a UK ETS to encourage the deployment of technologies such as BECCS.

192. In its first piece of advice to the UK Government and the Devolved Administrations, the CCC stated that, "Including Greenhouse Gas Removal (GGRs) in an ETS when technology maturity is reached can provide an effective mechanism for encouraging deployment". The CCC suggests this could be as early as 2030. However, the CCC also argues that it may be beneficial to limit the number of credits provided to GGRs.

UK Government's and Devolved Administrations' response

193. The UK Government and Devolved Administrations remain of the view that offsets should not be permitted in a UK ETS at this time.

194. An introduction of offsets would require time to develop stringent standards and tests for their acceptance in a UK ETS, which is not deliverable for the launch of a UK ETS by 1 January 2021. Similarly, an approach would have to be designed to mitigate the impact of the usage of offsets on the environmental integrity of a UK ETS. Without adequate mitigation, the usage of offsets could lead to an over-supply of allowances under the cap and therefore reduce our ability to achieve our overall environmental ambition.

195. However, the UK Government and Devolved Administrations are open to reviewing the usage of offsets in future, especially in deciding how best to implement CORSIA alongside a UK ETS.

196. We will review the usage of offsets in a UK ETS as part of the review process set out in the Phase and Review sections. Once there is more certainty on the development and implementation of global decarbonisation mechanisms such as CORSIA and the Paris Agreement, any review of this area will also consider how a UK ETS can best align with them.

197. As stated in the “Scope” section of Chapter 1, we recognise the case for expanding carbon pricing in future. Scope will be reviewed as part of the review process and we will continue to explore options for expanding carbon pricing.

198. The UK Government and Devolved Administrations acknowledge the potential opportunities of GGR technologies in our drive to achieve net zero. However, GGRs will not be permitted in a UK ETS at this time. We have taken steps to strengthen our understanding of GGR technologies through an £8.6 million GGR research programme delivered by UK Research & Innovation[19] and have announced a £31.5 million programme under the Strategic Priorities Fund for a number of demonstration projects[20]. Taking this funding and CCC advice into account, we will continue to monitor the maturity of GGR technology and look to review its potential for inclusion in the UK ETS as it evolves.

A note on Carbon Fee and Dividend

Summary of responses

199. 31 consultation responses from non-participants suggested the adoption of a Carbon Fee and Dividend approach as an alternative policy.

200. The Carbon Fee and Dividend approach involves introducing an escalating fee on fossil fuels, which is imposed as close to the extraction point of the fuel as possible. 100% of the funds raised after deduction of administration costs are redistributed to the population. Business competitiveness issues are mitigated by imposing import fees on products entering the country and rebates to exporting businesses. Advocates of the approach highlight that a well-designed scheme would have social and environmental benefits, equitably distributing the revenues and stimulating investment in low carbon technologies.

[19] https://nerc.ukri.org/research/funded/programmes/ggr/
[20] https://bbsrc.ukri.org/funding/filter/2019-greenhouse-gas-removal-demonstrators/

UK Government’s and Devolved Administrations’ response

201. The preferred approach, expressed by the UK Government and Devolved Administrations in the consultation document and supported by scheme participants, is for an effective emissions reduction tool. Placing a price on carbon creates the incentive for emissions to be reduced in a cost effective and technology-neutral way, while mobilising the private sector to invest in emissions reduction technologies and measures. While we recognise the merits of a Carbon Fee and Dividend policy, we do not propose to adopt it at this time.

Chapter 2: Operation of a UK ETS

Summary

202. Chapter 2 of the consultation document proposed elements and processes of a UK ETS that covered the operation of the system. These proposals broadly mirrored the operational approach of the EU ETS, with the exception of proposals on Monitoring, Reporting & Verification (MRV) and auctioning, where we proposed some changes. Views and responses received were mainly in agreement with the proposals.

203. The proposals for changes from the EU ETS for simplifying MRV rules and improving the auctioning processes were largely welcomed and some respondents reiterated that the MRV system should be at least as robust as rules that would be implemented if we stayed in the EU ETS.

204. Proposals relating to penalties received mixed responses with some disagreeing based on concerns that they were disproportionately high whereas those in favour stated that infringements were serious and should be “punished strongly”.

205. There were fewer views expressed on banking and borrowing proposals, with some supporting the intention to mirror EU ETS rules and others suggesting that the UK should take this opportunity to explore limits on banking or changing the indefinite validity of allowances.

206. In line with the broad agreement received across each of the design elements, both those that mirror the EU ETS and those that are minor departures, the UK Government and the Devolved Administrations will implement all of them as proposed.

Monitoring, Reporting and Verification (MRV)

Summary of proposals

207. The consultation document proposed mirroring the EU ETS MRV regime with five improvements intended to maintain or improve robustness of reporting while simplifying and reducing the administrative burden associated with complying with the ETS. These included:

- the ability to aggregate multiple source streams adding up to 10t CO2e or less;
- reduced frequency of offshore site visits by verifiers to oil and gas installations for offshore operators; and
- updating to the definition of “significant changes” which warranted notification to the regulator to exclude a change in default calculation values.

208. Additionally, we proposed adopting and implementing Phase IV discretionary changes regarding:

- reduced frequency of improvement reporting; and
- the simplification of monitoring plans.

Question 34

a) Do you agree with any (or all) of the proposals for MRV simplification in a UK ETS? (Y/N)

b) Do you agree to those proposals that would also apply to a Carbon Tax? (Y/N)

c) Please expand on your answers, providing supporting evidence where possible.

Summary of responses

209. 40 of the 55 respondents (80%) to this question agreed with the proposals with respondents citing the benefits of the anticipated reduced administrative burden. However, 17 of the 55 respondents (31%) stated that the proposal to aggregate source streams is unlikely to ease the MRV process for business. 15 of these respondents suggested the aggregation threshold be higher; 2 from the cement industry suggested 1000t CO_2e. Attention was also drawn to the fact that individual monitoring might still be required on each source stream to ensure the threshold is not breached.

210. 18% of respondents, from a variety of sectors, also stated their specific support for reduced frequency of improvement reporting.

211. A small number of respondents further suggested that the proposals "lack the ambition necessary to significantly reduce the administrative burden" placed on businesses. A similar number of respondents suggested that the MRV system should not be "weakened, risking MRV failures, to enable a reduction in administrative burden for business".

212. Additionally, 81% of respondents agreed that these measures should also apply to the MRV rules under a Carbon Emissions Tax.

UK Government's and Devolved Administrations' response

213. The UK Government and the Devolved Administrations will implement these proposals in a UK ETS in line with the views of most respondents, to help streamline the MRV process and reduce the administrative burden of compliance.

214. We are committed to maintaining confidence in the integrity of the system and are confident that these proposals will deliver against this commitment. Therefore, the threshold for aggregating small source streams will remain at the proposed level of 10t CO_2e.

215. We note the comments on increasing the aggregation threshold for small source streams and suggestions on other areas and as we develop the system, we will keep this policy in the scope of the review process and will also consider other improvements which could further reduce the compliance-associated administrative burden without compromising the integrity of the system.

Enforcement, Appeals and Penalties

Summary of proposals

216. In the consultation, we proposed maintaining the current arrangements under the EU ETS for enforcement and appeals in a UK ETS, including a power of entry. We also proposed implementing the changes to penalties outlined in the consultation (Chapter 4 Section E and Annex C) and in the separate Phase IV government response. The rationale for these changes is to ensure that penalties remain effective, proportionate and dissuasive. The consultation document also noted that the Market Abuse Regulations (MAR) would be onshored so that the Financial Conduct Authority (FCA) could continue their role of market oversight.

