



# UK Emissions Trading Scheme Provisional Common Framework

Presented to Parliament  
by the Secretary of State for the Department  
for Energy Security and Net Zero  
by Command of His Majesty

February 2023

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# Contents

Introduction	4
Scope	6
Principles for working together	9
The Joint Governance Process	14
Note on UK ETS Policy under the Finance Act	21
Interaction with other bodies	22
Dispute Avoidance	24
Dispute Resolution	26
Review and Amendment Mechanism	27
Monitoring	29
Framework Outline Agreement: The UK Emissions Trading Scheme	30
Explanatory note to accompany FOA publication:	30
SECTION1: CONTEXT	32
Policy Area	32
Scope	33
Definitions	51
SECTION 2: PROPOSED BREAKDOWN OF POLICY AREA AND FRAMEWORK	52
Summary of proposed approach	52
Detailed overview of proposed framework: legislation (primary or secondary)	59

Detailed overview of proposed framework: non-legislative arrangement	62
Detailed overview of areas where no further action is thought to be needed	64
OPERATIONAL DETAIL	67
SECTION 3: PROPOSED OPERATIONAL ELEMENTS OF FRAMEWORK	67
Decision making	67
Decision-making process	75
Roles and responsibilities of each party to the framework	98
Roles and responsibilities of existing or new bodies	98
Monitoring and enforcement	99
Review and amendment	100
Dispute resolution	100
SECTION 4: PRACTICAL NEXT STEPS AND RELATED ISSUES	106
Implementation	106
Annex A – Legislation Relevant to UK ETS	108
Annex B – Outline of technical scope of EU Emissions Trading System	110
Annex C – Primary Legislation: Legal Commentary	114
Climate Change Act (2008)	114

General	114
Schedule 2, Part 1 – Schemes Limiting Activities	115
Schedule 2, Part 3 – Administration and Enforcement	120
Finance Act 2020	124

# Introduction

1. This Concordat establishes a Common Framework in which decisions relating to the UK Emission Trading Scheme (UK ETS) can be made, and has been agreed jointly by the relevant Ministers from the UK Government, Scottish Government, Welsh Government and Northern Ireland Executive, who collectively constitute the UK ETS Authority (“the Authority”) under the Greenhouse Gas Emissions Trading Scheme Order 2020:
  - The Department for Energy Security and Net Zero (DESNZ),
  - The Department for Transport (DfT),
  - His Majesty’s Treasury (HMT),<sup>1</sup>
  - The Scottish Government (SG),
  - Department of Agriculture, Environment and Rural Affairs, Northern Ireland (DAERA), and
  - The Welsh Government (WG)
2. The approach to the UK ETS Common Framework agreed by the Authority, including agreement to establish this Concordat, is documented in the UK ETS Framework Outline Agreement (FOA).

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1 Within this Concordat, DESNZ, DfT and HMT shall collectively be referred to as the UK Government.

3. The Common Framework establishes how the four governments will work together as the Authority to exercise decision-making powers and responsibilities relating to the implementation and ongoing maintenance of the UK ETS.
4. Whilst this Concordat describes an agreement made at Ministerial level, the UK ETS scheme will be managed on a day-to-day basis by officials representing the four governments. Together these officials shall constitute “the Resource Pool” which will be accountable to the Authority and only able to act in virtue of the Authority. A contact list of officials, and further detail on the roles, responsibilities, and operational procedures of the Resource Pool shall be maintained within the UK Emissions Trading Scheme Authority Terms of Reference and Operating Procedures.
5. This Framework operates in accordance with the principles outlined in the overarching Memorandum of Understanding on Devolution<sup>2</sup> and is consistent with, and complemented by, other guidance on common working arrangements, notably the Common Frameworks principles described in the

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2 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/316157/MoU\\_between\\_the\\_UK\\_and\\_the\\_Devolved\\_Administrations.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/316157/MoU_between_the_UK_and_the_Devolved_Administrations.pdf)

Joint Ministerial Committee (EU Negotiations)'s communique of 16 October 2017<sup>3</sup>.

6. The Intergovernmental Relations Review was published on 13 January 2022<sup>4</sup>. This Common Framework is consistent with the outcomes of that review and reflects those outcomes where relevant.
7. This Concordat is an expression of political commitment and is not intended to be legally binding or enforceable.

## Scope

8. The scope of this Concordat covers any legislative and non-legislative arrangements applying to the role of the Authority in the implementation, and operation of the UK ETS. A summary of the relevant ETS legislation may be found at Annex A and shall be updated no later than 3 months after the introduction of new ETS legislation, or the amendment of existing ETS legislation.
9. Climate policy, including the establishment of emissions trading scheme under the Climate Change Act 2008, falls within devolved competence. However, the Authority has introduced

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3 <https://www.gov.uk/government/publications/joint-ministerial-committee-communique-16-october-2017>

4 <https://www.gov.uk/government/publications/the-review-of-intergovernmental-relations>



secondary legislation in each of the four UK legislatures to establish a single, UK-wide ETS with a common set of rules for participants. There are several benefits of such an approach:

- A UK-wide system, rather than separate national schemes, will create a larger carbon market, with greater liquidity, and a consistent carbon price across the UK.
  - Access to a larger carbon market increases opportunity for emissions reduction and the cost effectiveness of emissions trading.
  - A common, UK-wide approach to carbon pricing avoids ‘carbon leakage’<sup>5</sup> between different parts of the United Kingdom and globally, which could have a negative effect on the contribution of the policy towards reducing emissions in line with international obligations, and the UK’s pathway towards our net zero target.
10. In order to support this single UK ETS, the Authority has together developed non-legislative governance principles and arrangements, including processes for decision-making and dispute resolution, as an expression of shared political commitment to work together cooperatively and in good faith, to

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5 Carbon leakage occurs when businesses transfer production to other countries with less stringent emissions constraints.

govern and support a functional and effective UK ETS. These are set out in the Framework Outline Agreement.

11. The non-legislative arrangements are governance arrangements between the Authority for ongoing operation and maintenance of the UK ETS, and for future review and legislative changes.
12. However, the scope of the Common Framework does not include:
  - Governance arrangements for a potential link between the UK ETS and the EU ETS, or other international ETS.
  - Arrangements relating to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSI A), although there may be instances where changes to UK ETS secondary legislation as a result of CORSIA obligations need to be considered through UK ETS governance arrangements. The Convention on International Civil Aviation (“the Chicago Convention”) places obligations on DfT that are relevant to this policy area, making their participation in affected policy decisions essential.
  - Emissions trading obligations placed on NI electricity generators, which are subject to the NI Protocol (and are therefore consistent with

the requirements set out in the Northern Ireland (NI) Protocol).<sup>6</sup>

## Principles for working together

13. The Authority commits to the following principles in the joint governance of the UK ETS:
  - a. Proposals relating to all areas of UK ETS policy should be considered using the joint governance process described from paragraph 15 below, and the Common Framework principles agreed at the Joint Ministerial Committee (EU Negotiations) (JMC(EN)) in October 2017.
  - b. The Authority is committed to, wherever possible, taking decisions jointly. Where the four governments agree that an individual government holds exclusive legislative or executive competence over a particular matter, that government will not exercise that competence to take a decision unilaterally without first having discussed it with all other governments. Where exclusive competency

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

is disputed, the four governments shall consider, and where appropriate, seek legal advice and the view of the devolved legislatures. Where the competency dispute cannot be resolved by any of the three tiers of the UK ETS Authority governance structure (see paragraph 15, below), it becomes a formal dispute, and shall be subject to the formal dispute resolution process set out at paragraphs 38-40, below.

