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# Developing the UK ETS: initial UK ETS Authority response covering proposals to be implemented by 2023

A joint response from the UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland



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# Introduction

The UK ETS was established on 1st January 2021 by the UK ETS Authority (UK Government, Scottish Government, Welsh Government and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland, (DAERA)). We are committed to increasing the ambition of the scheme and ensuring it plays a crucial role in achieving the UK's ambitious climate targets, including net zero greenhouse gas emissions by 2050.

In March 2022<sup>1</sup>, the Authority consulted on a package of proposals to develop the UK ETS, which aim to ensure that it drives emission reductions towards our ambitious targets and continues to demonstrate the UK's leadership on carbon pricing<sup>2</sup>. This consultation included proposals on aligning the scheme's cap with our net zero target, reviewing the role of Free Allocation policy as a carbon leakage mitigation tool in the context of the net zero aligned cap and the initial considerations on expanding the scope of emissions trading across the economy.

A small number of proposals in the March consultation require implementation via legislation ahead of the 2023 scheme year. For this reason, we are providing an early response on these proposals to set out final positions to stakeholders before these positions take effect. For the remaining proposals included in the March consultation, including on aligning the UK ETS cap with net zero, we will provide a full response in due course.

This response outlines responses received and Authority decisions on the following proposals:

- The inclusion of flights from the UK to Switzerland in the UK ETS from January 2023; the permitting of virtual site visits for aviation verifiers in situations other than circumstances that are serious, extraordinary and unforeseeable; and updating the references in UK ETS legislation to the Renewable Transport Fuel Obligation (RTFO) sustainability criteria that are relevant to the eligibility of sustainable aviation fuels.
- Amendment to the Activity Level Changes Regulation<sup>3</sup> due to the 2020 COVID year
- Operational amendments to the UK ETS included in Chapter 9 of the consultation, including minor permitting, monitoring, reporting & verification (PMRV) amendments and a window for Hospitals and Small Emitters to re-enter the main scheme

In total, we received 90 responses to the proposals covered in this government response. These included a variety of stakeholders, including those from the Aviation, Chemical, Transport, Manufacturing, Financial, Power, Food and Drink, and Steel sectors, as well as other Trade Associations, Local Authorities, Consultancies, Think Tanks and NGOs, and other sectors.

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<sup>1</sup> <https://www.gov.uk/government/consultations/developing-the-uk-emissions-trading-scheme-uk-ets>

<sup>2</sup> To note, this consultation did not apply to NI electricity generators who participate in the EU ETS by virtue of the Ireland / Northern Ireland Protocol

<sup>3</sup> Commission Implementing Regulation (EU) 2019/1842, as it forms part of domestic law

An analytical annex is included as part of this response. This includes information on analysis used to support final positions relating to UK to Switzerland flights and COVID ALC amendments which are set out in this document.

# Government Response

## UK to Switzerland flights

Chapter 5 of Developing the UK ETS set out proposals for UK ETS development specifically relevant to the aviation sector. The below response focuses on proposals to include flights from the UK to Switzerland in the UK ETS from January 2023.

### Summary of proposal

The government response to the consultation on the Future of UK Carbon Pricing, published in 2020, committed to include flights departing the UK and arriving in Switzerland within the scope of the UK ETS, if an agreement with Switzerland could be reached.<sup>4</sup>

In the Developing the UK ETS consultation we proposed that flights from the UK to Switzerland should be included in the UK ETS from January 2023. We also proposed that:

- We would **not** consequentially adjust the UK ETS cap for implementation in 2023, given the relatively small amount of additional emissions captured. We will account for the inclusion of Swiss flights in proposals to align the UK ETS cap with a net zero trajectory.
- We would look to apply the same free allocation rules for UK to Switzerland flights as to other aviation activity in the UK ETS, including any outcomes of the review into aviation free allocation.

### Questions

67) Do you agree that flights from the UK to Switzerland should be included in the UK ETS from January 2023? (Y/N) Please expand on your answer and give evidence where possible.

68) Do you agree that this aviation activity should be subject to the same free allocation rules and review outcomes as the rest of the aviation sector in the UK ETS? (Y/N) Please expand on your answer and give evidence where possible.

69) Do you agree that we should not adjust the current UK ETS cap to account for the inclusion of UK to Switzerland flights? (Y/N) Please expand on your answer and give evidence where possible.

### Summary of responses

There were 24 responses to Question 67, of which 22 (91.7%) agreed with the proposal to expand the scope of the UK ETS to capture emissions from flights departing the UK and arriving in Switzerland from 2023. Respondents that agreed noted that these flights had

<sup>4</sup> <https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing>

previously been captured when the UK participated in the EU ETS and that including them in the UK ETS would cover a gap created in ETS coverage following the UK's departure from the EU. Of the respondents that agreed, six also argued that the Authority should seek to expand the scope of the UK ETS for aviation to all departing flights from the UK. Of the two responses that disagreed with the proposal, both argued that the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA) should be the only carbon pricing scheme that covers flights from the UK to Switzerland.

There were 20 respondents to Question 68 and 19 (95%) agreed with the proposal. Of those that agreed, six respondents argued that flights captured by the UK ETS should be treated equally and therefore the same free allocation rules should be applied to UK to Switzerland flights. The respondent that did not agree did so on the basis that they opposed the overall proposal to include UK to Switzerland flights in the UK ETS.

There were 23 respondents to Question 69 and 12 (52.2%) agreed with the proposal. Those that supported the proposal cited the small amount of emissions from UK to Switzerland flights in 2019, with five respondents arguing that inclusion of these flights within the UK ETS would be immaterial. 11 respondents did not agree, with some arguing that any scope expansion should be followed by a corresponding increase in the overall cap.

## UK ETS Authority response

The UK ETS Authority have decided to expand the scope of the UK ETS to include flights departing an aerodrome in the UK and arriving in an aerodrome in Switzerland (UK to Switzerland flights). Legislation will be laid to expand the scope of UK ETS aviation activity to include flights from Great Britain (England, Scotland and Wales) to Switzerland, to take effect from 1 January 2023. Legislation to expand the scope of UK ETS aviation activity to include flights from Northern Ireland to Switzerland will be laid as soon as the Northern Ireland Assembly is able to progress legislation.

Switzerland has amended the relevant domestic legislation to ensure that flights from aerodromes in Switzerland to aerodromes in the UK are included in the Swiss ETS from 2023.

From 1 January 2023, aircraft operators will be required to monitor and report their aviation emissions on flights from Great Britain to Switzerland, and surrender an equivalent amount of UK ETS Allowances. Obligations to monitor and report aviation emissions on flights from Northern Ireland to Switzerland, and surrender an equivalent amount of UK ETS allowances, will apply after the relevant legislation is made. The UK ETS Authority will communicate with aircraft operators to ensure that they are aware of when these obligations come into force.

In line with the responses received to this consultation, the UK ETS Authority will review all existing aviation free allocation entitlements and make any necessary adjustments to account for any historical aviation activity relating to Great Britain to Switzerland flights and will update the aviation free allocation table for the remainder of the 2021-2025 allocation period.<sup>5</sup> Aircraft

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<sup>5</sup> The UK ETS Authority is currently reviewing aviation free allocation policy. Future aviation free allocation entitlement will be subject to the outcome of this review with changes expected to take effect from 2024.

operators may be asked to provide further information to the relevant regulator to facilitate this recalculation.