Question 35

a) Do you agree with these proposals for the arrangements in relation to Enforcement, Appeals and Penalties as described above? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible. Concerns about a change in penalties in general should be addressed through relevant questions in Chapter 4. Please reference the paragraph number (or regulation in question if this relates to a penalty change) of the change and the reasons why you believe it to be inappropriate.

Summary of responses

217. 40 of 45 (89%) respondents to this question supported the proposals on enforcement, appeals and penalties. Respondents highlighted that enforcement, appeals and penalties should remain under the jurisdiction of civil laws and that current arrangements under the EU ETS should be retained in a UK ETS as far as possible. A number of respondents also highlighted that maintaining the current arrangements would be welcome as this would help ensure continuity and stability of relationships between regulators and industry.

218. Of those who disagreed with the proposals, concerns raised related to the complexity of the scheme and the level of resources operators need to dedicate to ensure that they comply. In addition, some respondents argued that enforcement action should take account of whether failure to comply was deliberate or a mistake and whether the complexity of the system was a factor in any failures to comply. A balanced, discretionary approach from regulators would prevent operators from being discouraged in declaring mistakes when discovered.

219. In addition to stating their agreement or disagreement with the proposals, many respondents highlighted the need for adequate support from regulators, in the form of clear and transparent guidance resources and training courses.

220. One respondent commented that should an entity fall into liquidation, then the liability for any outstanding non-compliance issues should fall to the beneficial owners, investors and shareholders of those businesses and not the UK taxpayer.

221. There was concern that the Excess Emissions penalty should be replaced with a more proportionate penalty. Some said that this is particularly an issue where a permit is transferred to a new operator.

222. Penalty levels were raised by several respondents, with concern that the proposals to increase the maximum penalty levels were not justified.

223. One respondent noted that the consultation did not cover the market oversight rules (Markets in Financial Instruments Directive (MiFID, 2014/65/EU) which regulate the EU ETS market and trading activities carried out in the UK.

UK Government's and Devolved Administrations' response

224. We intend to implement our proposals on penalties, appeals and enforcement, including powers of entry, as set out in the consultation. We believe this approach under a UK ETS will provide an effective and proportionate deterrent against non-compliance and note the majority of respondents agreed with this approach.

225. We recognise that the Phase IV EU ETS will make changes to compliance as set out above. In a UK ETS, we recognise these benefits and plan to mirror these changes which should help to minimise administrative burden for participants and regulators, and ensure penalties remain effective, proportionate and dissuasive.

226. We note that some respondents expressed concerns about the complexity of some rules, and we aim to facilitate participants' compliance, including through the provision of clear guidance.

227. Having considered the concern regarding cumulative Excess Emissions penalties that relate to an under surrender prior to a transfer of permits between operators, we are clarifying the responsibility of each operator for an ongoing surrender deficit: the previous operator should transfer all required allowances (either from an account it holds or from a trader) into the new operator's registry account as soon as possible after the error is discovered. The new operator then must surrender them within one month of receiving the allowances. To enforce this, we propose to apply a £20 per allowance penalty, to a previous operator who fails to transfer the allowances to the new operator, or to a new operator that fails to surrender these allowances if the transfer has taken place.

228. We will onshore the MAR of trading activities and the Markets in Financial Instruments Directive (MiFID) into domestic legislation for a UK ETS. The FCA will continue to be the financial regulator in the system.

229. The method to calculate some civil penalties requires a "carbon price", which under the EU ETS is determined annually by the Secretary of State based on the average EUA December Futures price for that EU ETS scheme year. However, in the first year of a standalone UK ETS, there will be no December Futures UK allowance (UKA) price data from that year to base the calculation on. Therefore, in the first year only of standalone UK ETS, we will use the average UKA auction clearing price (weighted by volume) from 1st January to 11th November 2021 to calculate year 1 civil penalties involving the carbon price in the same year. This would ensure that the year 1 Carbon Price would be equivalent to the average actual price of an allowance in year 1 of the system[21], with these penalties therefore being proportionate to the severity of the

[21] Note: penalties are applied in addition to any allowance surrender obligations and associated costs

breach. From year 2 onwards, aligning with the normal calculation period of November to November, we will use the same approach with the UKA Futures price as stated in Regulation 49 of GHG 2012.

Auctioning and Market Rules

Summary of proposals

230. In the consultation document, we proposed that in a UK ETS, the auction process should vary from that in the EU ETS in that auctions should be permitted to 'clear' even when not all of the allowances for sale are sold. We further proposed that unsold allowances at auctions should be 'rolled forward' to the following four auctions, and that each auction should offer for sale allowances up to a maximum of 125% of those originally intended for sale at that auction. The only scenario in which the latter criterion would come into effect would be one in which there was more than one auction in a four-week period at which there were unsold allowances.

Question 36

a) Do you agree with the proposals that the auction success criteria in a standalone UK ETS should be changed as described above? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

c) Do you agree with the proposed method of redistributing unsold allowances across future auctions and a reserve? (Y/N)

d) Please expand on your answers, providing supporting evidence where possible.

Summary of responses

231. Over 80% of 42 respondents agreed with the proposed success criteria change and 71% agreed with the clearer process for redistribution of allowances.

232. The reasons for agreement with these proposals, as stated by respondents, were that they should allow for a more even supply of allowances and support market stability and liquidity.

233. Those that disagreed with the proposal for redistribution of allowances suggested that it may put additional pressure on future auctions as there would be too much supply going forward.

UK Government's and Devolved Administrations' response

234. As our proposals will help to support a smoother, more stable flow of allowances into the market and protect against the impacts of repeated low demand, we intend to implement them both, in line with the overwhelmingly positive responses to these proposals.

235. We note the concerns of some respondents that these proposals might increase oversupply of allowances at auction compared to the current rules under the EU ETS. We believe that the changes we have proposed to success criteria and the process for redistribution of unsold allowances should help to decrease the risk of oversupplied auctions compared to the current rules. This is because the Phase III process for redistributing allowances under the EU ETS does not limit the number of allowances that can be ‘pushed forward’ into future auctions, nor how far into the future auctions can be inflated. By contrast, the combination of our proposed design changes should help to limit the pressure on future auctions in the event of consistently low demand. We recognise the CCC’s concern, set out in their advice on a standalone UK ETS from 20 March 2020, that there may be a large reserve of allowances in the long-term. We will consult on how we appropriately address this as part of the other planned reviews during Phase I of the UK ETS.

Banking and Borrowing

Summary of proposals

236. In the consultation document, we outlined proposals to mirror EU ETS rules on banking and borrowing i.e. allowances would remain valid indefinitely, entities can “bank” allowances without limitation. Entities entitled to free allocation can also “borrow” allowances by using in-year free allocation to comply with the previous years’ compliance obligation, which would continue to be permitted, except across phases.

Question 37

a) Do you agree that banking and borrowing arrangements in a UK ETS should mirror those of Phase IV in the EU ETS as described above? (Y/N)

b) In the case of a standalone UK ETS, how can we best balance the potential ability to bank allowances with the UK's wider decarbonisation goals?

c) Please expand on your answers, providing supporting evidence where possible.