- c. When taking decisions, the Authority will ensure that at least two weeks is allowed for internal clearance processes within all four governments, unless agreed by all four governments that an expedited process is required in a particular instance.
- d. The Authority will endeavour to ensure market and legislative stability throughout the agreed ETS phases<sup>7</sup>. The Authority should adhere to planned review points and ensure that wherever possible significant legislative

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7 The Government and Devolved Administrations' response to the 2019 consultation on The Future of UK Carbon Pricing (<https://www.gov.uk/government/consultations/the-future-of-uk-carbon-pricing>) advised that UK ETS Phase I will run from 2021-2030, with whole-scheme reviews scheduled for 2023 and 2028.

and policy changes are aligned with these planned review points. The UK ETS shall be governed to ensure full accountability of the parties of the Authority to their respective legislatures. This will include regular reporting to those legislatures and responding to any scrutiny initiated by those legislatures. The Authority will work jointly to respond to scrutiny from any individual legislature.

- e. The Authority is legally required to seek and take into account advice from their statutory advisor, the Climate Change Committee, prior to laying legislation, including on any matters relating, but not limited to, scope (gases, sectors, qualification threshold and related exclusions/opt-outs etc), the emissions cap and its trajectory, the duration and phases and reviews of the system (trigger points, timing, scale, process for changes).
- f. For all proposals, the Authority should seek to obtain appropriate and relevant evidence to inform recommendations. Any relevant evidence obtained must be taken into account in reaching a recommendation.
- g. For policy decisions made under the Climate Change Act, policy proposals may be suggested by any of the parties of the Authority and the final decision to implement

a particular policy will be taken jointly by the Authority. In preparation for such a decision, the UK Government's position will be confirmed by collective agreement between the relevant UK Government departments.

- h. Ministers from DESNZ, the Scottish Government, the Welsh Government and DAERA (and DfT officials and Ministers, where appropriate) will be sighted and engaged in discussions by HMT where a policy decision relating to elements of the policy set out under the Finance Act 2020 is being considered. Such discussions should constitute a two-way exchange between HMT and the other Parties, with UK Government, Scottish Government, Welsh Government and DAERA allowed sufficient time to consider the decision and raise challenges. Responsibility for final sign-off of decisions relating to the elements of a UK-wide emissions trading scheme set out in Finance Act provisions will lie with the Chancellor (HMT). However, HMT should respond to challenges raised and provide justification for decisions reached.
- i. As the UK Government department responsible for aviation policy, DfT should have the option to attend all Official Level Working Groups and Senior Official Level Boards, given the potential impact of

decisions made under the UK ETS on aviation. Agreement from DfT ministers must be gained before agreeing a UK Government policy position focused on transport under the UK ETS.

- j. Recognising the agreement between the four governments that the UK ETS is a joint scheme, system architecture and operational procedures shall reflect shared ownership and responsibility of the four governments. System architecture (including IT systems and related data) shall therefore be designed and made to support all four governments and their regulators to carry out their duties with regards to the UK ETS. Likewise, access to the system architecture shall be available equally to all four governments, notwithstanding commercial confidentiality around specific records. Ministers from the four governments agree that DESNZ shall act as the official owners, and contract managers with the IT suppliers, on behalf of all four governments. Should it be agreed by the four governments that such an arrangement should be changed, the option of replacing the contracts for the IT systems to any of the other National Authorities (and the repercussions of doing so) should be considered.

14. Further detail on the operational elements of this framework (including decision-making processes) may be found within the Framework Outline Agreement (FOA) that accompanies this Concordat.

## The Joint Governance Process

15. The four governments acting as the UK ETS Authority agree to adopt a three-level joint governance structure for the UK ETS. The three levels are as follows (more details are set out in paras 20-26 below):
  - ETS Official Level Working Group (“the Working Group”): this working group is where issues, evidence and proposals around any policy areas under the UK ETS (excepting those identified at paragraph 12, above) are first raised and discussed at the earliest opportunity and with sufficient time for all parties to engage effectively. The Working Group, includes officials from DESNZ, HMT, Scottish Government, Welsh Government, DAERA and DfT (where appropriate) and the environmental regulators (where appropriate). It functions, inter alia, as the working group for this Common Framework. Policy should be developed collaboratively and wherever possible, agreement should be reached on a decision or recommendation at the Working Group, before being passed to the Board and/or the inter-



ministerial group (IMG) for sign-off, if such sign-off is necessary (see paragraphs 17-18, below).

- ETS Senior Official Level Board (“the Board”): the Senior Official Level of the UK ETS Governance structure comprises Senior Civil Service representation (from DESNZ, HMT, Scottish Government, Welsh Government and the DAERA, and DfT where appropriate) at a Board level. The function of the Board is to provide strategic oversight of the performance of the scheme, agree operational resource allocations, sign off decisions or recommendations reached by the Working Group where necessary, and act as a route for resolving disagreement at the Working Group where possible. It thus functions, inter alia, as the working group for this Common Framework. Each of the four governments will be represented on the Board to ensure the scheme delivers their respective requirements. They will be supported by additional Board members who will represent delivery partners (e.g. environmental regulators) and provide independent support (e.g. assurance).
- Arrangements for both the Working Group and the Board will be captured in the UK ETS Authority Terms of Reference document to be agreed by the four governments, and how they will broadly operate is set out in section 8 of the FOA.

- Net Zero, Energy and Climate Change Interministerial Group (IMG): this forum will be established to support effective engagement and collaboration in areas of shared interest between the portfolio Ministers leading on Net Zero, Energy and Climate issues within the four governments<sup>8</sup>. Its responsibilities will include acting as the ministerial level of the UK ETS Authority governance structure, for consideration of matters related to the UK ETS. This group will provide final approval of decisions reached at the Board where necessary will act as a route for resolving disagreement where agreement cannot be reached at Board level. Decisions reached on issues, concerns, and disagreements will be respected and upheld. This group will comply with best practice as agreed in the Intergovernmental Relations Review (IGRR)<sup>9</sup>.
16. Issues and proposals to be considered through the UK ETS governance structure as set out in the Common Framework may include:
- Ongoing oversight and review of the UK ETS;

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8 <https://www.gov.uk/government/publications/interministerial-group-for-net-zero-energy-and-climate-change-terms-of-reference/terms-of-reference-for-the-interministerial-group-for-net-zero-energy-and-climate-change>

9 <https://www.gov.uk/government/collections/intergovernmental-relations>

- Agreement of strategic policy, including relating to the scope and ambition of the scheme;
  - Development and approval of policy decisions which require new legislation, or the amendment of existing UK ETS legislation;
  - Funding and resourcing of the UK ETS and UK ETS Authority;
  - Regular review and maintenance of UK ETS governance arrangements;
  - Any other actions that the UK ETS Authority is required by the UK ETS legislation to carry out.
17. Ministerial approval of issues and proposals to be considered by the UK ETS Authority may not be required in all instances. Generally, the ministerial level of the UK ETS Governance structure will consider:
- Approval of UK ETS policy decisions requiring legislative amendments, noting the agreement around responsibility for decisions relating to the elements of a UK-wide emissions trading scheme set out in the Finance Act, described at paragraph 29, below;
  - Major funding and spending decisions related to the UK ETS; and
  - Reviews and reporting required by Ministers on the operation of the UK ETS.