An aircraft operator that did not apply for a UK ETS free allocation entitlement by the 31 March 2021 deadline, but whose historical aviation activity includes Great Britain to Switzerland flights, will have the opportunity to apply for a free allocation entitlement based on those Great Britain to Switzerland flights only. The application process and requirements will broadly be the same as those in the initial free allocation exercise, and the deadline for this application will be 31 March 2023.

Any free allocation entitlement with respect to historical aviation activity based on Northern Ireland to Switzerland flights will be pro-rated to reflect the remaining period of the scheme year, depending on when the legislation laid in Northern Ireland comes into force.

The cap will not be amended in 2023 to account for the inclusion of UK to Switzerland flights, given the relatively small amount of additional emissions captured. In 2019, UK to Switzerland flights amounted to 0.28MTCO<sub>2</sub> which would equate to less than 0.2% of the UK ETS cap for the 2023 scheme year. Further, the UK ETS Authority have consulted on aligning the UK ETS cap with a net zero trajectory. We believe it would be inconsistent to increase the cap, and legislate for this, by this small amount in 2023 when we already intend to legislate to align the cap to a net zero consistent trajectory in 2024. The UK ETS Authority will account for the inclusion of UK to Switzerland flights in the proposals to align the UK ETS cap with a net zero trajectory.

On wider comments made regarding the application of carbon pricing to international flights, the majority of international flights departing the UK are covered by CORSIA and the UK continues to play a leading role in the work of the International Civil Aviation Organization (ICAO) in negotiating for ambitious global action to tackle international aviation emissions, including protecting and strengthening CORSIA.

By including UK to Switzerland flights in the UK ETS, the Authority will cover the gap in ETS coverage that was created following the UK's departure from the EU ETS and fulfil our commitment in the government response to the Future of UK Carbon Pricing consultation to do so once agreement with Switzerland had been reached. The UK Government is currently considering how CORSIA and the UK ETS will interact on flights in scope of both schemes and will consult again in due course. Flights from the UK to Switzerland will be subject to these same considerations.

The responses to the remaining question in this section are currently being reviewed and will be addressed as part of the wider government response to the consultation.

## Virtual Site Visits for Aviation

### Summary of proposal

Chapter 5 also proposed permitting a verifier of aviation activities to conduct a virtual site visit, provided that the regulator approves a request from an aircraft operator for that verifier to do so. A provision enabling virtual site visits in serious, extraordinary and unforeseeable circumstances was introduced during the COVID-19 pandemic. This proposal would enable verifiers of aviation activities to conduct virtual site visits in normal circumstances, provided that the regulator's approval is obtained, to reduce administrative burden, costs, and emissions from travel for both aircraft operators and verifiers.

#### Question

73) Should we permit verifiers of aviation activities to conduct remote site visits if an appropriate risk assessment has been carried out and any precautionary conditions, such as Regulator approval, have been met? (Y/N) Please explain your answer.

### Summary of responses

There were 16 responses to the question and all respondents agreed with the proposal to enable virtual site visits for aviation verifiers. Respondents agreed that doing so would reduce costs and save emissions from the travel required to conduct physical site visits, citing the successful completion of virtual site visits during the COVID-19 pandemic.

### UK ETS Authority response

The UK ETS Authority will legislate to enable virtual site visits for verifiers of aviation activities in normal circumstances provided that the regulator's approval is obtained.

The approval for a virtual site visit will have to be obtained by the aircraft operator prior to the submission of its annual emissions report.

## Sustainability Criteria for Sustainable Aviation Fuels

### Summary of proposal

Chapter 5 also considered the treatment of sustainable aviation fuels (SAF) under the UK ETS in the short and longer-term. SAF use is key to achieving net zero aviation and it is therefore important that SAF provisions under the UK ETS effectively support the uptake of this technology alongside other government and industry interventions. Currently, where SAF meeting the sustainability criteria set out in the existing Renewable Transport Fuel Obligation (RTFO) is purchased and delivered to an aircraft or aerodrome fuelling system by an aircraft operator in the scheme year, the emissions factor applicable to that fuel in the UK ETS is zero

and the aircraft operator may be able to claim a related emissions reduction. This will reduce the number of UK allowances that the aircraft operator has to surrender.

As part of the consultation, we proposed that SAF eligible under the UK ETS should continue to keep pace with the sustainability criteria set out in the RTFO. We are confirming our position on this proposal now and we will be implementing a corresponding technical amendment to UK ETS legislation for the 2023 scheme year.

The consultation also considered more widely the long-term treatment of SAF in the UK ETS as SAF policy develops further and technology takes up. Responses to consultation questions relating to the appropriate accounting of greenhouse gas emissions (GHG) from SAF, the continued reduction of UK ETS obligations for SAF use and interaction with the SAF mandate are being carefully considered to inform further policy development. We will respond to these questions as part of the wider government response to the consultation.

#### **Question**

61) Do you agree that we should continue to ensure that UK ETS rules keep pace with the latest SAF sustainability criteria? This would include reflecting the latest amendments to the RTFO sustainability criteria. (Y/N) Please explain your answer.

### **Summary of responses**

There were 39 responses that directly responded to Question 61 and 38 (97.4%) agreed with the proposal that SAF claimed under the UK ETS continues to keep pace with latest SAF sustainability criteria. Themes from these responses included the need to maintain consistency and clarity between schemes as the SAF market develops rapidly. Respondents also noted the importance of ensuring that climate impacts from SAF use are reported accurately. Some UK ETS participants from the stationary sectors also argued that SAF sustainability criteria should encourage the use of CO<sub>2</sub> captured by stationary installations as a feedstock for SAF production. More broadly, respondents noted the importance of alignment with the proposed UK SAF mandate.

One respondent did not agree with the proposal and argued that all SAF should be considered carbon neutral for aircraft operators under the UK ETS and responsibility for emissions within the SAF's lifecycle should be placed on the fuel producer.

There were two further respondents that did not respond directly to the question, but expressed some concern about diverging from global sustainability criteria for SAF and highlighted the benefit of aligning with international rules for consistency.

### **UK ETS Authority response**

We will ensure that UK ETS SAF policy continues to remain aligned to the RTFO sustainability criteria whilst that scheme rewards SAF supply in the UK, until a mandate is introduced in 2025. At that stage we expect the UK ETS to align with the SAF mandate sustainability criteria once this comes into effect. The proposed approach to the SAF mandate sustainability criteria

was set out in the 2021 SAF mandate consultation<sup>6</sup> and the government response, published in July 2022.<sup>7</sup> By aligning with existing and future UK SAF policy and sustainability standards, we can ensure that the SAF supplied to the UK and claimed under the UK ETS is truly sustainable, and that this can also be claimed under the RTFO, or the future SAF mandate when operational. Without this alignment, should a fuel that complies with wider sustainability standards but not the RTFO be supplied to the UK, the UK ETS could paradoxically encourage supply of SAF that do not contribute to RTFO targets and for which fuel suppliers would not be able to claim certificates under the scheme. This would also result in an additional financial burden on fuel suppliers, as renewable fuel supplied under the RTFO which does not comply with the scheme's sustainability criteria incurs an obligation - a similar approach is envisaged for the SAF mandate when operational. The sustainability standards of the RTFO and the future SAF mandate, however, are constantly updated and take into consideration, among other factors, global sustainability developments. We will review any future amendments and their applicability to aircraft operators under the UK ETS.