Summary of responses

237. 48 of 56 (86%) respondents who answered this question supported the proposals on banking and borrowing. These proposals would also provide flexibility on compliance.

238. Several respondents stated that they did not see the ability to bank allowances as something that needs to be balanced against broader decarbonisation goals and our ability to meet carbon budget targets; banking and borrowing were seen as things that could enable long term decarbonisation. Additionally, some respondents suggested that the cap would be the primary driver of decarbonisation.

239. Those that disagreed with the proposals on banking did so in two ways: some suggested that banking should not be allowed at all as they perceived it to create distortions in the market that allowed profiteering; and others offered a balance, proposing a time limit on allowance validity (e.g. of between 3 and 5 years).

240. Borrowing was discussed much less than banking. One respondent suggested that short-term borrowing would be helpful for participants in managing their compliance and should limit price peaks ahead of compliance periods. Of those that disagreed with the proposals on borrowing, one respondent stated that borrowing should be allowed across phases to minimise allowance shortfalls. Another respondent suggested that borrowing should not be allowed since this practice might create opportunities for fraud.

UK Government's and Devolved Administrations' response

241. We intend to implement our proposals on banking and borrowing as set out in the consultation. The proposals were widely supported by respondents, will enable participants to smooth short-term price fluctuations, and enhance their compliance flexibility

242. Participants will likely lose access to the Consolidated System of European Registries (CSEUR) after the 2020 surrender deadline of 30 April 2021. We advise participants to transfer their surplus EUAs before this deadline to accounts in the parts of the CSEUR administered by other participating states of the EU ETS in order not to lose access to their holdings. In a standalone UK ETS, participants will not be permitted to use any banked EUAs for UK ETS compliance obligations. Further guidance will be provided on the use of EUAs in the UK ETS in the future and may be added to current technical notice on the matter.[22]

243. We note the suggestion for adding a time limit on the validity of allowances. At this point, we will not be implementing this having considered the possible implications of such a change e.g. a potentially perverse incentive for installations to use up allowances that are about to expire.

244. As the system evolves, we will carry out necessary reviews from 2023 and 2028 with changes to be implemented by 2026 and 2031 respectively (see Phases and Reviews for details). These are also in line with the EU Phase IV reviews and Global Stocktake efforts under the Paris Agreement. Banking and borrowing policy will be part of the scheduled review areas and will continue to be balanced with our broader decarbonisation goals.

Governance

Summary of proposals

245. In the consultation, we stated that the UK Government and Devolved Administrations were planning to implement a Governance structure for the UK ETS which broadly mirrors the core functions of the EU ETS Governance structure. Under the EU ETS, the main functions are:

- the Authority (the European Commission),
- the Environmental Regulator (the Environment Agency (EA), the Scottish Environment Protection Agency (SEPA), Natural Resources Wales (NRW) and Northern Ireland Environment Agency (NIEA), Offshore Petroleum Regulator for Environment and Decommissioning (OPRED)),

[22] Technical notice: https://www.gov.uk/government/publications/meeting-climate-change-requirements-if-theres-no-brexit-deal/meeting-climate-change-requirements-if-theres-no-brexit-deal

- the Financial Regulator (the Financial Conduct Authority), and
- The Judicial process (a combination of UK Courts and CJEU)

246. As this is a matter for the UK Government and Devolved Administrations to develop, alongside the parties highlighted above, no questions were asked in the consultation document. We have, however, outlined our position on the continuing development of this structure below.

UK Government's and Devolved Administrations' response

247. As set out in the consultation proposals, where bodies are already undertaking these functions across the UK, we proposed they should continue to do so.

248. The UK Government and Devolved Administrations are working together to develop a common framework which sets out roles, decision-making processes and working arrangements under a UK ETS.

249. All environmental regulators would continue to perform their functions and the FCA would continue their regulatory role in the UK ETS market. We are working with all of these parties to ensure the smooth transition to a new system.

Establishing a UK Registry

Rules for All Accounts and Authorised Representatives

Summary of proposals

250. In the consultation, we proposed a number of changes to the operation of a UK Registry that differ from the EU ETS Registry Regulations and are applicable to all accounts and authorised representatives:

- to allow an Account Holder to change the roles of its appointed Authorised Representatives without having to remove them from its account first,
- to allow an Authorised Representative to remove itself from an account,
- to allow the UK Registry Administrator to request any information it considers necessary in order to satisfy itself that the applicant or nominated Authorised Representative is fit and proper to participate in the UK Registry,
- to remove the mandatory requirements for an annual declaration by each Account Holder that its account information is still up-to date, accurate and true, and
- to clarify that remedial action must be taken for suspended accounts within 28 calendar days.

Question 38

a) Do you agree with the above proposed changes to account administration relating to all accounts and Authorised Representatives? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

251. 44 respondents answered this question. Of these 88% of all respondents and 93% of respondents currently participating in the EU ETS agreed with the proposed changes to account administration. 12% of respondents and 7% of respondents currently participating in the EU ETS disagreed with the proposed changes. Some respondents highlighted the need for changes not to risk a link to the EU Registry. Overall, respondents were very positive about the proposals and welcomed the simplifications and added flexibility.

UK Government's and Devolved Administrations' response

252. In line with the very positive responses, the UK Government and Devolved Administrations intend to implement the above changes, making them applicable to all account holders and authorised representatives. We believe the changes will simplify usage of the Registry for account holders and authorised representatives while maintaining a robust and secure Registry.

Rules for Operator and Aircraft Operator Holding Accounts

Summary of proposals

253. In the consultation, we also proposed a number of changes to the operation of a UK Registry that differ from the EU ETS Registry Regulations. These changes are applicable only to Operator and Aircraft Operator Holding Accounts (OHAs and AOHAs):

- to allow the UK Registry Administrator to open OHAs and AOHAs with fewer than two Authorised Representatives,
- to allow surrender by one Authorised Representative,
- to remove the need for verifier approval in the UK Registry where the emissions are entered by the UK Registry Administrator or uploaded into the UK Registry by the Regulator on behalf of the Account Holder, and
- to allow the UK Registry Administrator to open OHAs or AOHAs which are marked as 'closure pending', solely in order for an Account Holder to fulfil an outstanding obligation to surrender or return an over-allocation.

254. In addition, we also said we would further test the security implications of allowing direct transfers from a nominated third-party account (for example, a Trading Account) into a UK Registry surrender account on behalf of an Account Holder.

Question 39

a) Do you agree with the above proposed changes to account administration relating to only operator and aircraft operator holding accounts? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

255. 33 respondents answered this question. Of these, 94% of all respondents and 95% of respondents currently participating in the EU ETS agreed with the proposed changes to account administration relating only to operator and aircraft operator holding accounts. Respondents welcomed the proposals to provide flexibility and simplify the scheme for operators, stating that the proposals are proportionate and sensible.

UK Government's and Devolved Administrations' response

256. To make the UK Registry significantly easier to use for participants, we intend to implement the changes applicable to Operator Holding Accounts and Aircraft Operator Holding Accounts. This is in line with the very positive responses received on these proposals

257. Based on further review of the 2019 Registry Regulations, the closure pending status is not necessary for the UK context as it only exists to allow national administrators in other Member States with a different legal system to carry out certain actions.

258. Allowing surrender by nominated third parties is not deliverable for the start of a UK ETS as it requires further work to assess its security implications.