18. Where the Authority agrees that Ministerial approval is not necessary, decisions may be taken at the Working Group or Board levels without the need for further escalation, if such an approach is agreed unanimously by the four governments. Further detail on the types of decisions that may be taken at Working Level and/or Board levels shall be set out in the UK ETS Authority Terms of Reference.
19. Where the Authority is required to undertake other types of actions related to the ongoing operation of the UK ETS, the four governments may agree to delegate these decisions to a particular group as appropriate.
20. Where necessary, policy proposals and/or recommendations shall be returned by the Board or the IMG to the Working Group for reconsideration or further development, before being resubmitted for final sign off through the three-level hierarchy. Indicative detailed examples of how the decision-making process should operate are included in the UK ETS Framework Outline Agreement that accompanies this Concordat.
21. Working Group and Board meetings shall be arranged as far as possible to facilitate the attendance of all four governments. Working Groups and Boards will be quorate when attended by one lead official representing each of the four governments, although there may be occasions

where the four governments jointly agree to progress with a meeting in the absence of one or more national representative, with their agreement, and to seek the absent party's views through another means (for example, by correspondence). Additional officials may be invited to participate in or lead discussions which may impact their portfolios. The DESNZ official will ordinarily lead discussions on behalf of the UK Government. HMT and DfT officials may decide to attend as appropriate and shall receive standing invitations to Working Groups and Boards.

22. Working Groups and Boards shall meet regularly, with the exact frequency to be agreed jointly and set out in the UK ETS Authority Terms of Reference and Operating Procedures. The procedure for scheduling of these meetings shall allow sufficient flexibility for increased engagement, where this is required.
23. Any of the parties of the Authority, as contributors to the Resource Pool described at paragraph 4, may act as Authority Secretariat for the Working Groups and Boards. Initially, DESNZ will act as Authority Secretariat during these meetings, with this arrangement subject to review after one year of UK ETS governance arrangements being in place, if so agreed by the Authority. The Authority Secretariat shall be responsible for maintaining a log of all decisions and actions made at these

meetings, and a record of points of disagreement. Further detail on the role and responsibilities of the Authority Secretariat shall be included in the UK ETS Authority Terms of Reference and Operating Procedures.

24. Arrangements for the IMG including membership, meeting frequency and secretariat, will be set out in the IMG Terms of Reference, and where necessary shall be referenced within the UK ETS Authority Terms of Reference and Operating Procedures document to be agreed by the four governments.
25. In particular, the IMG Terms of Reference shall note that, for the purposes of UK ETS governance, IMG meetings will be quorate when attended by one lead Minister representing each of the governments. Additional Ministers may be invited to participate in discussions and lead on decisions on policies which fall within their portfolios. The DESNZ Minister will ordinarily lead discussions on behalf of the UK Government. HMT and DfT Ministers may decide to attend as appropriate but shall receive standing invitations to ministerial meetings to discuss the UK ETS.
26. Similarly, the IMG Terms of Reference shall note that, for the purposes of UK ETS Governance, the frequency and timing of IMG meetings shall be agreed jointly, with reference to planned UK ETS review points in 2023 and 2028. The procedure for

scheduling of IMG meetings shall allow sufficient flexibility for increased engagement, where this is required.

## **Note on UK ETS Policy under the Finance Act**

27. The UK Government considers that fiscal, economic, monetary and tax policy and financial market regulation are reserved to the UK Government, with HMT responsible for policy in these areas.
28. The Welsh Government takes a different view on these financial elements, considering them to be the mechanism by which the ultimate goal of the system – environmental protection via incentivising decarbonisation – is achieved. Welsh Ministers retain the ability to seek the legislative consent of the Senedd for any provisions they believe have a purpose falling within the Senedd’s legislative competence.
29. The Scottish Government reserves the right to take a view on these matters on a case-by-case basis. The purpose and effect of any future provision that deals with these financial elements will require to be considered. Scottish Ministers retain the ability to seek the legislative consent of the Scottish Parliament for any provision they believe has a

purpose falling within the Scottish Parliament's legislative competence.

30. Recognising the divergent interpretations described in paragraphs 27 and 28, acknowledging the right of Welsh Ministers to seek the legislative consent of the Senedd as they consider appropriate and the right of Scottish Ministers to seek the legislative consent of the Scottish Parliament, and the process set out in paragraph 13(viii), the four governments nonetheless agree that responsibility for final decision-making on decisions relating to the elements of a UK-wide emissions trading scheme set out in Finance Act provisions will lie with the Chancellor of the Exchequer, where relating to reserved matters.

## **Interaction with other bodies**

31. The Working Group and Board shall, during their governance duties, engage with the regulators and other relevant bodies as necessary. These bodies shall include, but not be limited to:
  - a. The Environmental Regulators (Environment Agency, Scottish Environment Protection Agency, Natural Resources Wales, the Northern Ireland Environment Agency and the Offshore Petroleum Regulator for Environment and Decommissioning), which



are responsible for ensuring compliance and system integrity.

- b. The Financial Conduct Authority (FCA), which is responsible for ensuring the monitoring and enforcement of the financial integrity of the system, the identification and investigation of financial misconduct within the UK ETS, and the provision of advice in cases of non-compliance.
- c. The Courts within UK jurisdictions, which are the overall judicial authority and the highest court of appeal for the UK ETS.
- d. The Climate Change Committee (CCC). The Climate Change Act 2008, the Climate Change (Scotland) Act 2009, the Environment (Wales) Act 2016 and the Climate Change Act (Northern Ireland) 2022 require that the CCC perform an advisory and reporting role on the emission reduction targets of the UK, Scottish, Welsh and Northern Ireland Governments, respectively. The Working Group and Board shall engage with the CCC to secure advice and evidence to inform UK ETS policy (particularly as part of the planned review points in 2023 and 2028), as well as providing the CCC with the data necessary for it to execute its reporting function.

- e. The Office for Environmental Protection (OEP), Environmental Standards Scotland (ESS), and future equivalent governance bodies in Wales and NI. The four governments note that whilst UK ETS is a joint, UK-wide initiative, the establishment and remit of environmental oversight and regulatory bodies is a matter for each Government to determine unilaterally. Nonetheless, the four governments commit to exploring options for a cooperative approach between equivalent governance bodies in relation to the UK ETS.

## Dispute Avoidance

32. For the most effective use of the governance structure, agreement will be sought on a recommendation or decision at the Working Group, with final decisions confirmed by the Board and/or the IMG if such confirmation is agreed by the Authority to be necessary and in line with agreed delegations. Every effort shall be made to resolve issues, concerns or disagreements at the lowest level possible and decisions on resolved issues, concerns, and disagreements will be respected and upheld.
33. Operational decisions will be taken in accordance with pre-agreed protocols and supported by input

from scheme delivery organisations, such as the environmental regulators, as appropriate.

34. Policy decisions will ordinarily be supported by evidence which the Working Group members from each of the four governments will collectively share and scope, and where appropriate commission, either from internal analytical resources or external experts. This does not preclude each of the National Authorities developing additional evidence as required.
35. Where appropriate, the Working Group may invite expert advisors, for example academics or specialist consultants, into discussions or to peer review the evidence base informing decisions. As noted in paragraph 13(v), there is also a statutory requirement to seek advice from the CCC where a decision results in legislation on the trading scheme.
36. Where agreement on a particular policy or operational issue cannot be reached at Working Group level, and where a lack of agreement risks material impact on the effective functioning of the UK ETS, consideration will be given to the nature of the issue, before a decision is made on whether to escalate the disagreement to Board level. Where time allows, the Working Group should consider what additional information or analysis could support a resolution of the disagreement,

including the procurement of additional evidence, expert advice and/or stakeholder input, and explore such options as far as is practically possible before escalation to Board or IMG levels.