To ensure that the UK ETS remains aligned with the RTFO, the Authority will be making a small, technical amendment to UK ETS legislation for 2023. Currently UK ETS legislation refers to the sustainability criteria set out in the Schedule to the RTFO Order.<sup>8</sup> In December 2021 an amendment was made to the RTFO Order to spread the sustainability criteria across three Schedules, without amending the substance of the criteria.<sup>9</sup> This has introduced some ambiguity in UK ETS legislation. The UK ETS Authority will amend UK ETS legislation to refer to the Schedules to the amended RTFO Order and will clarify that SAF will be assessed against the applicable sustainability criteria for the year in which it was purchased.

As noted, one respondent disagreed with the proposal and argued that all SAF should be considered carbon neutral for aircraft operators. It is important to note that SAF meeting the RTFO sustainability criteria is currently treated in the UK ETS as having an emissions factor of zero and that the planned legislative amendments mentioned above will not alter this approach. More widely, however, the consultation considered the future treatment of SAF in the UK ETS, including how lifecycle emissions from SAF could be accounted for appropriately. As noted previously, responses to these remaining consultation questions in the SAF section are currently being reviewed and will be addressed as part of the wider government response to the consultation.

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<sup>6</sup> <https://www.gov.uk/government/consultations/mandating-the-use-of-sustainable-aviation-fuels-in-the-uk>

<sup>7</sup> <https://www.gov.uk/government/consultations/mandating-the-use-of-sustainable-aviation-fuels-in-the-uk#:~:text=We%20will%20introduce%20a%20sustainable,reduction%20scheme%20with%20tradeable%20certificates>

<sup>8</sup> <https://www.legislation.gov.uk/uksi/2007/3072/contents/made>

<sup>9</sup> <https://www.legislation.gov.uk/ukdsi/2021/9780348228854/article/13>

## Amendment to the Activity Level Changes Regulation due to the 2020 COVID year

Chapter 2 of “Developing the UK ETS” set out proposals for UK ETS development relating to free allocation policy, and notably potential amendments to Activity Level Changes to take into account the impacts of the COVID-19 pandemic.

### Summary of proposal

In Chapter 2 we proposed to either:

- Maintain the current application of the Regulation for the 2022 Activity Level Changes process or;
- Amend the Activity Level Changes Regulation to omit the 2020 COVID-impacted scheme year in the calculation of change in activity level in 2022, for those operators who can demonstrate to the Authority significant discrepancies between reductions in output and emissions caused by the COVID-19 pandemic. We outlined that this option may be considered by the Authority if robust evidence that could apply across all UK ETS sectors was provided by respondents. We also highlighted that this option may incur delays in the Activity Level Changes process in 2022.

### Questions

13) Should the current rules be maintained for the 2022 Activity Level Changes process? (Y/N) Please explain your answer.

14) What accurate, robust and verifiable data could you provide to the Authority to evidence that the discrepancy between reductions in output and emissions was caused specifically by the COVID-19 pandemic?

15) How should the determination of “significant discrepancies between reductions in output and emissions” be made? Which data should be used in making this determination?

16) Should specific thresholds be set between the reduction in output levels and reduction in emission levels for operators to be eligible to have the 2020 Covid year omitted from the 2022 Activity Level Changes calculation? (Y/N) Please explain your answer.

17) If the 2020 year is omitted, which years should be taken into account in the calculation of Activity Level Changes in 2022? Please explain your answer.

## Summary of responses

Of 39 respondents, 24 (62%) stated that the current rules should not be maintained for the 2022 Activity Level Changes process. Several respondents cited the exceptional nature of the Covid-19 pandemic and the significant impacts that it has had on production patterns and activity levels. Certain respondents stated that they experienced discrepancies between their reductions in emissions and reductions in activity levels due to the pandemic and their industrial process. Several respondents also highlighted that UK Government have taken into account the exceptional nature of the Covid-19 pandemic in other schemes, such as Climate Change Agreements (CCA) and Energy Intensive Industries (EII).

Of 39 respondents, 15 (38%) responded that the current rules should be maintained for the 2022 Activity Level Changes process. Several respondents stated that their operation was not significantly affected by Covid-19 and were not expecting Activity Level Changes to trigger. Certain respondents stated that effecting a change to 2022 Activity Level Changes at short notice would negatively impact market certainty for other market participants. Several respondents also highlighted that the current rules will work as intended, as Activity Level Changes function to ensure free allowances are reflective of an operator's activity, and that in the year of reduced activity the operator would have received a higher level of free allowances than they should have had it not been for this reduction.

Regarding data that could be provided to the Authority to evidence that the discrepancy between emissions and activity reductions was caused by the Covid-19 pandemic, many respondents suggested that verified activity and emissions data could be provided and compared to non-Covid impacted levels. Several respondents noted that it would be difficult in practice to prove the correlation and that this would need to be inferred. Regarding how the determination of "significant discrepancies between reductions in output and emissions" should be made, several responses were similar to the previous question, highlighting the differences between 2020 data and pre-Covid data. Some respondents also raised that "output" should be directly linked to a metric that is accurately reflective of the operator's activity. One respondent also noted that this would be specific to each operator and their respective activity.

Of 13 respondents, 6 (46%) agreed that specific thresholds should be set between the reduction in output levels and reduction in emission levels for operators to be eligible to have the 2020 Covid year omitted from the 2022 Activity Level Changes calculation. Several respondents raised that all operators who experienced a reduction in activity of over 15%, and therefore met the trigger for ALC, should be eligible to have the 2020 year omitted from the calculation of activity levels in 2022 ALC. One respondent highlighted that a threshold should be set to reduce the administrative burden on the UK ETS Authority, and limit delays to the 2022 ALC process.

Of 13 respondents, 7 (54%) disagreed that thresholds should be set. Several respondents raised that instead of a threshold, eligibility should be determined on a case-by-case basis.

Of 23 respondents, 9 (39%) responded that if the 2020 year is omitted, 2019 and 2021 should be taken into account in the calculation of ALC in 2022 as these would be a better

representation of regular activity levels. Other responses included using an average of 2018, 2019 and 2021, using only the 2021 year, using only the 2019 year, and using historical activity levels initially used to calculate free allocation. Some respondents also highlighted that their activity was also impacted by the Covid-19 pandemic in 2021 and requested that this year be also omitted from ALC calculations.

## UK ETS Authority response

Following consideration of the responses received, the Authority is proposing to amend the Activity Level Changes Regulation to omit the 2020 COVID year in the calculation of change in activity level in 2022, for those operators who can demonstrate to the Authority significant discrepancies between reductions in activity and emissions in the 2020 scheme year caused by the COVID-19 pandemic. In order to determine if there is a significant discrepancy, a threshold level of 15% between the reduction in activity and reduction in emissions in the 2020 scheme year will be applied.

Free allocations are given to industries to mitigate their risk of carbon leakage. The Activity Level Changes Regulation stipulates that if recent average activity levels (calculated from the previous 2 years activity levels) show an increase or decrease in activity of more than 15% from historic activity levels, the installation's free allocation of allowances is recalculated. For operators whose emissions reduced proportionally with activity levels, the ALC policy will be working exactly as intended: they will have received more free allocation in 2020 than they should have to cover their (reduced) emissions. ALC will therefore rectify this by reducing their free allocation of allowances in following scheme years. Several respondents were able to provide evidence of a reduction in activity levels without a correlating reduction in emissions as a result of the COVID-19 pandemic, leading to a substantial discrepancy between the reduction in emissions and activity. This would result in a reduction in their free allocations following the 2022 ALC process, increasing their exposure to the carbon price and in doing so potentially increasing their carbon leakage risk. This is not aligned with the policy intent of free allocations, mitigating the risk of carbon leakage and is not aligned with the policy intent of ALC to ensure that changes in free allocations are reflective of activity.