Security and Preventing Criminal Activities

Summary of proposals

259. In the consultation, we proposed that when deciding to open accounts, register verifier accounts, or approve authorised representatives, the registry administrator may take into account any convictions or pending investigations in the preceding five years for fraud, money laundering, terrorist financing or other serious crimes. We believe this would increase the security of the Registry and help prevent criminal activities.

Question 40

a) Do you agree with these proposals intended to increase the security of the Registry and prevent criminal activities? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

260. 37 respondents answered this question. Of these 97% of all respondents and 100% of respondents currently participating in the EU ETS agreed with this proposal intended to increase the security of the Registry.

UK Government's and Devolved Administrations' response

261. Since these proposed changes will ensure that the UK Registry is secure and has adequate safeguards against criminal activities and is aligned with the views of almost all respondents, we intend to implement them.

Discretionary Options in the EU Registry Regulations

Summary of proposals

262. The current EU Registry Regulations allow member states to implement any of the below options:

- to require that at least one Authorised Representative is resident in the UK,
- to require Trading Account Holders to be resident in /have place of juridical registration / be registered for VAT in the UK, and
- to only allow an individual, company or other entity which has legal rights in the UK to hold Trading Accounts.

263. While we have not implemented any of these to date, nor did we propose to do so in the consultation, we invited stakeholder views on whether implementing any of these options would further enhance the security of a UK Registry.

Question 41

Would one or several of the options above further enhance the security of the UK Registry and the integrity of the UK carbon market? (Y/N)

Please expand on your answer, providing evidence in support of your response where possible.

Question 42

Are there further simplifications or improvements that could be made to the operation of a UK Registry? (Y/N)

Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

264. 23 responses to this question were received. 16 (70%) of all respondents and 80% of respondents currently participating in the EU ETS said that one or several of these options would further enhance the security of a UK Registry. Those who agreed indicated no preference for any of the options. Seven respondents disagreed noting that it could lead to barriers to market participation and adversely impact liquidity.

265. Eight respondents believed that further simplifications or improvements could be made to the operation of a UK Registry. Of these, three respondents stated that the UK Registry should be able to import verified emissions data.

UK Government's and Devolved Administrations' response

266. As there was no clear preference expressed for any of the options, we do not view it as beneficial to implement any one of them at this time as it could adversely limit trading activity.

267. We are currently exploring options to further simplify the interaction between the Registry and other digital tools for permitting, monitoring, reporting and verification of emissions.

Chapter 3: Aviation

Summary

268. The UK Emissions Trading System (UK ETS) will include aviation to ensure the sector continues to make a proportionate and cost-effective contribution to achieving the UK's high climate ambition. This chapter explains how we have taken on board the responses we received to the consultation and what this means for the elements of design and operation specific to aviation. Other elements of a UK ETS will apply to the aviation sector in the same way as to the stationary sector.

269. The Future of UK Carbon Pricing consultation ran prior to the on-going COVID-19 emergency. The government recognises the challenging times facing the aviation sector as a result of COVID-19 and we are working closely with the sector which is vital to our future as a global trading nation and plays a critical role in local economies. Detail of the UK Government and Devolved Administrations support for business can be found in the Introduction.

270. It is important that we continue to work on our longer-term priorities including tackling climate change. COVID-19 has meant people have had to profoundly change the way they live, work and travel, and it is clearly sensible that our plans to reduce emissions look to understand and take account of this.

Inclusion of Aviation in a UK ETS

271. The consultation on the Future of UK Carbon Pricing set out proposals on how a UK ETS could apply to aircraft operators, seeking views from a variety of stakeholders. Overall, the majority of respondents agreed with the proposals in Chapter 3: Aviation, responding positively to almost all policy recommendations.

272. The UK recognises that the aviation industry must do its fair share to address its contribution to climate change and reduce emissions as much as possible. The UK was instrumental in reaching agreement in 2016 on a global market-based measure for international aviation, the Carbon Offsetting and Reduction Scheme for International Aviation (CORSIA). As the first global scheme to tackle emissions in any single sector, this represents a significant achievement.

273. The UK continues to lead efforts in the International Civil Aviation Organisation (ICAO) to negotiate for robust, environmentally effective emissions reduction measures that address international aviation emissions in the most cost-effective way.[23] This is why, in the UK Government's Aviation 2050 green paper, we proposed to begin negotiating in ICAO for a long-term goal for international aviation emissions that, like our national targets, is consistent with the temperature goals of the Paris Agreement.

274. While the UK is committed to fully implementing CORSIA, the UK Government and the Devolved Administrations have higher climate change ambitions than those set by ICAO. For example, while global in scale, CORSIA only requires aircraft operators to

[23] Aviation 2050: The Future of UK Aviation, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/769695/aviation-2050-web.pdf

offset the growth in international aviation CO_2 emissions covered by the scheme above 2019/20 levels and does not include emissions from domestic flights, which are included in UK climate targets.[24] For this reason, as well as the positive responses received from stakeholders, we intend to go beyond participation in CORSIA by targeting further emissions reductions through the inclusion of aviation in a UK ETS (please see CORSIA Interaction with a UK ETS for further detail).

Linking to the EU ETS

275. Many aircraft operators participating in the EU ETS will also participate in a UK ETS and, as stated in The Future Relationship with the EU[25], the UK is open to considering a link between any future UK Emissions Trading System and the EU ETS, if it suits both sides' interests.

Routes

Summary of proposals

276. The EU ETS covers CO_2 emissions from flights taking place within the European Economic Area (EEA). Since the EU-Swiss linking agreement came into force on 1 January 2020, Swiss domestic flights and flights between the EEA and Switzerland are also included in the linked system.

277. After the end of the transition period, we anticipate that UK domestic flights, flights between the UK, Gibraltar and the EEA and flights from the UK to Switzerland will not be included in the EU ETS. We also anticipate that flights from Switzerland to the UK will not be included in the Swiss ETS.

278. In the consultation we proposed to include the following routes in a UK ETS: Domestic UK flights, flights from the UK to the EEA, flights from the UK to Switzerland (Option 3).

Question 43

a) Do you agree with the proposed routes (Option 3) to be covered by a UK ETS? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

279. Out of 23 responses, 15 respondents (65%) from a mixture of sectors agreed with the proposed routes set out under Option 3. A respondent from the aviation sector

[24] CORSIA is aimed at achieving ICAO's medium term climate change goal of Carbon Neutral Growth from 2020 (CNG2020). It requires operators to offset any increase in emissions over a base year, currently defined in the CORSIA SARPs as an average of 2019 and 2020 emissions. Discussions are ongoing in ICAO as to whether 2020 emissions are unsuitable for use in calculating the baseline, considering the significant fall in global air traffic as a result of COVID-19.

[25] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868874/The_Future_Relationship_with_the_EU.pdf

suggested that their preference was for the linking of the UK and EU ETSs, and that the routes proposal was the most effective way to achieve this. One respondent stated that they agreed with the routes set out in Option 3, under the assumption that flights arriving in the UK from the EEA and Switzerland would be included in the EU and Swiss ETSs respectively.

280. Eight respondents (35%) disagreed with the proposed routes. There was a split between those who disagreed: one respondent suggested a UK ETS should only cover UK domestic flights, while other responses indicated a preference for a greater coverage than that proposed.

281. Several respondents also provided further views on how a UK ETS should interact with ICAO's global scheme, CORSIA. These points are covered under the section on CORSIA Interaction with a UK ETS.