37. When faced with a disagreement between the four governments, the Authority shall consider the extent to which the disagreement could impact negatively on the efficient functioning of the scheme, or the ability to meet the Common Frameworks principles agreed at JMC(EN) in October 2017. In those areas where a common approach is not needed, an “agreement to disagree” could be considered an acceptable resolution.
38. Where an issue, concern or disagreement cannot be resolved by the Working Group, it may be escalated to the Board. Where the Board cannot resolve the issue, concern or disagreement, it may be escalated to the IMG for resolution.

## Dispute Resolution

39. When an issue, concern or disagreement cannot be resolved at any of the three tiers of the UK ETS Authority governance structure, it becomes a dispute, and may be escalated to the intergovernmental relations (IGR) secretariat. The ultimate responsibility for final decision-making relating to the elements of the UK ETS set out in Finance Act provisions, while noting the positions

stated in paragraphs 27-30, shall lie solely with the Chancellor (HMT), where relating to reserved matters, with whom responsibility for the timing of such decisions also lies.

40. This mechanism of escalation to the (IGR) will be utilised only where agreement cannot be reached, and divergence or continued disagreement would impact negatively on the ability to meet the Common Frameworks principles.

## **Review and Amendment Mechanism**

41. The Authority commits to a comprehensive review of the governance framework within three months of the conclusion of the first planned UK ETS review point in 2023. This governance review shall provide the opportunity to assess decision-making and dispute resolution processes and allow for amendments to this Concordat or any subsidiary governance agreements or documentation. Any such amendments shall require unanimous agreement from the IMG before being adopted.
42. Following the initial governance review (to take place within three months of the conclusion of the first planned UK ETS review point in 2023) a formalised schedule for further reviews will be agreed.

43. The planned reviews described at paras. 26, 31(iv), 41, and 42 do not prejudice the ability of the Authority to undertake ad hoc reviews of either ETS policy, or governance arrangements, or both, if there is consensus such reviews are deemed to be necessary. Similarly, whilst the Authority shall ensure that wherever possible significant legislative and policy changes are aligned with planned review points, such a principle does not prejudice their ability to raise or enact policy proposals or recommendations outside of these planned review points.
44. Third parties can be used by any party to the Framework to provide advice or evidence to inform policy or governance reviews.
45. If agreement is not reached in either the review or amendment stage, any one of the four governments can raise it as a dispute through the Framework's dispute avoidance and resolution mechanism.
46. In the event that a link between the UK ETS and EU ETS is agreed, the Framework will need to be reviewed immediately by the Authority, in parallel with policy and legal development. In particular, implications for Northern Ireland electricity generators (who by virtue of the NI Protocol,

participate in the EU ETS) must be considered, including their introduction into the UK ETS.<sup>10</sup>

## Monitoring

47. The Working Group shall meet regularly to monitor the Common Framework. The meetings shall consider:
- intergovernmental cooperation and collaboration as a result of the Framework;
  - whether the four governments are implementing and complying with the Framework;
  - whether divergence has taken place in contravention of the Common Framework Principles; and
  - whether divergence has taken place that impacts negatively on the UK ETS.
48. The outcomes of these meetings will be used as a basis for joint decision-making in the future and subsequent reviews and amendment processes. If there is an unresolved disagreement, the dispute avoidance and resolution mechanism should be used.

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10 For this to happen, the NI Protocol would be superseded by a UK – EU bilateral agreement, by virtue of Article 13 of the NI Protocol.

# Framework Outline Agreement: The UK Emissions Trading Scheme

Authors: the UK Government (UKG), the Scottish Government, the Welsh Government, and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland (DAERA)

## Explanatory note to accompany FOA publication:

Following the UK's exit from the European Union and anticipating the launch of a new UK-wide greenhouse gas emissions trading system (UK ETS) at the beginning of 2021, the UK Government, the Scottish Government, the Welsh Government, and the Department of Agriculture, Environment and Rural Affairs for Northern Ireland (DAERA) (hereafter referred to as the 'Parties') sought to agree how they would jointly govern the UK ETS. As a result, two documents were produced: a UK ETS Framework Outline Agreement (FOA), and a UK ETS Concordat.

The FOA was used as a working document to support the development and agreement of joint working arrangements between the Parties and was drafted and agreed between mid-2019 and late 2020, before the



end of the Transition Period and while the UK was still a member of the EU ETS. In developing joint governance arrangements for the new UK ETS, it was both necessary and desirable to document and draw upon the Parties' shared experience of EU ETS operation and governance. Consequently, a large part of the FOA is used to set out how the EU ETS and its governance structure operated prior to the end of the Transition Period on 31st December 2020.

Since the FOA was developed and agreed, the Parties successfully launched the UK ETS in January 2021 and have ceased to participate in EU ETS governance. However, NI electricity generators continue to participate in the EU ETS to protect the single electricity market on the island of Ireland, as required by the Protocol on Northern Ireland/Northern Ireland (NI Protocol). Whilst minor updates have been made to the FOA text prior to publication to correct tenses and add reference to the EU-UK Trade and Cooperation Agreement, no substantive changes have been made. The arrangements set out in this FOA continue to be the basis of the ongoing governance of the UK ETS. The original context in which the FOA was drafted and its primary use as an iterative tool to develop governance arrangements should therefore be noted when reading the document.

The UK ETS governance arrangements currently in operation have been agreed by the Parties and are reflected in the UK ETS Concordat, which is published alongside the FOA.

This document sets out the outline of a Common Framework Agreement for the UK Emissions Trading Scheme between the following (hereafter ‘the Parties’):

- UK Government,
- Scottish Government,
- Welsh Government,
- Northern Ireland, Department of Agriculture, Environment and Rural Affairs (DAERA)

## **SECTION 1: CONTEXT**

This section of the UK ETS Framework Outline Agreement explains how the policy area intersects with devolved competence and summarises how the framework for the UK’s participation in the EU ETS previously operated. Further considerations for the development of a Common Framework in this area are outlined, including relevant international obligations and implications of the Northern Ireland Protocol (NI Protocol).

### **Policy Area**

Implementation of UK Emissions Trading Scheme: Directive 2003/87/EC establishes the European Union Emissions Trading System (EU ETS) for greenhouse gases. The scheme sets a maximum volume of greenhouse gases (GHGs) that can be emitted by all participating installations and aircraft operators.

These operators then monitor, verify, and report their emissions, and must surrender allowances equivalent to their emissions annually. Allowances are issued either by being sold at auction or allocated for free to some operators. Allowances can be traded, with the price determined by the market.

The aim of the EU ETS is to encourage cost-effective decarbonisation. This is done by setting a cap on the maximum level of GHG emissions for the sectors covered and establishing a market for emissions permits. This sets a price for the production of emissions and so encourages emission reductions.

When the UK left the EU, there was a requirement for a replacement policy to stimulate GHG emissions reduction from large emitters within the industrial, power, and aviation sectors that formerly participated in the EU ETS. This Framework Agreement covers the entire UK Emission Trading Scheme policy area, including elements under the Climate Change Act 2008 (CCA) and the Finance Act 2020 (FA).

## **Scope**

As a cornerstone of EU climate policy, the aim of the EU ETS is to deliver EU-wide carbon emissions reductions from the traded sector to contribute to the EU's 2030 emissions reduction target cost-effectively.