The Authority is only proposing to amend the Activity Level Changes Regulation to omit the 2020 COVID year in the calculation of change in activity level in 2022, for those operators who can demonstrate to the Authority significant discrepancies between reductions in activity and correlating emissions caused by the COVID-19 pandemic. Therefore, operators will be required to submit evidence of both their activity levels and correlating emissions to show that they meet the threshold level, and that the discrepancy between emissions and activity reductions was caused by the COVID-19 pandemic to their respective Regulator. Operators may be required to provide verified sub-installation emissions data as part of said evidence.

The Authority defines a threshold as the difference between the percentage reduction in activity and the percentage reduction in correlating emissions for the 2020 scheme year. Instances where this difference is significant expose areas where the Activity Level Change process may not be working as intended. The threshold approach has been chosen by the

Authority as it is sector-agnostic and allows for a methodological way of approaching changes to ALC.

The Authority proposes to define significant discrepancies by assessing a threshold level that would capture installations that experienced a high level of discrepancy, 15%, between the reduction in activity and reduction in correlating emissions. This level will capture installations who have seen the largest, and therefore most impactful, reduction in activity which has not aligned with their reduction in emission levels, and will not capture installations for whom the discrepancy is lower, and therefore where ALC policy should be working as intended.

The Authority is also conscious of the importance of limiting delays to ALC to provide operators with certainty on their free allowances. A focus on the most impacted installations with a 15% threshold will minimise the risk of delays to the processing of 2022 ALC.

Furthermore, the ALC process currently triggers where there is a difference of 15% in activity which is associated with a change in emissions. Whilst this value is not directly linked to discrepancies between emissions and activity, 15% is recognised and accepted as a reasonable measure of how much tolerance exists in current ALC legislation.

The Authority remains committed to having a sector-agnostic and methodological way of approaching changes to free allocations or ALC in order to give certainty to participants. We are proposing this change due to the unprecedented and in some instances large impacts of COVID-19 on activity levels, but not emissions, that were felt by some installations which led to the ALC process not working as intended.

We expect this proposal to capture a relatively small number of the most impacted stakeholders and therefore will minimise the risk of any delays to 2022 ALCs being processed by regulators. We will do this as soon as is practicably possible with the aim of completing this ahead of 2023 free allocation distribution by 28 February 2023.

If the 2020 year is omitted for eligible operators, having considered the responses we received, we will use 2019 and 2021 in the calculation of 2022 ALCs for operators eligible for relief. These are years which are reflective of recent activity and associated emissions closest to 2020, which is consistent with the policy intent of ALC to ensure that changes in free allocations are reflective of activity.

5 respondents to this section also requested that changes be made to 2021 ALC as they also used the 2020 year in the calculation of activity levels. The Authority recognises that 2021 ALCs have already been calculated, but notes that the issue has been raised and will respond in the wider government response to the consultation.

## Operational amendments included in “Developing the UK ETS” Chapter 9

Chapter 9 of “Developing the UK ETS” sets proposed operational amendments to the UK ETS, to address a number of operational and technical issues identified during the development of

policy and legislation for the scheme. We will legislate for the Chapter 9 amendments set out below ahead of the 2023 scheme year to support the ongoing operational effectiveness of the UK ETS. The remaining amendments included in Chapter 9 will be considered in due course.

## Primary energy savings

### Summary of proposal

We proposed an amendment to UK ETS legislation regarding new entrants to the UK ETS that are classified as electricity generators, who wish to apply for a free allocation of allowances on the basis that they produce measurable heat by means of co-efficiency generation. We proposed that these operators may not apply for a free allocation of allowances from the new entrant reserve until they are able to provide a full calendar year of activity level data. Currently, it is possible for the determination of a new entrant's primary energy savings to be made over a very limited timeframe, creating a risk that this data would not be an accurate representation of the operator's activity.

#### Question

176) Do you agree that in the case of new entrants that are classified as electricity generators and who wish to apply for a free allocation of allowances on the basis that they produce measurable heat by means of high-efficiency co-generation, they may not apply for a free allocation until the operator can provide a full calendar year of activity level data? (Y/N) Please explain your answer.

### Summary of responses

Out of 11 respondents, 6 (55%) agreed with the proposal. One respondent noted that this proposal would avoid a potential over-allocation of allowances, and several noted that the proposal would be fair in its implementation.

5 respondents (45%) disagreed with the proposal, with several noting that the delay in receiving free allowances would increase costs in the initial year of inclusion in the scheme.

### UK ETS Authority response

The UK ETS Authority will implement the proposed changes to UK ETS legislation. New entrants that are classified as electricity generators, who wish to apply for a free allocation of allowances on the basis that they produce measurable heat by means of co-efficiency generation, will only be able to do so once they can provide a full calendar year of activity level data. This will ensure that the determination of a new entrant's primary energy savings will be representative of the operator's activity.

## Flexible share

### Summary of proposal

We proposed amending the UK ETS legislation to allow the Authority to create the total number of allowances from the flexible share in a scheme year, in addition to the annual cap. The flexible share is a portion of up to 3% of the cap, amounting to 40,984,970 allowances over the 2021-2030 phase, that is held in reserve and can be drawn from by the cost containment mechanism or used to mitigate the application of a cross-sectoral correction factor, should it be applied in a scheme year. Currently, it is not possible for the Authority to create the total amount of allowances from the flexible share in a scheme year, as this would surpass the cap on the amount of allowances that can be created each scheme year, as set out in article 20 of the Greenhouse Gas Emissions Trading Scheme Order 2020. This could prevent the flexible share from fulfilling its intent to mitigate the triggering of a cross-sectoral correction factor, should it be applied in a scheme year.

#### Question

177) Do you agree that the Authority should have the ability to create the total number of allowances from the flexible share in a scheme year in addition to the annual cap? (Y/N)  
Please explain your answer.

### Summary of responses

Out of 21 respondents, 20 (95%) agreed with the proposal. These respondents agreed that the Authority should be able to create the total number allowances from the flexible share in a scheme year in addition to the annual cap to ensure the smooth running of the scheme.

One respondent disagreed with the proposal stating that the annual cap should not be exceeded, even to mitigate the application of a cross-sectoral correction factor.

### UK ETS Authority response

The UK ETS Authority will implement the proposed changes to UK ETS legislation to allow the Authority to create the total number of allowances from the flexible share in a scheme year, in addition to the additional cap. This will avoid a scenario where the flexible share could be prevented from fulfilling its intent to mitigate the triggering of a cross-sectoral correction factor.

## Permitting, monitoring, reporting & verification (PMRV)

### Definition of a verifier

#### Summary of proposal

We proposed deleting the redundant phrase 'or another legal entity' from the definition below.

*‘Verifier’ means a legal person or another legal entity carrying out verification activities pursuant to this Regulation and accredited by the national accreditation body pursuant to Regulation (EC) No 765/2008 and this Regulation at the time a verification report is issued;*

*(3a) ‘national accreditation body’ means the national accreditation body of the United Kingdom appointed in accordance with Article 4(1) of Regulation (EC) 765/2008(a);*

This recognises the position set out in our 2020 response to the ‘Future of UK Carbon Pricing’ consultation, that we would continue to apply the EU ETS legislation on MRV, except in specific areas where we made changes.

### **Question**

179) Do you have any comments on the way that a verifier is defined in the legislation, and in particular do you agree that the phrase ‘or another legal entity’ should be deleted?