UK Government's and Devolved Administrations' response

282. The UK Government and Devolved Administrations have agreed the ambition to implement the proposed route option presented in the consultation (Option 3). Therefore, a UK ETS will impose surrendering obligations on the following routes from day one:

- UK domestic flights,
- Flights departing from the UK to aerodromes within EEA states.

283. This apportioning of routes will apply in both a standalone and a linked UK ETS, with flights arriving in the UK from the EEA covered by the EU ETS, if it is agreed by both sides. This has been the principle adopted by the EU-Swiss agreement to link emissions trading systems and mirrors how other international flight emissions are calculated.

284. If an agreement is reached with Switzerland, a UK ETS would also impose surrendering obligations on the following routes:

- Flights departing from the UK to aerodromes within Switzerland.

285. It is our assumption that in this scenario flights departing Switzerland to the UK would be covered by the Swiss ETS.

286. Flights between the UK and Gibraltar will be included in a UK ETS. They are currently included in the EU ETS.

287. For clarification, flights departing the UK to Ceuta and Melilla (Spain), the Åland Islands (Finland) and Jan Mayen (Norway), which are territories of Member States that are part of the EEA, would be included in a UK ETS.

288. Flights to offshore installations will be included in a UK ETS.

289. A UK ETS will not cover:

- Flights to/from the three Crown Dependencies of the Isle of Man and the Bailiwicks of Jersey and Guernsey.
- Flights to/from the nine EU Outermost Regions.

Cap and Trajectory

Summary of proposals

290. In the consultation, we proposed to calculate the aviation component of the cap so that it is at least as ambitious as our expected notional share of the EU ETS cap. The aviation component of the cap would then reduce annually in line with the overall UK ETS cap. We also proposed that all allowances from aviation and stationary sectors be interchangeable, as they are in the EU ETS Phase IV.

Question 44

a) Do you agree that the aviation component of a UK ETS cap and trajectory should be calculated to ensure that it represents a level of ambition at least as ambitious as our proportional share of the EU ETS cap? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

291. Out of 27 respondents, 21 (78%) agreed that the aviation component of a UK ETS cap should be at least as ambitious as the UK's expected notional share of the EU ETS cap. A respondent from the aviation sector added that, although they agreed with the proposal, they believed exceeding the level of EU ambition would make the UK aviation sector uncompetitive. An NGO in the transport sector noted that the aviation cap should be tightened if and when the EU tightens its cap to increase climate ambition. Seven respondents argued that the aviation component for the cap should be calculated to ensure that it represents the highest possible level of ambition.

292. Three respondents further reasoned that the cap and trajectory should be linked to the UK's commitment to achieving net zero emissions by 2050. One respondent from the industrial sector noted that a linked UK ETS should be as ambitious as the EU ETS, but a standalone UK ETS should align with the UK's net zero target.[26]

293. Six respondents (22%) disagreed with the proposal. A respondent from the aviation sector suggested that if the trajectory does not reflect the efficiency gains that can be made in aviation, it risks creating a cost burden to operators without achieving a UK ETS goal of reducing emissions through cost-effective abatement. Another respondent from the aviation sector supported the cap and trajectory proposal but did not agree with the inclusion of international flights in a UK ETS. They suggested aviation carbon pricing policy objectives should be achieved through the UK's participation in CORSIA, please see CORSIA Interaction with a UK ETS for further detail.

294. An NGO in the transport sector was pleased that the consultation recognises that the EU ETS provides a higher level of ambition than CORSIA and noted that

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[26] UK becomes first major economy to pass net zero emissions law
https://www.gov.uk/government/news/uk-becomes-first-major-economy-to-pass-net zero-emissions-law

complementary carbon pricing options will still be needed to work alongside ICAO's scheme from 2021.

295. One respondent suggested that making allowances between participating sectors interchangeable would lessen the incentive to reduce aircraft emissions. Similarly, a respondent from the industrial sector suggested a full impact assessment would be needed before a decision on this could be made.

UK Government's and Devolved Administrations' response

296. In line with views of the majority of respondents, the aviation component of the UK ETS cap will be at least as ambitious as our expected notional share of the EU ETS aviation cap for Phase IV, as proposed in the consultation.

297. There will be a single cap for all participating sectors in a UK ETS, as set out in Chapter 1, which takes into account the scope of aviation emissions covered by the system. The initial cap will be reduced annually by 4.2 million allowances, meaning that the UK ETS cap will remain 5% below where we would have expected the UK's notional share of the Phase IV EU ETS cap to be year on year. Please see Chapter 1 – Cap and Trajectory for further details.

298. There will be no impact to aircraft operators' day one free allocation entitlement as a result of the UK Government's and Devolved Administration's decision on a UK ETS cap and trajectory.

299. Four respondents noted that the cap and trajectory should be linked with the UK's net zero commitments. The UK is committed by law to reducing emissions to net zero by 2050, and the UK ETS will play a key role in decarbonising aviation. Please see Chapter 1 – Cap and Trajectory for our response on net zero commitments.

300. One respondent suggested that the proposed cap does not reflect the efficiency gains that can be made in aviation. However, all sectors participating in the UK ETS have varying capabilities and capacities to abate. Therefore, under a UK ETS, we will set a single cap covering stationary installations and aircraft operators. This will help ensure that decarbonisation can first happen where it is most cost-effective to do so. We will be reviewing the abatement potential for different UK ETS participating sectors, taking efficiency gains into account for future UK ETS policy design.

301. As set out in the consultation document, all allowances in the system will be interchangeable between participating sectors, as in Phase IV of the EU ETS. This is also subject to review in light of the integration of the global offsetting scheme, CORSIA, please see CORSIA Interaction with a UK ETS for further detail. It is worth noting that in Phase III of the EU ETS, aircraft operators can purchase stationary allowances; in Phase IV, the reverse will also be true as stationary operators will be able to buy aviation allowances. The UK Government and Devolved Administrations have found no negative impacts of mirroring EU ETS Phase IV in this way.

Allocation Methodology

Summary of proposals

302. In a UK ETS, aircraft operators will continue to receive an allocation of free allowances that will reduce annually in line with the cap, and which will reflect the aircraft operator's historic activity on routes covered by a UK ETS.

303. Questions 45 and 46 sought views on the level of free allocation provided to aviation operators and how this free allocation will be calculated.

Question 45

a) Do you agree with the proposed approach to determining free allocation of allowances for the aviation sector? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

304. Nine respondents (45%) out of 20 agreed with the proposed approach to determining free allocation, while 11 disagreed (55%). The most common point raised in disagreement (from five respondents) was that aircraft operators should not receive free allocation. Two respondents also advocated for carbon fee and dividend, and the remainder did not provide a reason for their disagreement. The rationale put forward for lowering free allocation was that the aviation industry should be responsible for a larger proportion of the costs to decarbonise. This would, it was argued, reflect a greater ambition to decarbonise and bring the consumer costs of flying more in line with non-traded forms of transport such as rail.

UK Government’s and Devolved Administrations’ response

305. While acknowledging the consultation responses arguing for an immediate reduction in free allowance allocation, we propose to keep the day one UK ETS free allocation approach the same as EU ETS Phase IV. This is to ensure a smooth transition for participants in a system launching in 2021.

306. Free allocation to aircraft operators will reduce annually in line with the overall UK ETS cap. The UK ETS will look to honour the EU ETS Phase III Special Reserve allocation but similarly to Phase IV, a UK ETS will not have a new special reserve opening.