The majority of the implementation of the EU ETS Directive (EU Directive 2003/87) and related legislation

falls within devolved competence under the respective devolution settlements. Since the outset of the EU ETS in 2005, the Parties have agreed to putting in place a UK-wide arrangement via UK statutory instruments. Following the recognition of the convention (which is set out in the Memorandum of Understanding on Devolution) in the Scotland Act 1998 s28, and the Government of Wales Act 2006 s107, the UK Government (UKG) will not normally legislate in devolved areas without the consent of the Scottish Parliament, Senedd Cymru, and Northern Ireland Assembly (NIA). The amendments for Phase III of the EU ETS (which ran until the end of 2020) were transposed into domestic law by the Greenhouse Gas Emissions Trading Scheme Regulations 2012 (SI 2012/3038) (“the 2012 Regulations”). The 2012 regulations are made by UKG under section 2(2) of the European Communities Act 1972 and section 2 of the Pollution Prevention and Control Act 1999.

The scope of this Common Framework includes any legislative and non-legislative arrangements applying to the design, implementation, and operation of a UK-wide emissions trading scheme as a replacement policy for the UK’s participation in the EU ETS. The scope of this Common Framework does **not** include:

- Governance arrangements for a potential link between a UK ETS and the EU ETS;

- Arrangements relating to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA); or
- Northern Ireland electricity generators (and is therefore consistent with the requirements set out in the Northern Ireland Protocol).

The focus of this agreement is to establish a Common Framework in which decisions relating to the UK ETS (jointly created by all four governments) can be made. This Framework seeks to create a joint governance process which respects reserved and devolved competence and respective language laws and standards. It sets out how the Parties will work together to exercise decision-making powers and responsibilities relating to the implementation and ongoing maintenance of the UK ETS. This role for the Parties broadly replicates the governance role undertaken by the European Commission, the European Parliament and the Council of the EU under the EU ETS.

## **Finance Act (FA)**

The majority of the policy areas are provided for under the Climate Change Act (CCA) and are within devolved competence. Some elements need to be taken forward via a different legislative vehicle, the FA. The UKG considers provisions under the FA to be reserved because they relate to the reservation for ‘fiscal, economic and monetary policy’ (“FEMP”) in the Scotland, Wales and Northern Ireland devolution settlements. It,

therefore, concludes that HM Treasury (HMT) will have ultimate responsibility for the following policy elements:

- The allocation of allowances in return for consideration (i.e. auctioning allowances)
- Determining how auction revenues are used

The Welsh Government takes a different view on these elements, considering them to be the mechanism by which the ultimate goal of the scheme – environmental protection via incentivising decarbonisation – is achieved. Welsh Ministers retain the ability to seek the legislative consent of the Senedd for any provisions that they believe have a purpose falling within the Senedd’s legislative competence. This happened in May 2020, in relation to the Finance Bill 2020. The Welsh Government was supportive of the policy for auctioning arrangements set out in that Bill, and consequently recommended that legislative consent be granted. Consent was granted on 24th June 2020. The Scottish Government will take a decision on competence issues arising under the FA on a case-by-case basis, taking into account the purpose and effect of each proposal. Scottish Ministers likewise retain the ability to seek the legislative consent of the Scottish Parliament for any provision they believe has a purpose falling within the Scottish Parliament’s legislative competence. The UKG remains of the view that fiscal, economic, and monetary policy relating to the implementation of the UK ETS is reserved to the UKG

and is HMT's responsibility to establish through primary and secondary legislation.

## **Climate Change Act (CCA)**

In the UK, under the devolution settlements (the Government of Wales Act 2006, the Scotland Act 1998 and the Northern Ireland Act 1998), control of pollution and the protection of the environment are generally matters falling within the legislative competence of the Scottish Parliament, Senedd Cymru, and the Northern Ireland Assembly. In Northern Ireland, the Department of Agriculture, Environment and Rural Affairs (DAERA) works closely with the Department for Economy (DfE) when considering policy decisions.

Climate change policy is a devolved matter. Section 44 of the CCA provides the Scottish Ministers, Welsh Ministers, and relevant NI department (DAERA) with a power to, by regulation, make provision for trading schemes relating to greenhouse gases (i.e. schemes for limiting, or encouraging the limitation of, activities that contribute to greenhouse gas emissions), provided that matters provided for in a trading scheme are within devolved competence.

Elements of the policy area within devolved competence therefore include:

- setting the scope, cap, and trajectory of an ETS,

- making provision for regulators to ensure appropriate monitoring, reporting, and verification (MRV) and enforcement with operators,
- determining the numbers of allowances available within the cap in any one year,
- determining the numbers of allowances that are allocated for free.

A more detailed commentary on the CCA provisions is included in Annex 2 of the Framework Outline Agreement.

## Operation of the EU ETS Framework

The EU ETS comprises core governance functions which serve as a mechanism to set rules and regulations, ensure compliance, provide a fair market for participants, and assert a judicial process (including to manage appeals). These functions are outlined below, along with the bodies that undertook them while the UK was a participant of the EU ETS.

### Authority

In the EU ETS, **the Commission** acts as the central oversight body and sets the rules and regulations for the system through delegated and implementing acts. The powers for the Commission to establish rules and regulations for the system are derived from the EU ETS Directive. Changes proposed by the Commission are put forward for co-decision (ordinary legislative procedure)



by the Council of the EU (Member States) and European Parliament.

## System Administrator

The Commission administers the central, cross-border functions of the EU ETS, for example the operation of the EU ETS registry.

- The **Environment Agency (EA), Scottish Environment Protection Agency (SEPA), Natural Resources Wales (NRW), Northern Ireland Environment Agency (NIEA) and the Offshore Petroleum Regulator for Environment and Decommissioning (OPRED)** were responsible for compliance and enforcing the rules and regulations set by the Commission within their respective nations. This included day to day functions such as providing advice on the Monitoring, Reporting and Verification system (including assessing operators' annual emissions reports), issuing permits, ensuring installations were complying with their installation specific emissions plan and investigating non-compliance.
- The Environment Agency was also the national administrator of the EU ETS Registry for the UK, responsible for the maintenance and administration of the UK national registry section within the European Union Registry. The EU registry is an online database that keeps track of the ownership of allowances held in electronic accounts.

## Market oversight

The EU Financial Instrument Directive and Regulation (MIFID II) and the Market Abuse Regulation (MAR) are applicable to the EU carbon market. These financial regulations were monitored and enforced in the UK by the **Financial Conduct Authority (FCA)**.

## Judicial issues

At a UK level, the environmental regulators had the ability to impose civil penalties on participants for breaches of EU ETS rules. In England and Wales, the First Tier Tribunal considered appeals by participants against the Regulators. In Scotland and Northern Ireland, this role was fulfilled by the Scottish Ministers and the Planning Appeals Commission, respectively.

Challenges to the legality of EU ETS rules were brought by way of judicial review in the UK's domestic courts.

**The CJEU (Court of Justice of the European Union)** is the highest court of appeal for legal challenges brought against EU ETS rules by Member States or individual operators regulated under the regime (i.e. companies). The CJEU also considers infringement proceedings brought by the Commission against Member States for non-compliance with the ETS rules.

The **technical scope** of the EU ETS is outlined at **Annex B** along with a brief description of how each element of the system is defined and operated.

## Scope for divergence in the EU ETS

The EU ETS Directive sets out the structure of the EU ETS, including its scope, phases, gases covered, industry sectors and thresholds and the cap and trajectory, with EU Regulations setting out the detailed rules for its operation. Member states have very limited discretion in implementing rules established by the Commission. When the UK participated in the EU ETS, the UK Government used discretion available to establish opt out schemes for small emitters and hospitals (Directive 2003/87/EC, Article 27), to establish its own system of penalties (Directive 2003/87/EC, Article 16), and to establish how verification of data submitted to the regulator takes place.