## **Summary of responses**

Out of 10 respondents, 4 (40%) agreed with this proposal. These respondents agreed that the term in the legislation is redundant and should be removed from the legislation.

6 respondents disagreed with the proposal. Respondents who disagreed with the proposals cited a desire to maintain consistency with EU legislation.

## **UK ETS Authority response**

The same amendment has been made to the EU ETS legislation, meaning that consistency will be maintained if the change is made. Given that this was the only concern cited, the UK ETS Authority has taken the decision to delete the redundant phrase ‘or another legal entity’ from the definition of a verifier.

## **Permit transfers, mergers and splits**

### **Treatment of full transfer and merger<sup>10</sup>**

#### **Summary of proposal**

Currently, where there is a full transfer of a permit to an operator with an installation on the same site, the legislation sets out how the free allocation of allowances for the years after the permit transfer occurs are merged and, if necessary, adjusted in line with the activity level change process. The legislation does not clearly set out whether and if so, how, the free

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<sup>10</sup> As defined in Article 2(17) of the Free Allocation Regulation; ‘merger’ means a fusion of two or more installations already holding greenhouse gas permits provided that they are technically connected, operate on the same site and the resulting installation is covered by one greenhouse gas permit.

allocation of allowances should be merged, issued and adjusted in the year in which the permit transfer occurs.

We proposed to treat allocations differently based on the date of the permit transfer.

1) If the effective date of the permit transfer is before the activity level reporting deadline in a scheme year (i.e. between 1 January and 30 March), the free allocation of allowances for that scheme year (and subsequent years) will be merged. To deliver this, the allocations (for both installations affected by the merger) for the scheme year in which the transfer took effect will be withheld until the allocations have been merged and adjusted in line with the activity level change process.

2) If the effective date of the permit transfer is on or after the activity level reporting deadline in a scheme year (i.e. between 31 March and 31 December), the free allocation of allowances for the year in which the transfer occurs would have been issued to the transferring operator and an activity level report should have been submitted by each operator relating to the separate installations. The allocation for each installation in the year in which the transfer occurs should be adjusted separately in line with the activity level change process.

### Questions

179) Do you agree that in the case of a full transfer of a permit (with a merger), that allocations for the scheme year in which the transfer occurs should be treated differently based on the effective date of the transfer? (Y/N) Please explain your answer.

180) Do you agree with our proposed approach? (Y/N) Please explain your answer.

181) Is there an alternative approach that has not been considered?

### Summary of responses

Of 16 respondents to question 179, 12 (75%) agreed that in the case of a full transfer of permit, that allocations for the scheme year in which the transfer occurs should be treated differently based on the effective date of the transfer. 4 (25%) respondents disagreed.

Of 16 respondents to question 180, 10 (63%) agreed with the proposed approach. Several respondents highlighted that this was a helpful clarification of how the process works. One respondent agreed with the approach for transfers occurring 1 April - 31 December, but raised that for transfers occurring 1 January – 31 March that the original operator should be responsible for submitting the activity level report to avoid administrative burden for the new operator.

6 (37.5%) respondents disagreed with the proposed approach. One respondent raised that the withholding of allowances for future scheme years could have financial implications for the sites. However, the consultation proposal suggested that the allocations only for the scheme year in which the transfer took effect would be withheld until allocations have been merged and adjusted through the activity level change process, which will occur over the course of the

year. One respondent noted that treating allocations differently would introduce additional complexity to this process.

Regarding alternative approaches, one respondent suggested that for consistency, all transfers should use the approach presented for permit transfers between 31 March – 31 December. Another respondent suggested that for transfers between 1 January – 30 March, the original operator should submit the activity level report on behalf of the new operator.

## UK ETS Authority response

The UK ETS Authority will implement the proposed changes to UK ETS legislation. Where there is a full transfer of a permit to an operator with an installation on the same site, allocations will be treated differently based on the date of the permit transfer.

1) If the effective date of the permit transfer is before the activity level reporting deadline in a scheme year (i.e. between 1 January and 30 March), the free allocation of allowances for that scheme year (and subsequent years) will be merged. The allocations (for both installations affected by the merger) for the scheme year in which the transfer took effect will be withheld until the allocations have been merged and adjusted in line with the activity level change process. The merged allocation will be determined and adjusted as if the merger had occurred at the start of that scheme year. The new operator must submit an activity level report for the scheme year two years before the scheme year in which the effective date of the transfer falls. For example, if the effective date of the transfer is 1 March 2022, the operator must submit a report of its activity levels in 2020 as if the merger had taken place at the start of 2020. This will ensure that the merged allocation may be adjusted in line with the activity level change process.

2) If the effective date of the permit transfer is on or after the activity level reporting deadline in a scheme year (i.e. between 31 March and 31 December), the free allocation of allowances for the year in which the transfer occurs would have been issued to the transferring operator and an activity level report should have been submitted by each operator relating to the separate installations. The allocation for each installation in the year in which the transfer occurs should be adjusted separately in line with the activity level change process. If there has been an over-allocation to the transferred installation, the transferring operator should return those allowances from the operator holding account (OHA) of the transferred installation. The instruction from the Regulator to the Registry Administrator to close the OHA relating to the transferred installation will be delayed until the allocation has been adjusted and the transferring operator has returned any over-allocation. The allocation for the years after the effective date of the transfer will be merged.

## Treatment of partial transfer and split of allocation<sup>11</sup>

### Summary of proposal

Currently, where there is a partial transfer, the legislation sets out how the free allocation of allowances for the years after the partial transfer occurs are split and, if necessary, adjusted in line with the activity level change process. The legislation does not clearly set out whether and if so, how, the free allocation of allowances should be split, issued and adjusted in the year in which the partial transfer occurs.

We proposed to treat allocations differently based on the date of the partial transfer.

1) If the effective date of the partial transfer is before the activity level reporting deadline in a scheme year (i.e. between 1 January and 30 March), the free allocation of allowances for that scheme year (and subsequent years) will be split. To deliver this, the allocation to the original installation for the scheme year in which the transfer took effect will be withheld until the allocation has been split and adjusted in line with the activity level change process.

2) If the effective date of the transfer is on or after the activity level reporting deadline in a scheme year (i.e. between 31 March and 31 December), the free allocation of allowances for the year in which the partial transfer occurs would have been issued to the OHA relating to the original installation and an activity level report should have been submitted for that installation. The transferring operator will be responsible for returning any over-allocation relating to the year in which the partial transfer occurs.

#### Questions

182) Do you agree that in the case of a partial transfer of a permit, that allocations for the scheme year in which the partial transfer occurs should be treated differently based on the effective date of the partial transfer? (Y/N) Please explain your answer.

183) Do you agree with our proposed approach? (Y/N) Please explain your answer.

184) Is there an alternative approach that has not been considered?

### Summary of responses

Of 11 respondents to question 182, 6 (55%) agreed that in the case of a partial transfer of permit, that allocations for the scheme year in which the partial transfer occurs should be treated differently based on the effective date of the partial transfer. 5 (45%) respondents disagreed.

Of 13 respondents to question 183, 6 (46%) agreed with the proposed approach. Several respondents noted that this would be a reasonable approach for addressing these situations.

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<sup>11</sup> As defined in Article 2(18) of the Free Allocation Regulation; 'split' means a division of an installation into two or more installations that are covered by separate greenhouse gas permits and are run by different operators.