307. Although it is the UK Government and Devolved Administrations’ position to keep the day one UK ETS free allocation approach the same, we will review free allocation for aviation, considering competitiveness and our domestic and international climate commitments, with any change likely to be implemented from the start of Phase I(b) (see Chapter 3 - Phases) at the latest.

308. An update to activity data and benchmark calculation will also be considered for Phase I(b) to provide free allocation that is more reflective of current activity. Existing activity data and benchmarks will be used from day one as explained below.

Question 46

Do you agree with the proposal to ask aircraft operators to submit their 2010 tkm data and 2010-2014 tkm data (if benefiting from the special reserve) should it not be possible to obtain this data from European Regulators? (Y/N)

Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

309. 11 out of 14 respondents (79%) supported the proposed method of determining free allocation entitlement by asking aircraft operators to submit their 2010 (and 2010-2014 if benefiting from the special reserve) tonne-kilometre (tkm) data. Of the total respondents, 5 out of 6 (83%) who are current EU ETS participants and 6 out of 8 (75%) who are not current EU ETS participants, agreed with the proposal, with one commenting that a "direct request for such data would be eminently reasonable".

UK Government's and Devolved Administrations' response

310. As the UK ETS will use the same free allocation approach as Phase IV of the EU ETS, if an aircraft operator participating in the UK ETS wishes to apply for free allocation entitlement, they will need to provide their verified 2010 tkm data (and 2010-2014 tkm if currently benefiting from the EU ETS Special Reserve). In the UK ETS, an aircraft operator's free allocation will be calculated based on their tkm data on UK ETS routes.

311. Further details on the process for submitting this data will be announced in due course ahead of the launch of the UK ETS.

Thresholds and Exemptions

Summary of proposals

312. In the EU ETS, thresholds have been set which exempt smaller aircraft operators from any obligations if their annual emissions or number of flights operated fall below a certain level. Similarly, flights that meet certain criteria based on the size of the aircraft or the category of flight may also be exempt from surrendering obligations.

313. Questions 47, 48 and 49 sought views on how thresholds and exemptions should be set for a UK ETS.

Question 47

a) For a linked UK ETS, do you agree that the EU ETS thresholds should be adopted? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Question 48

a) For a standalone UK ETS, do you agree that the thresholds should be defined in relation to the routes in a UK ETS only? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Question 49

a) Do you agree that both linked and standalone UK ETS should mirror all other EU ETS exemption criteria? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Question 47 - Summary of responses

314. There were 20 respondents to Question 47, of which 14 (70%) agreed with the proposal.

315. Of those who disagreed, one respondent from the aviation sector argued that the threshold based on the number of flights operated should be removed to ensure users of business jets pay proportionally towards climate change mitigation. Another respondent, also from the aviation sector, argued that this threshold should be raised because it is based on full scope activity (flights to, from and within the EEA), which results in some non-EEA operators with few flights in surrendering scope of the scheme having to comply with EU ETS surrendering obligations. Similarly, another respondent from the aviation sector suggested raising the CO2 emissions threshold because it captures non-EEA aircraft operators.

Question 48 - Summary of responses

316. In the consultation, the UK and Devolved Administrations proposed to set thresholds for a standalone UK ETS based on UK ETS routes. As set out in the consultation, this approach was proposed to ensure a standalone UK ETS captures a similar proportion of emissions to the current EU ETS thresholds and would avoid placing unnecessary administrative burden on aircraft operators with very little activity on UK ETS routes.

317. There were 16 respondents to Question 48, of which 11 (69%) agreed with the proposal. Agreement amongst current EU ETS participants was even stronger, at 83%. One respondent noted that to ensure the integrity of a standalone UK ETS, its thresholds should capture a similar proportion of emissions as currently captured in the EU ETS. Two individuals argued that the thresholds for aviation should be identical to those of stationary operators. A trade body indicated that for them, in practice, there could be no standalone UK ETS.

Questions 47 and 48 - UK Government's and Devolved Administrations' response

318. As stated previously, if it can be done in line with both parties' interests, we are open to exploring a link between the UK ETS and the EU ETS.

319. In any scenario for a day one UK ETS, the thresholds for commercial and non-commercial aircraft operators would be the same as those in the current EU ETS. This will ensure that there is no loss of environmental ambition compared to the current EU ETS and a smooth transition for operators.

320. Commercial aircraft operators would not be subject to any obligations if they meet either of the following criteria:

- Operate fewer than 243 flights per period for three consecutive four-month periods based on full scope activity. The four-month periods are: January to April, May to August, September to December,
- Operate flights with total annual emissions less than 10,000 tonnes of CO_2 per year based on full scope activity.

321. Non-commercial aircraft operators would not be subject to any obligations if they operate flights with total annual emissions lower than 1,000 tonnes of CO_2 per year based on full scope activity.

322. In a UK ETS, full scope activity would cover all flights that either arrive or depart from an aerodrome within the UK, Gibraltar or European Economic Area, regardless of where the aircraft operator is registered.

323. While the thresholds in a UK ETS would remain based on full scope activity, aircraft operators would only be required to surrender allowances for emissions from flights on UK ETS routes.

324. In a standalone UK ETS, the thresholds set out above would be subject to a targeted review, with a view to setting thresholds defined in relation to UK ETS routes only, in line with the proposal set out in Question 48 and the majority of responses received. Any changes would be implemented by the start of Phase I(b) (see Phases). New thresholds would be at least as ambitious, capturing a similar proportion of emissions to the current thresholds, while avoiding placing unnecessary administrative burden on aircraft operators.

325. Two respondents suggested that any UK ETS should align exemption thresholds between the stationary and aviation sectors. This would not be suitable because inclusion for the stationary sector is dependent on an installation's thermal capacity, in addition to its emissions.

Question 49 - Summary of responses

326. Alongside the threshold levels, aircraft operators may be exempt from surrendering obligations for flights operated for certain purposes and/or using light aircraft. In the consultation, we proposed to adopt the exemption criteria currently used in the EU ETS.

327. There were 17 respondents to Question 49, of which 12 (71%) agreed with the proposal. One respondent indicated that the mirroring of exemption criteria appears necessary to ensure harmonisation. Two individuals who disagreed indicated that aircraft operators should be treated in the same way as stationary operators. One respondent from the aviation sector stated that the aviation exemption criteria should be more restrictive but did not provide further details.

Question 49 – UK Government's and Devolved Administrations' response

328. In line with the majority of respondents, we have decided to implement the proposal from the consultation. Therefore, flights operated by both fixed-wing and rotary-wing aircraft would be included unless the flight is operated using aircraft with a maximum take-off mass of less than 5,700kg. This is the same weight threshold as both the EU ETS and CORSIA, although helicopters are exempt under the latter scheme.

329. Additionally, flights operated for the following purposes would also be exempt under a UK ETS:

- Flights performed exclusively for the transport, on official mission, of a reigning Monarch and his/her immediate family, Heads of State, Heads of Government and Government Ministers of a country other than the UK,
- Military flights performed by military aircraft as well as customs and police flights,
- Search and rescue flights, fire-fighting flights, humanitarian flights and emergency medical service flights,
- Any flights performed exclusively under visual flight rules as defined in Annex 2 to the Chicago Convention,
- Flights terminating at the aerodrome from which the aircraft has taken off and during which no intermediate landing has been made,
- Training flights performed exclusively for the purpose of obtaining a licence, or a rating in the case of cockpit flight crew. Should these flights also be used for the transport of passengers and/or cargo or for the positioning or ferrying of the aircraft, they would not be exempt,
- Flights performed exclusively for the purpose of scientific research or for the purpose of checking, testing or certifying aircraft or equipment whether airborne or ground-based.