To ensure a consistent carbon pricing policy across the UK, the Parties had agreed to a UK-wide approach to implementing the EU ETS through the 2012 regulations, made by the Secretary of State. Consequently, **there was no divergence within the UK** while participating in the EU ETS.

**The geographic scope of this Common Framework** to replace the EU ETS is therefore also on a UK-wide basis, recognising the benefits of maintaining a UK-wide consistent approach for the market, and the success of the longstanding joint approach on implementing the EU ETS. Further explanation of the rationale for seeking a UK-wide approach is set out in section 2.

## **Further considerations for development of a Common Framework**

### **Relevant international obligations**

The Common Frameworks Principles agreed at Joint Ministerial Committee (EU Negotiations) state that frameworks will be established where necessary to ensure the UK can negotiate, enter into and implement new trade agreements and international treaties, and ensure compliance with international obligations.

These principles were established in the context of an ambition for close working between the UK Government and the Devolved Governments on reserved matters that significantly impact devolved responsibilities in Common Frameworks.

Common Frameworks will allow the parties, in a timely manner, to ascertain the impact of international trade on managing UK policy divergence. All parties to the framework will consider any impact in a way that meets the requirements of the JMC (EN) principles. Common Frameworks will afford an opportunity to consider any implications stemming from international trade which have a direct bearing on the operation of a Common Framework. The scope of this consideration will not extend beyond Common Frameworks.

International policy formulation will be developed in line with the current Devolution Memorandum of Understanding (MoU) and its accompanying International

Relations Concordat (IR Concordat)<sup>11</sup>. International obligations will be implemented in line with these agreements. In this respect, the parties will automatically use any updated IR Concordat, and the wider outcomes of the Joint Intergovernmental relations (IGR) Review, as the basis for such international considerations.

Following the UK's exit from the EU, the UK remains party to the following international agreements relevant to the EU ETS:

- The **Kyoto Protocol** (KP) committed signatories to reduce GHG emissions based on 1990 levels. This can be done via flexibility mechanisms; international emissions trading; the Clean Development Mechanism (allowing signatories to earn Emissions Reduction Units by promoting clean development in developing countries); and Joint Implementation (allowing the earning of Emissions Reduction Units by funding projects in other countries). KP units are no longer linked to the UK ETS scheme.
- The **Paris Agreement** aims to avoid dangerous climate change by keeping the increase in global average temperature to well below 2°C above

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11 [https://www.gov.uk/government/publications/devolution-memorandum-of-understanding-and-supplementary-agreement#:~:text=The%20Memorandum%20of%20Understanding%20\(%20MoU,underlie%20relations%20between%20these%20administrations.](https://www.gov.uk/government/publications/devolution-memorandum-of-understanding-and-supplementary-agreement#:~:text=The%20Memorandum%20of%20Understanding%20(%20MoU,underlie%20relations%20between%20these%20administrations.)

pre-industrial levels. Reforms to the EU ETS will be implemented prior to Phase 4 (2021-2030) to ensure the EU's commitments under the Paris Agreement are met. Article 6 of the Paris Agreement offers Parties to the agreement the opportunity to use cooperation mechanisms to achieve their NDCs (Nationally Determined Contributions). This enables the EU ETS to be linked to similar schemes to create a cross-border carbon market through direct bilateral cooperation (Article 6.2). The UK is a signatory to the Paris Agreement.

- **CORSIA** is the Carbon Offsetting and Reduction Scheme for International Aviation, a global scheme which aims to stabilise the sector's net CO<sub>2</sub> emissions as at 2020 levels. It has force in international law by incorporation into the Chicago Convention on International Civil Aviation as Annex 16 Volume IV. The UK and all EU Member States are currently (voluntarily) signed up to participate in CORSIA from 2021, as stated in the Bratislava Declaration. The European Commission produced an Impact Assessment in 2017 which outlines possible options for EU ETS-CORSIA interaction from 2021. An inception document and impact assessment were published by the Commission in July 2020, and further details were published in July 2021, as part of the EU's 'Fit for 55' package. In January 2021, the Department for Transport

published a consultation containing high-level options for implementing CORSIA alongside the UK ETS, and will consult on detailed proposals for any interaction between the two schemes in due course.

The UK is a party to the above international obligations and therefore a Common Framework in this area will help to honour these obligations.

## **System-wide considerations**

The EU ETS is one of the key pillars of EU climate policy, with other key areas covered by the Governance of the Energy Union & Climate Action Regulation; Effort Sharing Regulation; Renewable Energy Directive; CCS Directive; Industrial Emissions Directive and internal electricity market legislation. These policies include references to the EU ETS, either as a whole system or by reference to specific elements of the policy (for example allowances, the surrender of allowances or licenses). The development of the UK ETS has considered Frameworks, legislation, and policy in these areas.

## **Aviation policy**

The aviation sector is included in the scope of the EU ETS, with aircraft operators required to surrender sufficient allowances to meet their compliance obligations under the system. The Parties have agreed that aviation will continue to be included in the scope of the UK ETS. As the Department for Transport (DfT) is responsible for aviation policy, including obligations arising under

the Convention on International Civil Aviation through which CORSIA was adopted, this Common Framework recognises the role of DfT in governance arrangements for the UK ETS.

## Devolution-specific considerations

- **Scotland:** Scotland has its own legislative frameworks and targets in relation to climate change and emissions reduction. The Scottish Government has legislated for net zero targets by 2045, including emissions from international aviation, under the Climate Change (Scotland) Act 2009, as amended by the Climate Change (Emissions Reduction Targets) (Scotland) Act 2019. The 2019 Act also changed the basis on which emissions are reported to account for actual emissions reduction rather than adjusted for the traded sector.
- **Wales:** Wales has its own legislation in relation to climate change and emissions reduction. Welsh Ministers' statutory duties under the Environment (Wales) Act 2016 are: the duty to set emissions reduction targets for 2030, 2040 and 2050 (sections 29 and 30); the duty to set carbon budgets (section 31); and the duty to establish a method of calculating the net Welsh emissions account (including the treatment of international aviation emissions). Further detail is placed in regulations,



with the most current being the March 2021 suite of four statutory instruments as follows:

- The Climate Change (Wales) Regulations 2021:
  - The Environment (Wales) Act 2016 (Amendment of 2050 Emissions Target) Regulations 2021
  - The Climate Change (Interim Emissions Targets) (Wales) (Amendment) Regulations 2021
  - The Climate Change (Carbon Budgets) (Wales) (Amendment) Regulations 2021
  - The Climate Change (Net Welsh Emissions Account Credit Limit) (Wales) Regulations 2021
- **Northern Ireland:** Northern Ireland has its own legislative frameworks and targets in relation to climate change and emissions reduction. The Climate Change Act (Northern Ireland) 2022 came into operation on 7th June 2022. It sets a 2050 net zero GHG emissions reduction target and includes requirements for setting 5-year carbon budgets. A requirement for the development and publication of climate action plans to meet carbon budgets and targets is also in the Act. The Act sets out how net GHG emissions are to be calculated and provides a power to allow a scheme to be established for

registering or otherwise keeping track of carbon units. There is also a power to make regulations for emissions of a greenhouse gas from international aviation or international shipping to count as Northern Ireland emissions.

## **Northern Ireland Protocol**

The Agreement on the Withdrawal of the United Kingdom from the EU sets out the current arrangements where, although remaining within the UK's custom territory, Northern Ireland will remain aligned with the EU. Article 9 of, and Annex 4 to, the NI Protocol are relevant to this Framework.