7 (54%) disagreed with the proposed approach. One respondent highlighted that withholding free allowances could have financial implications for the operator. One respondent noted that treating allocations differently would introduce additional complexity to this process.

Regarding alternative approaches, one respondent suggested that for consistency, all partial transfers should use the approach presented for partial transfers between 31 March – 31 December. Another respondent suggested that for partial transfers between 1 January – 30 March, the original operator should submit the activity level report on behalf of the new operator.

## UK ETS Authority response

The UK ETS Authority will implement the proposed changes to UK ETS legislation. Where there is a partial transfer of a permit, allocations will be treated differently based on the date of the partial transfer.

1) If the effective date of the partial transfer is before the activity level reporting deadline in a scheme year (i.e. between 1 January and 30 March), the free allocation of allowances for that scheme year (and subsequent years) will be split. The allocation to the original installation for the scheme year in which the transfer took effect will be withheld until the allocation has been split and adjusted in line with the activity level change process. The split allocation will be determined and adjusted as if the split had occurred at the start of that scheme year. The two operators must submit an activity level report for the scheme year two years before the effective date of the transfer. For example, if the effective date of the partial transfer is 1 March 2022, both operators must submit a report of their activity levels in 2020 as if the split had taken place at the start of 2020. This will ensure that the split allocations may be adjusted in line with the activity level change process.

2) If the effective date of the transfer is on or after the activity level reporting deadline in a scheme year (i.e. between 31 March and 31 December), the free allocation of allowances for the year in which the partial transfer occurs would have been issued to the OHA relating to the original installation and an activity level report should have been submitted for that installation. The transferring operator will be responsible for returning any over-allocation relating to the year in which the partial transfer occurs. The allocation for the years after the effective date of the transfer will be split.

## Global warming potentials

### Summary of proposal

In Chapter 9, we proposed amending UK ETS legislation to apply updated GWP values set out in the IPCC's Fifth Assessment Report (AR5), as agreed at COP24 and COP 26.

#### Question

Q185) Do you agree with the proposal that we should apply the AR5 without-feedback values for the purposes of the UK ETS?

## Summary of responses

Out of 12 respondents, 11 (91.7%) agreed with this proposal. Of those in agreement, several respondents cited the need for the UK ETS to use the most relevant standards for emissions reporting in order to maintain consistency across global emissions reporting. There were some concerns about whether the without feedback values reflected the true impact of greenhouse gas emissions.

The single respondent who disagreed with the proposal requested a further consultation on the impacts that the GWP values would have on the carbon price index.

## UK ETS Authority response

As proposed, we will apply the AR5 without feedback values, as agreed at COP26, for the purposes of the UK ETS.

## Updates required to EN ISO 14065

### Summary of proposal

In Chapter 9, we proposed amending the UK ETS legislation to reflect the updated version of ISO 14065 (EN ISO 14065:2020) which lays out General principles and requirements for bodies validating and verifying environmental information. This is to maintain the consistency of UK with international standards. The legislation currently references ISO 14065:2013.

### Question

186) Do you agree that we should amend the Order to reflect EN ISO 14065:2020?

## Summary of responses

Out of 12 respondents, 10 (83.3%) agreed with this proposal. One respondent stated that applying this standard would ensure uniformity across the system.

The two respondents who disagreed with the proposal did not provide a reason.

## UK ETS Authority response

We will amend the UK ETS legislation to reflect the updated version of ISO 14065 (EN ISO 14065:2020), to maintain the consistency of UK with international standards. The International Accreditation Forum has set the deadline to transition all Verification Bodies as 30 June 2024, so we will set the deadline accordingly.

## HSE re-entry to the scheme

### Summary of proposal

We proposed to offer a one-off window between January and March 2023 for participants in the Hospital and Small Emitters (HSE) scheme in the first allocation period to re-enter the main UK ETS scheme from 2024 onwards. This recognises that operators made the decision to be HSEs when expecting a different set of rules than those currently in use (EU ETS Phase IV rules rather than those of the UK ETS). We also proposed that operators re-entering the scheme voluntarily would be eligible to apply for free allocation provided they made an application that was assessed as valid for free allocation under Phase IV of the EU ETS. This procedure would be the same as the one outlined in Schedule 8A to The Greenhouse Gas Emissions Trading Scheme Order 2020.

#### Questions

188) Do you agree that current Hospital or Small Emitters should be offered a window for re-entry into the main UK ETS?

189) Do you agree that they should be eligible to apply for Free Allocation on the condition that they had made an application for Free Allocation under Phase IV of the EU ETS?

### Summary of responses

Out of 18 respondents to Question 188, all agreed with the proposal to offer a window for re-entry into the main UK ETS from the HSE scheme.

Seven respondents suggested that there should also be the opportunity for operators that have reduced their emissions to below 25,000 or 2,500 tCO<sub>2</sub> per annum, to join the HSE or Ultra Small Emitters (USE) schemes, respectively.

One respondent highlighted the fact that new installations which meet the HSE criteria should be allowed to enter the HSE scheme immediately, rather than join the main UK ETS scheme first.

We received 15 responses to Question 189. 13 responses agreed with the proposal, with one respondent stating that the option to apply for Free Allocation should also be available to those who only submitted a partial NIMs return.

### UK ETS Authority response

We will legislate this year to introduce a one-off window between January and March 2023 for HSEs in the first allocation period to re-enter the main UK ETS scheme from 2024 onwards. Operators re-entering the scheme voluntarily will be eligible to apply for free allocation provided they made an application that was assessed as valid for free allocation under Phase

IV of the EU ETS. This procedure will be the same as the one outlined in Schedule 8A to the Order.

We acknowledge respondents' suggestions to give operators that have reduced their emissions to below 25,000 or 2,500 tCO<sub>2</sub> per annum the opportunity to join the HSE or USE schemes. We recognise that many parties feel this would be an improvement and we will therefore consider this proposal and may consult on it in future. We also note that the suggestion to allow new installations that are below 25,000 or 2,500 tCO<sub>2</sub> per annum, to join the HSE or USE schemes, respectively. This is also an option that we will consider and may consult on in due course.

## Further operational amendments to be included in planned legislation

In addition to the policy positions outlined in this response, we are intending to include several further amendments in planned legislation to take effect ahead of the 2023 scheme year. These amendments were not included in "Developing the UK ETS" consultation either because they will have very limited impact on operators, are correcting previous errors in legislation or are primarily administrative in nature.

These planned amendments are outlined in the table below for information:

<b>Amendment</b>	<b>Summary</b>	<b>Nature of amendment</b>
<b>Descriptions of an installation in Monitoring Methodology Plan (MMP) and monitoring plan</b>	Amend legislation to remove requirement to have description of installation in MMP and monitoring plan to avoid duplication. Description of installation is already required for permit.	Minor administrative change to avoid duplication.
<b>Removal of Article 39(3) of the Monitoring and Reporting Regulation (MRR)</b>	Remove provision from legislation because guarantees of origin referred to in the provision relate to electricity production, which is not relevant to the monitoring and reporting of annual emissions; (a) electricity generation in relation to monitoring and reporting of allocation data for allowances is covered by the free allocation regulation and (b) the UK does not have a guarantee of origin scheme for biogas injected into the national gas grid. The green gas support scheme is not a guarantee of origin.	Legislative amendment with no impact on operators