330. These exemptions will ensure operators would face the same compliance obligations for a category of flight missions across the two systems, ensuring that there is no loss of environmental ambition compared to the current EU ETS and a smooth transition for operators.

Small emitters and simplified reporting

331. Although the thresholds for classification as a small emitter and eligibility to use simplified reporting methodology were not consulted on, they are set out below for clarity on the design of the system.

332. If classed as a small emitter, an aircraft operator can use a simplified monitoring approach using an approved tool to estimate their fuel consumption. In a UK ETS, aircraft operators would be eligible to use EUROCONTROL's Small Emitters Tool (SET) if they meet either of the following criteria:

- Operate flights with total annual emissions less than 25,000 tonnes of CO_2 based on full scope activity,
- Operate fewer than 243 flights per period for three consecutive four-month periods based on full scope activity.

333. In a UK ETS, aircraft operators would be eligible for simplified reporting and allowed to use annual emissions reports generated from the EUROCONTROL ETS support facility (ETS-SF) to compile their emissions monitoring report if they meet either of the following criteria:

- Operate flights with total annual emissions less than 25,000 tonnes of CO2 based on full scope activity,
- Operate flights with total annual emissions less than 3,000 tonnes of CO2 based on activity within the scope of a UK ETS.

334. The thresholds for eligibility to use the SET or simplified reporting will be reviewed in the first years of a UK ETS, with any changes likely to be implemented by the start of Phase I(b) (see Phases). This approach will ensure a smooth transition for operators. We are aware that there are some inconsistencies regarding the rules for small emitters with regards to CORSIA. These will be reviewed in due course, with any changes also likely to be implemented by the start of Phase I(b).

Monitoring, Reporting and Verification (MRV)

Summary of proposals

335. In the consultation, we proposed that the aviation Monitoring, Reporting and Verification rules would mirror those of the EU ETS Phase IV.

Question 50

a) Do you agree that MRV requirements for a UK ETS should align with the EU ETS? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

336. Out of 18 respondents, 15 (83%) agreed with this proposal. A respondent from the aviation sector commented that changes were not necessary because the EU ETS MRV requirements are proven to be effective. They also noted that this would help the sector transition from the EU ETS, with the additional benefit that verifiers would be able to operate across both schemes. Another respondent from the oil sector felt that the work of aligning the MRV requirements of a UK ETS with CORSIA's Standards and Recommended Practices (SARPs) should also continue[27]. Two more respondents elaborated that this approach would ensure harmonisation with the EU ETS.

337. Of those that disagreed, a respondent from the aviation sector also argued that even though the EU have proposed some amendments to EU ETS MRV to align with CORSIA, there remain multiple inconsistencies. They felt adopting the revised EU ETS MRV would be unacceptable for UK policy. One respondent from a trade association advised against aligning a UK ETS with the EU ETS MRV requirements because they felt this would contradict the intention to ensure that the UK's future approach minimises

[27] SARPs are the implementation vehicle of ICAO. For CORSIA, they may be found here: https://www.icao.int/environmental-protection/CORSIA/Pages/SARPs-Annex-16-Volume-IV.aspx

complexity, highlighting differences in fuel monitoring methodologies between the EU ETS and CORSIA as one such example.

338. A respondent from the aviation sector argued that the structure of a UK ETS should mirror the EU ETS. They also argued that a UK ETS should use a one-year compliance cycle rather than the three-year compliance cycle implemented for CORSIA as this would create market distortion through spikes in carbon prices and increase the risk of non-compliance. This comment was recorded under Question 51 of the consultation, but the response has been set out here as it is more relevant to the MRV section.

UK Government's and Devolved Administrations' response

339. In line with the views of the majority of respondents, we will ensure the UK ETS and EU ETS MRV requirements are compatible to ensure a smooth transition for operators. This ensures that a UK ETS is underpinned by a tried and tested, effective and comprehensive MRV framework. On the benefit of verifiers being able to operate across both schemes, the UK Government and Devolved Administrations agree that this would be a preferred outcome.

340. There are still a few technical inconsistencies between EU ETS MRV requirements and those required for CORSIA. The UK Government has been heavily involved in EEA-wide decisions regarding having one set of rules for all aviation carbon pricing schemes (a UK ETS, EU ETS and CORSIA). There has been substantial progress so far; the amended MRR and AVR EU ETS regulations addressed many MRV incompatibilities between the two schemes, which was supported by a Delegated Act adopted on 20 October 2019.[28] [29] [30]

341. However, we are aware that there are still some technical inconsistencies which need to be addressed to make the MRV rules of the EU ETS and CORSIA compatible. We have raised these concerns with the EU and expect the Commission to address these inconsistencies with CORSIA, including the MRV rules for small emitters, as part of a 2020 review. We have begun work to address these inconsistencies in the UK ETS and provide a full legislative basis for CORSIA MRV in 2021. In particular, we aim to:

- Include all five monitoring methods in UK ETS MRV (currently only two out of five methods are approved for use by both schemes),
- Expand the MRV scope of a UK ETS to make flight reporting mandatory on all domestic and international flight routes for UK operators, enabling CORSIA compliance.

Aircraft Operator compliance cycles in a UK ETS

342. We did not consult stakeholders on policy relating to aircraft operator compliance cycles in a UK ETS. However, in the consultation section titled 'CORSIA interaction with a UK ETS' (Chapter 3), we presented a number of high-level considerations the UK Government and Devolved Administrations could explore to align a UK ETS with CORSIA. One such consideration was to postpone the first UK ETS surrendering deadline for aircraft operators until 2025, to make it clear that aircraft operators do not

[28] EU ETS MRR: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.334.01.0001.01.ENG
[29] EU ETS AVR: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.334.01.0094.01.ENG
[30] Delegated Act:
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2019.250.01.0010.01.ENG&toc=OJ:L:2019:250:TOC

need to pay twice for the same tonne of CO2, while the rules of CORSIA-ETS interaction are still being agreed.

343. The feedback we have received at various stakeholder events as well as in the consultation response is that a three-year aviation compliance cycle would create too much uncertainty around the carbon price for operators, increasing the potential for non-compliance. We have taken account of these views in our assessment of this policy consideration, particularly focusing on the ways in which aircraft operators purchase allowances. The UK Government and Devolved Administrations determined that a longer compliance cycle would not have any beneficial impact on CORSIA-ETS interaction. Having considered these views, we further explored this proposal and concluded that we should remove this option from our policy considerations. Therefore, we will maintain an annual compliance cycle in a UK ETS for aircraft operators.

Phases

Summary of proposals

344. In the consultation, we proposed that Phase I of a UK ETS should be split into two sub-phases for aviation: Phase I(a) 2021-2023 and Phase I(b) 2024-2030. This is to ensure that any amendments to aviation UK ETS policy following targeted reviews are made by the end of Phase I(a) at the latest, including those for CORSIA, without disrupting the overall phase structure.

Question 51

a) Do you agree with the proposed phase structure for the inclusion of the aviation sector in a UK ETS? (Y/N)

b) Please expand on your answer, providing evidence in support of your response where possible.