This Framework reflects the specific circumstances in NI that arise as a result of the NI Protocol and remains UK wide in its scope. As such decision making and information sharing will always respect the competence of all parties to the Framework and in particular the provisions in Article 18 of the NI Protocol on democratic consent in Northern Ireland.

Where one or more of UK Government, the Scottish Government or the Welsh Government proposes to change rules in a way that has policy or regulatory implications for the rest of the UK, or where rules in Northern Ireland change in alignment with the EU, the Framework is intended to provide governance structures and consensus-based processes for considering and managing the impact of these changes.

- As rules evolve to meet the emerging regulatory needs of the UK, Scottish and Welsh Governments, this Framework will ensure the full participation of Northern Ireland in discussions such that the views of the relevant Northern Ireland Executive Minister(s) are taken into account in reaching any policy or regulatory decisions by the UK, Scottish or Welsh Governments.
- Where rules in Northern Ireland change in alignment with the EU, the Framework will form the basis of a mechanism to ensure consideration by the four governments of any changes and will enable them to determine any impacts and subsequent actions arising from these changes.

Where issues or concerns raised by the relevant Northern Ireland Executive Minister(s) in respect of GB-only proposals have not been satisfactorily addressed, they will have the right to trigger a review of the issue as set out in the dispute resolution process at section 13 of this document.

**Article 9 and Annex 4 of the Ireland / Northern Ireland Protocol apply** in the absence of a link between the UK ETS and the EU ETS, ensuring a common carbon price to maintain the SEM (Single Electricity Market). A consistent carbon price for the SEM on the island of Ireland is an important factor in cross-market harmonisation, allowing the market to continue to function at an optimum level. To this end, NI Electricity Generating

Installations continue to remain in the EU ETS and so out of scope of the UK ETS.

By virtue of the NI Protocol, NI has a dual system of carbon pricing of UK ETS and EU ETS until such times UK ETS links with EU ETS. If a link between the UK ETS and the EU ETS is achieved establishing a level playing field of carbon pricing, NI electricity generators in EU ETS by virtue of the NI Protocol could be ‘folded’ back into the UK ETS. For this to happen, the NI Protocol would be superseded by a UK – EU bilateral agreement, as per Article 13 of the NI Protocol.

As stated above, this Common Framework does not cover:

- governance arrangements relevant to the participation of Northern Ireland electricity generators in the EU ETS,
- governance arrangements for any future link between the UK ETS and the EU ETS established through negotiations.

In the event of a linking agreement between the UK ETS and the EU ETS being agreed and NI electricity generators coming within the scope of the UK ETS, governance arrangements established through this framework may be amended as required.

## **EU-UK Trade and Cooperation Agreement**

The policy area covered by this Common Framework intersects with the EU-UK Trade and Cooperation

Agreement (TCA) and therefore topics relevant to the framework may be considered from time to time by relevant TCA Specialised Committees or the Partnership Council. Where a UK-EU meeting agenda includes an item concerning implementation in an area of devolved competence, UKG should facilitate Scottish Government, Welsh Government, and DAERA attendance of a similar level to that of the UKG representatives with final discretion as to the UK delegation a matter for the UK co-chair. UKG should engage the Scottish Government, Welsh Government, and DAERA as fully as possible in preparation for these meetings regardless of attendance, and on all relevant implementation matters.

The implementation of any linking agreement secured with the EU in devolved areas would fall within devolved competence.

## **Intergovernmental Relations Review**

The Intergovernmental Relations Review was published on 13 January 2022. This Common Framework is consistent with the outcomes of that review and reflects those outcomes where relevant.

## **Definitions**

- CCA (2008) – The Climate Change Act 2008
- FB (2020) – The Finance Bill 2020
- JMC(EN) - The Joint Ministerial Committee (JMC(EN)) was a set of committees that comprised

ministers from the UK and devolved governments, providing central coordination of the overall relationship between the UK Government, Scottish Government, Welsh Government and Northern Ireland Executive.

- [Link to the JMC\(EN\) Principles](#)
- [Link to Memorandum of Understanding \(MoU\) on Devolution](#)

## **SECTION 2: PROPOSED BREAKDOWN OF POLICY AREA AND FRAMEWORK**

Section 2 of the Framework Outline Agreement outlines the approach to establishing a Common Framework and the UK ETS, through new legislation and a non-legislative agreement (concordat). It also describes which components of the EU ETS governance framework are in the UK ETS governance framework.

### **Summary of proposed approach**

#### **Why are the Parties seeking a Common Framework?**

At the end of the Transition Period, the UK ceased to participate in the EU ETS (with the exception of those installations included through the NI Protocol) and a replacement carbon pricing policy was required to maintain the national climate ambition, contributing to the

UK's emissions reduction targets and goal of net zero greenhouse gas emissions by 2050. Early in 2019, the Parties ran a public consultation seeking views on the UK's future carbon pricing policy and setting out policy proposals for a UK ETS which would be operational from 1st January 2021. Responses to this consultation indicated widespread support for the proposed design of a UK ETS.

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 ETS, and established London as a global centre of carbon trading. Carbon pricing schemes are being established around the world: as of 2021, 65 carbon pricing initiatives had been established or scheduled for implementation globally, covering around 21.5% of global greenhouse gas emissions. Of these, 25 are emissions trading schemes.

Establishing separate trading schemes through legislation in Scotland, Wales and Northern Ireland falls within devolved competence. However, the Parties have agreed to jointly legislate to establish a single, UK-wide Emissions Trading Scheme with a common set of rules for participants. A key benefit of a UK-wide scheme, as opposed to separate schemes in the four UK nations, is the creation of a larger carbon market, with greater liquidity, and a consistent carbon price across the UK. Access to a larger carbon market increases the opportunity for emissions reduction and the cost

effectiveness of emissions trading. Through a UK-wide scheme, the Parties increase the likelihood that their carbon pricing policy provides cost-effective opportunities for emissions reduction and therefore its potential to make a significant contribution to the UK's climate ambition and net-zero goal.

All Parties have committed to enter into the UK ETS for an initial period of ten years, with pre-agreed review periods. The Parties agree to work cooperatively and in good faith to ensure policies are in place to support a long term, well-functioning scheme to provide certainty to business and support climate policies and targets across the UK.

Divergent approaches to the policy area could also have unfavourable consequences. Differing carbon pricing policies in the four UK nations could lead to nations having different carbon prices, or no carbon price at all. If nations were more favourable to their respective industries it would undermine the level playing field within the UK and potentially lead to 'carbon leakage'<sup>12</sup>, which could have a negative effect on the contribution of the policy to emissions reduction efforts and the UK's net zero target. However, the framework also includes a procedure by which future proposals for divergence could be implemented, following a full consideration of the

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12 Carbon leakage occurs when businesses transfer production to other countries with less stringent emissions constraints



impacts across the UK and to any linked carbon market (see section 5 below).

This could also have an impact on the ability to secure future trade agreements with other countries. With reference to the JMC(EN) Principles, a UK-wide ETS therefore helps to ensure a future carbon pricing policy as it:

- enables the functioning of the UK internal market, while acknowledging policy divergence; and
- ensures the UK can negotiate, enter into, and implement new trade agreements and international treaties.