<b>Amendment</b>	<b>Summary</b>	<b>Nature of amendment</b>
<b>Notification of non-adjustment of free allocation</b>	Amend legislation so regulator is required to notify Authority where a decision is made not to adjust free allocation. Under Article 6 of the Activity Level Changes Regulation, the regulator may decide not to adjust an allocation where the activity level change has occurred purely because of a change in energy efficiency. As they are making a decision to do nothing, there are currently no requirements for (a) the regulator to notify the UK ETS Authority under Article 6a, (b) the UK ETS authority to approve the decision (or instead require that the allocation should be adjusted) and (c) for the regulator to notify the operator of the final decision.	Legislative amendment with minimal impact on operators. Regulators have been consulted on proposed change.
<b>Adjust UK ETS treatment of tallow default GHG emissions saving</b>	Amends legislation so that operators using Category 1 and 2 tallow for the purpose of onsite generation of heat energy are permitted to use the default greenhouse gas savings criteria set out in the Renewable Energy Directive (RED) 2009.	Minor administrative change that is already how the scheme works in practice and is what is set out in scheme guidance
<b>Activity level reports and cessation</b>	<p>Make amendments to paragraphs 11 and 12 of Schedule 6 to the Order to make it clear that, when an operator surrenders its permit, or its permit is revoked:</p> <ul style="list-style-type: none"> <li>• The permit continues to require operators to submit an activity level report relating to activity levels in the year before the cessation, even if the deadline for submission of this report is after the ‘end date’</li> <li>• the permit does not require operators to submit an activity level report relating to activity levels in the year of the cessation.</li> </ul>	Clarificatory amendment
<b>Deletion of bioliquids permit condition</b>	Delete paragraph 4(2)(c) of Schedule 6, which currently requires that a greenhouse gas emissions permit must contain ‘a condition requiring the operator to satisfy the regulator, if an emissions factor of zero is reported in respect of	Minor administrative change

<b>Amendment</b>	<b>Summary</b>	<b>Nature of amendment</b>
	<p>the use of bioliquids, that the sustainability criteria...have been fulfilled.'</p> <p>A specific permit condition is not needed in relation to bioliquids as the position is now clear in the Monitoring and Reporting Regulation. Operators must include details of bioliquids and the sustainability criteria in their annual emissions report in order to report an emissions factor of zero. Verifiers will assess whether the sustainability criteria are met, alongside their verification of the other information in the report. If the criteria are not met, an emissions factor of zero may not be used.</p> <p>This means that the bioliquids assessment will be dealt with in the same way as other aspects of an annual emissions report and there does not need to be a separate permit condition covering it.</p>	
<b>Scrubbing (urea)</b>	Amend the Monitoring and Reporting Regulation, to reflect correct values for net calorific value, conversion factor and oxidation factor for scrubbing (urea).	Error correction.
<b>Correction to Schedule 8a</b>	Correct incorrect cross-reference to provision of the Free Allocation Regulation.	Error correction.

## Next Steps

We will proceed with passing legislation to bring the positions outlined in this document into effect from January 2023. We expect that this legislation will come into force by December 2022.

We will publish a full Government Response to the March consultation on developing the UK ETS in due course, before legislating for further changes, including amending the UK ETS cap, ahead of the 2024 scheme year.

# Analytical Annex

## Introduction

This annex summarises the analysis carried out to assess the impacts of the decisions set out in the early Government Response to the “Developing the UK ETS” consultation. Two sections are covered Section 1: the inclusion of UK to Switzerland flights into the scope of the scheme, and Section 4, the amendments to the Activity Level Changes Regulation due to the impact of COVID in 2020.

The other sections of this early Government Response are not covered in this annex, as they are technical amendments with no substantial direct impacts to be assessed.

## UK to Switzerland flights

### Key impacts

As set out in the Government Response, flights between the UK and Switzerland are not covered in either the UK ETS or Swiss ETS, creating a gap in ETS coverage that was previously covered by the EU-Swiss linking agreement and the UK's participation in the EU ETS. Including flights from the UK to Switzerland in the UK ETS will cover this gap.

The key impacts from this are:

- **Cost impacts:** several previously uncovered flights will now face obligations to surrender UK allowances (UKAs).
- **Decarbonisation impact:** this increased cost will introduce incentives to decarbonise these flights.
- **Impacts on the carbon price:** expanding the scope of the scheme could have an impact on the price of UKAs. However, we expect this impact to be minimal due to the relatively small number of additional emissions considered.

The next section summarises the analysis carried out to assess these impacts.

### Analysis

As mentioned above, any impacts of the inclusion of UK to Switzerland flights in the UK ETS on the UK ETS carbon price would be too small to be accurately measured by our analysis. Therefore, our assessment focused on estimating costs and decarbonisation impacts.

The additional costs to the aviation industry of including UK to Switzerland flights in the scope of the scheme would depend on three main factors: emissions, corresponding to UK to Switzerland flights, the price of UKAs and the number of free allowances which would be issued for these flights. Additional administrative costs are unlikely to be significant, given that the vast majority of aircraft operators will already have Monitoring Reporting and Verification (MRV) systems in place to comply with their UK ETS obligations for other routes.

The price of UKAs is inherently uncertain and will depend on a large number of factors, including the chosen trajectory of the UK ETS cap. This analysis does not attempt to project how the carbon price could change over time in the future. Internal BEIS and Department for Transport (DfT) analysis suggests that additional carbon costs could represent roughly a 10-15% increase in the variable costs of operating UK to Switzerland flights using a price range consistent with the first half of 2022. Assuming full cost pass-through to ticket prices – which should be seen as an upper-end estimate of cost pass-through – this could lead to a similar increase in ticket prices. DfT modelling suggests that the price elasticity of demand for flights from the UK to the “rest of Europe” region is of around -0.9, suggesting up to a 9-14%

decrease in demand for these flights on average, provided some of these flights cannot be decarbonised at a significantly lower cost than the carbon price.<sup>12</sup>

In 2023, aircraft operators will receive a proportion of free allowances for the UK to Switzerland flights they operate, following the same methodology used for all other flights in scope of the scheme. The future trajectory of aviation free allocation, including free allowances for UK to Switzerland flights, will be determined in the full government response to the “Developing the UK ETS” consultation, with changes expected to take effect from 2024. Nonetheless, independent research on carbon leakage in the UK aviation sector found that the amount of free allocation does not impact the proportion of the value of the allowances which is likely to be passed onto ticket prices.<sup>13</sup> Thus, while the amount of free allocation matters in determining the costs to industry, the final impact on ticket prices and on demand will be roughly the same irrespective of it.

The above analysis suggests that emissions from UK to Switzerland flights would likely fall by a similar amount to demand, thus potentially in the range of 9-14%. In the short term this is anticipated to arise from capacity reduction associated with a fall in demand, however over time, adoption of cost-effective abatement technologies is expected to mitigate the increase in variable costs for operating UK to Switzerland flights.

The true decarbonisation impact of expanding the scope of the UK ETS to these flights, however, depends on the UK ETS cap rather than actual emissions from these flights. For the period 2024-2030 the UK ETS cap will be amended to align it with a Net Zero trajectory. This trajectory will account for flights from the UK to Switzerland: we would therefore expect additional emissions in the traded sector equal to the volume of additional allowances to account for them, over the scheme’s lifetime. However, due to the relatively small quantity of emissions concerned it is not possible to map a specific proportion of the Net Zero-consistent cap to such flights. We therefore do not attempt to separate out an estimate of decarbonisation impacts for these flights alone: this impact should be assessed as part of the overall impacts of a Net Zero-consistent cap on aviation emissions.