Summary of responses

345. Out of 17 respondents, 12 (71%) agreed with this proposal. Of those in agreement, one respondent elaborated that this approach would be necessary to ensure harmonisation. Another respondent from the power sector commented that the phase structure is logical and added that the scope of the system should be known as far in advance as possible, to enable the market to function smoothly.

346. Five respondents (29%) disagreed with the proposal. One respondent from the aviation sector felt that, at this early stage, we should not make decisions assuming an overlap between the application of CORSIA and ETS and only do so once the rules for CORSIA are set.

347. A respondent from the aviation sector commented that if the objective of the UK is to ensure the successful implementation of CORSIA, it would be more rational for the UK to take CORSIA as the basis for any carbon pricing policies instead of creating new ones, please see CORSIA Interaction with a UK ETS for further detail. Another respondent from the aviation sector agreed and added that CORSIA-based scheme should begin from 2021. They also noted that planning for changes from 2023 is sensible in any case.

UK Government's and Devolved Administrations' response

348. In line with the majority of consultation respondents, we will align aviation phases with the overall UK ETS phase structure, which includes a 10-year first phase running from January 2021 to December 2030. This would mean that the scope of a UK ETS, including the routes covered, will continue throughout the whole of Phase I as a default. We will also split aviation Phase I into two sub-phases:

- Phase I(a): start of phase-2023 (mirroring CORSIA's pilot phase)
- Phase I(b): 2024-2030

349. This split phase structure mirrors EU ETS aviation review periods. As the rules for CORSIA have now been set, we will make the necessary changes for a UK ETS to accommodate CORSIA by the end of Phase I(a) at the latest. The UK Government and Devolved Administrations will consult aircraft operators in sufficient time before any proposed major change to aviation in a UK ETS so that they can prepare accordingly.

350. The UK Government and Devolved Administrations will ensure that by the start of Phase I(b) at the latest, participating aircraft operators will have clarity over the interaction of both carbon pricing schemes. It is our intention to avoid a scenario in which aircraft operators pay twice for the same tonne of CO2 emissions.

351. All changes resulting from the aforementioned aviation targeted reviews, including of free allocation, will be made for the start of Phase I(b) at the latest, alongside any net zero changes. These are independent of the 2023 whole-system review detailed in Chapter 1 – Phases and Reviews.

352. As per the consultation, the overall UK ETS will be reviewed in 2028, with changes to be implemented in time for Phase II (2031-2040). This will be an opportunity to assess the effects of any major changes to aviation made in Phase I(a), such as any effect on environmental ambition, and allow for improvements to be made for the next phase.

CORSIA Interaction with a UK ETS;

353. CORSIA is aimed at achieving ICAO's medium-term climate goal of Carbon Neutral Growth from 2020 (CNG2020). It requires qualifying aeroplane operators to offset the growth in international aviation CO2 emissions covered by the scheme above average 2019 and 2020 levels. This means that the emissions offset by the scheme will increase over time in line with the sector's gross emissions. 83 states representing over 75% of global aviation activity have volunteered to participate in the scheme from the start in 2021, including all EEA states. From 2027, the scheme will become mandatory (subject to exemptions).

354. The EU ETS sets an overall cap on historical emissions at 95% of 2004-06 levels. This means that the 'aviation share' of the cap is lower than the CORSIA baseline of average 2019 to 2020 levels when considering flights that qualify for both schemes.

355. While we have not sought views on CORSIA as part of the consultation, we will ensure any views expressed on the topic are taken into account as we continue to

assess how a UK ETS can work alongside CORSIA to achieve both the UK's high climate ambition and reduce emissions from aviation globally. We recognise that complying with more than one scheme could place a greater burden on aircraft operators and, where possible, we will look to simplify administration processes.

Summary of responses

356. Six respondents expressed concern about how a UK ETS would interact with CORSIA. One respondent from the aviation sector advised that attention should also be given on how to link a UK ETS and CORSIA and that it might be too early to determine the details of a UK ETS for aviation before the final CORSIA framework is determined.

357. Four respondents suggested that certain areas of aviation UK ETS policy, such as the aviation component of the cap and trajectory, are incompatible with CORSIA, with one respondent from the aviation sector and two trade associations suggesting that creating a separate UK ETS would undermine the overall objectives of the industry, arguing that the UK should focus its efforts on CORSIA as a means to reduce emissions.

358. A respondent from the aviation sector commented that the UK should not follow the EU ETS. Instead, they suggested that CORSIA should be used as the basis for any future aviation carbon pricing policy, with the option of extending CORSIA to cover more emissions to increase the scheme's level of environmental ambition. Another respondent from the aviation sector argued that there is a potential for a greater use of offsets for aviation in a UK ETS but that the primary objective should be alignment with the EU ETS and the UK should not do anything to restrict this.

359. Amongst other organisations in the aviation sector, one argued for the existence of a linked UK ETS, at least until the point that CORSIA can demonstrate that it has the same level of environmental ambition. However, they noted the importance of CORSIA implementation and that determining how CORSIA will interact with a UK ETS should be the subject of an early discussion. Similarly, an aircraft manufacturer indicated that stability between a UK ETS and the EU ETS should be a priority, but considerations may be needed in terms of linkage of UK ETS with CORSIA for international flights.

360. An NGO in the transport sector stated that any future consideration of CORSIA offset units should be undertaken in conjunction with the EU, highlighting that potential price disparity between allowances and offsets could result in significantly lower compliance cost for airlines in a UK ETS compared to the EU ETS. In contrast, a respondent from the energy sector noted that the use of offsets may be necessary for the aviation sector due to the lack of abatement options available.

361. A respondent from the aviation sector argued that including aviation in a UK ETS contradicts CORSIA SARPs. They argued that while two or more countries could mutually agree to implement emissions reductions measures in addition to CORSIA, those countries cannot apply these measures to the international flights and operators of non-participating countries.

UK Government's and Devolved Administrations' response

362. As set out in the consultation, we are committed to CORSIA and will ensure aircraft operators participating in a UK ETS are able to comply with CORSIA rules. While this proposal was endorsed by all respondents, several responses suggested a UK ETS should only cover domestic flights to prevent overlap between itself and

CORSIA. However, to exclude international aviation in the scope of a UK ETS would likely represent a reduction in environmental ambition compared to current ETS coverage. A UK ETS will therefore include both domestic and international aviation as set out in the section on Routes.

363. As the rules for CORSIA have now been set, we have begun a review on how a UK ETS could interact with CORSIA. As set out in the consultation, this review will examine how the UK can meet its national and international obligations, while ensuring that aircraft operators will not have to submit both UK ETS allowances and offset credits for the same tonne of CO2 emissions. Any changes will be implemented no later than the start of Phase I(b). This review is outside of the 2023 whole system review detailed in Chapter 1.

364. The UK Government and Devolved Administrations emphasise that UK ETS aviation policy is designed without prejudice to CORSIA and, consequently, compliance with the CORSIA SARPs. Adjustments may be made to UK ETS aviation design elements, such as the aviation cap component and trajectory, based on the outcome of this review. Any such adjustments would also take into account future reviews on CORSIA by ICAO and the EU.[31]

[31] EU ETS regulations commit the European Commission to reviewing and presenting a report on CORSIA, which will consider how to implement the scheme through revisions to EU ETS legislation.
This report is expected before the start of the scheme in 2021.

This publication is available from: https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing

Any enquiries regarding this publication should be sent to us at: emissions.trading@beis.gov.uk

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