However, for 2023 only, we will not adjust the cap, hence there would be no net increase in traded sector emissions associated with 2023 UK to Switzerland flights, as any emissions would have to be covered by the existing pool of emissions allowances.<sup>14</sup> Nonetheless, these emissions will be removed from the non-traded sector, leading to a net reduction in UK emissions.

The emission savings in that year would therefore total around 0.28 Mt CO<sub>2</sub>, if we assumed that 2023 emissions from these flights were the same as they were in 2019.<sup>15</sup> Following BEIS

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<sup>12</sup> The full modelling framework can be found here:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/1061972/jet-zero-modelling-framework.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1061972/jet-zero-modelling-framework.pdf). The price elasticity of demand represents the percentage change in demand following a 1% increase in price; for example, if the price elasticity of demand is -1, a 1% increase in the price of a good would result in a 1% fall in demand for that good.

<sup>13</sup> <https://www.gov.uk/government/publications/impacts-of-carbon-pricing-on-the-uk-aviation-sector>

<sup>14</sup> This is assuming that all allowances in the currently legislated cap would eventually be released into the market and used for compliance.

<sup>15</sup> In 2019, this corresponded to under 3% of aviation emissions in scope of the scheme.

guidance on valuing GHG emission changes, these would have a value to society in a range of £35m-£105m, with a central estimate of £70m.<sup>16</sup> Assuming a 12% reduction in emissions as a result of carbon pricing in that year (roughly in the middle of the range estimated above), the additional number of allowances that aircraft operators would need to surrender in that year would total around 240,000. If these were monetised using the range of UKA prices observed in the first half of 2022, this would amount to an additional cost of about £18m-£21m in the 2023 compliance year.

Finally, as stated in the Government Response, while flights from Great Britain to Switzerland will be included into the scope of the scheme from the 1st of January 2021, flights from Northern Ireland to Switzerland will only be included after the Northern Ireland Assembly is able to progress legislation. The impact of this partial delay in implementing the expansion of the scheme to cover UK to Switzerland flights is expected to be small, as flights from Northern Ireland to Switzerland accounted for less than 1% of the emissions from UK to Switzerland flights in 2019, i.e. about 0.01 Mt CO<sub>2</sub> out of 0.28 Mt CO<sub>2</sub>.

### Outstanding risks and limitations

The above analysis is proportionate given the small amount of emissions being added to the scheme and the fact that this decision effectively fills a gap in ETS coverage. It does not attempt to isolate the decarbonisation impacts of the sub-section of flights impacted by the decision beyond 2023, nor to assess the impact that the decision will have on the UK ETS carbon price. Both such impacts are unlikely to be significant in isolation, however, for the reasons outlined above.

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<sup>16</sup> <https://www.gov.uk/government/publications/valuing-greenhouse-gas-emissions-in-policy-appraisal/valuation-of-greenhouse-gas-emissions-for-policy-appraisal-and-evaluation>

## Analysis Annex - Amendments to the Activity Level Changes Regulation due to the 2020 COVID year

### Analytical Approach

The **analysis discussed in this annex is not the final assessment of eligibility or amendments to installation allocations**; these are expected to be carried out as part of the 2022 ALC process. Operators will be required to submit evidence that they meet the threshold level and that the discrepancy between emissions and activity reductions was caused by the pandemic to their respective Regulator.

Analysis was undertaken to 1) Support the decision on whether to intervene, 2) develop additional detail to inform decisions on the design, methodology and data used in the policy intervention (e.g., the threshold), 3) provide evidence on the potential direct impacts on 2022 activity level changes, under potential specifications of the policy, given available information.

Analysis used initial data submitted to regulators for the 2022 ALC process, and existing data from initial free allowance issuance and subsequent ALCs to estimate the 2022 ALC changes, at sub-installation level. It then estimated the policy effect by estimating (terminology defined below): the **discrepancy** between emissions and output, and comparing this with various **threshold options** to determined **eligibility**. Eligible sub-installations were **recalculated** using the proposed revised methodology.

Terminology	Method (this analysis only <sup>17</sup> )
Discrepancy (estimate)	The percentage point difference between the percentage change in emissions, and the percentage change in activity level (2019-2020) <sup>18</sup> .
Threshold (options)	Value against which discrepancy is compared. Values tested included (not limited to) 0%,5%,10%,15% and 20%.
Eligibility (estimate)	Eligibility: sub-installation estimated to have reductions through 2022 ALCs and any discrepancy is greater than the threshold.
Recalculation (estimate)	2022 ALCs are recalculated (including whether ALC applies) using a revised AAL based on 2019 & 2021 activity data, instead of 2020 & 2021.

<sup>17</sup> This method was used for the initial analysis; the final methodology is subject to review.

<sup>18</sup> For example, if between 2019 and 2020, emissions fell by (-25%), and activity by (-31%), the discrepancy would be assessed as 6%. This would need to exceed the "threshold".

## Summary of key impacts

The analysis indicated that the majority of sub-installations showed little or no evidence of substantive discrepancies between emissions and activity. This is consistent with expected normal scheme operation, where reductions in output are associated with a corresponding reduction in inputs & activity, and hence emissions. Therefore, the intervention is expected to impact a relatively small minority of sub-installations, across most of the range of thresholds. These sites represent a small proportion of the total ALC reductions (in terms of FA volumes). However, while aggregate impacts were moderate, it did provide evidence that there were some firms with substantive discrepancies, supporting the rationale for intervention set out in the early government response text.

Analysis indicated that on aggregate, for the estimated eligible sites, a large portion of the 2022 ALC reductions would still occur after recalculation, indicating the ALC mechanism was still broadly functioning as intended. Hence, many sites benefitting would likely still experience some reduction in FAs due to ALCs, but these reductions would be smaller in magnitude. Again, despite the aggregate impacts being relatively small, the impact of the change was estimated to be material for the sites benefitting, further supporting the rationale for intervention. Impacts were spread across a range of sectors, however the largest individual sites with potential evidence of discrepancies were in the refining and oil & gas sectors.

Given the changes would not apply to future years, and given the small estimated number of firms impacted, and relatively low estimated volume of additional allowances issued<sup>19</sup> (compared to total supply), we do not expect there to be any significant impact on the carbon price, emissions or carbon leakage risk. The primary impact will be a moderate social transfer from government to eligible firms in the form of the additional free allowances.

The analysis informed the decision on the threshold primarily by estimating the number & distribution of sites impacted at varying thresholds, and the magnitude of the change in FA issuance. This evidence was used alongside evidence from the consultation responses and consideration of existing FA and ALC rules to inform the threshold decision.

## Outstanding risks and limitations

The analysis discussed in this annex is not the final assessment of eligibility or amendments to installation allocations.

- This is primarily because the data used were preliminary. We used the available initial 2022 ALC data and judged it to be sufficient in coverage and quality for the initial analysis to inform policy decisions, however at the time of the analysis Regulators had not yet completed their assurance processes or finalised the data.

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<sup>19</sup> Here “additional allowances issued” generally means a *smaller magnitude reduction* from ALCs, rather than a gross increase in allowances issued.

- Additionally, elements of the methodology for assessing eligibility, such as the treatment of missing or erroneous data, were made proportionately to allow for initial analysis but will require more detailed consideration for the final assessment.
- Lastly, we have not yet collected (and hence considered) the evidence from sites that activity reductions were caused by the pandemic. Consequently, our analysis was based on estimates of historical activity level changes in comparison with emissions level changes where we assumed that they are all caused by the pandemic.

However, the analysis was sufficient to support decisions on whether and how to intervene, and how to approach the methodology of the intervention.

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