The Parties have consequently decided to establish a Common Framework in this area to support collaboration, co-operation, and co-ordination between the four nations, for example through early engagement and timely sharing of information. The UK ETS is established using a combination of new secondary legislation made using existing primary powers under the CCA, and a non-legislative agreement to set out the ongoing oversight and governance by Ministers from the four governments (concordat). The concordat and Framework Outline Agreement (FOA) are expressions of political commitment and are not intended to be legally binding or enforceable.

## Overview of legislative approaches

Legislation is needed to establish an ETS, setting the scope, rules, and operational elements of the scheme. Legislative provision for the UK ETS has been made under existing primary legislation:

- Climate Change Act 2008 (CCA)
- Finance Act 2020 (FA)

The differences in positions between UK and Welsh Governments on legislative competence over the Finance Act 2020 auctioning provision does not detract from an agreement between both governments on the need for the clause, its purpose or wording, nor the desire and need to reach similar agreements in the future.

The difference of legal opinion only becomes relevant should either government wish to unilaterally adopt a different approach to charging for the allocation of allowances. The likelihood of this risk is low and therefore should be tolerated and not inhibit the ability of both governments to agree this FOA.

## Overview of non-legislative approaches

The UK ETS requires a governance structure to ensure scheme changes and decisions are made jointly and effectively. The governance structure of the UK ETS comprises the core functions of the EU ETS structure: an Authority, a Scheme Administrator (the environmental regulators), a Financial Regulator, and the Enforcement system.

The UK ETS Authority (the Authority) comprises Ministers from all four governments and is the core decision-making mechanism. The Parties have considered decisions relating to aspects of the policy under the CCA and under the FA jointly. This Framework Outline Agreement sets out the governance arrangements for the Authority. Guidance and principles on how such decisions are made are established in a concordat, which formalises joint governance principles and the decision-making processes set out in this document.

The planned legislation and concordat have been developed in accordance with the JMC(EN) Principles for Common Frameworks, ensuring that the Framework fulfils the objectives agreed at the Joint Ministerial Committee in October 2017:

1. Common frameworks will be established where they are necessary to:
  - enable the functioning of the UK internal market, while acknowledging policy divergence;
  - ensure compliance with international obligations;
  - ensure the UK can negotiate, enter into, and implement new trade agreements and international treaties;
  - enable the management of common resources;
  - administer and provide access to justice in cases with a cross-border element;

- safeguard the security of the UK.
2. Frameworks will respect the devolution settlements and the democratic accountability of the devolved legislatures, and will therefore:
    - be based on established conventions and practices, including that the competence of the devolved institutions will not normally be adjusted without their consent;
    - maintain, as a minimum, equivalent flexibility for tailoring policies to the specific needs of each territory as is afforded by current EU rules;
    - lead to a significant increase in decision-making powers for the devolved governments.
  3. Frameworks will ensure recognition of the economic and social linkages between Northern Ireland and Ireland and that Northern Ireland will be the only part of the UK that shares a land frontier with the EU. They will also adhere to the Belfast Agreement.

### **Note on future negotiations regarding linking the UK ETS internationally:**

We recognise the importance of international cooperation on carbon pricing and the important role international carbon markets can play. The Authority is open to linking the UK ETS internationally in principle.

The Trade and Cooperation Agreement with the EU makes clear both parties will have their own effective

systems of carbon pricing in place to help fulfil their respective climate goals. The UK and EU have agreed to cooperate on carbon pricing, including through giving consideration to linking their respective carbon pricing systems, although neither side is under any obligation to do so.

**The development of a Framework in this area is without prejudice to the UK's negotiations with the EU or internationally. This Framework Outline Agreement (FOA) focuses on arrangements for a domestic UK ETS.**

Linking arrangements with the EU ETS are subject to future negotiations. The role of the Scottish Government, Welsh Government, and DAERA in negotiations is the subject of ongoing quadrilateral Ministerial dialogue. The role of the Scottish Government, Welsh Government, and DAERA (Officials and Ministers) in the next phase will therefore be subject to further guidance.

## **Detailed overview of proposed framework: legislation (primary or secondary)**

Legislative provision for a UK ETS has been made using existing powers in the CCA and new charging powers in the FA. An Order in Council for a UK-wide ETS was drafted under the powers of all four governments through the CCA and a draft of the instrument was laid before, and approved by, a resolution of each House of Parliament and the devolved legislatures before being

made by the Privy Council on 11th November 2020<sup>13</sup>. The UKG also introduced legislation using FA powers to make provisions for the fiscal elements of the scheme falling under the FA<sup>14</sup>, with these regulations being made on 21st April 2021.

This legislation, and subsequent amendments, established a UK-wide emissions trading scheme with a common set of rules for participants and other parties operating in an ETS (for example, verifiers and regulators). These rules include (but are not limited to) setting the scope of the ETS (including installations; aircraft operators, and the GHGs covered); how allowances are distributed (including calculating free allocation); how installations and aircraft operators should measure their energy consumption; monitoring, reporting, and verification requirements; the roles and powers of the regulators; how allowance auctions will be conducted; and which market stability mechanisms may be used.

Details of the provisions of both Acts in the context of a UK ETS are set out in a note in Annex 2. This note details how the secondary legislation will draw on primary powers to establish the scope and rules of a UK ETS.

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13 <https://www.legislation.gov.uk/ukxi/2020/1265/introduction/made>

14 <https://www.legislation.gov.uk/ukxi/2021/484/made>

## **Potential for policy divergence:**

Whilst there is currently some limited scope for divergence between the four governments under the EU ETS, none has occurred. Divergence in policy areas of the UK ETS established under the CCA is within the executive competence of the Scottish Government, Welsh Ministers, and DAERA. However, all Parties have recognised the benefits of working closely together to develop a UK-wide ETS. Proposals for policy divergence between Parties will be considered by the four Parties jointly, using the governance process that will be established in the UK ETS Concordat and Section 3 of this FOA. Any areas in which divergence is proposed will be considered by all Parties to the framework in light of potential impact on the functioning of the UK internal market, in line with the JMC(EN) Framework Principles.

This does not prevent the Parties seeking to establish other emissions trading schemes for sectors not covered by the UK ETS.

## **Rationale for legislative approach**

Since the UK is no longer part of the EU ETS, all existing rules have ceased to apply, and an ETS cannot be maintained (or created) by non-legislative approaches. Secondary legislation is needed to set out the rules for participants and roles of various parties to establish a UK ETS. The four governments jointly legislated to introduce an ETS with UK-wide application from 1st January 2021. In doing so, the UK ETS ensures a consistent carbon

pricing regime across the UK, with participants in all four governments able to access a UK-wide carbon market.

Please refer to Annex C for a more detailed commentary on UK ETS legislation.

## **Detailed overview of proposed framework: non-legislative arrangement**

A non-legislative approach has been taken to establish governance arrangements in a UK ETS. These build on the legislative underpinning for this Common Framework. An inter-governmental concordat has been agreed, setting out the principles of engagement between the UKG (DESNZ, HMT, and DfT) the Scottish Government, Welsh Government, and DAERA. This concordat is guided by the overarching Frameworks Principles established by JMC(EN): that any Framework should secure the proper functioning of the regime whilst at the same time respecting the devolved competence of the Scottish Government, Welsh Government, and DAERA.

The concordat completed and agreed by the Parties:

- formalises the working arrangements of the UK ETS Authority;
- supports the effective operation of the Emissions Trading Scheme;
- facilitates effective engagement and joint decision-making between all four UK nations;



- serves as a foundation for best practice and scheme etiquette; and
- aligns with Updated Common Frameworks Governance Guidance.

The governance arrangements formalised by the concordat provide a structure where joint decisions around policy areas under the CCA and the FA in a UK ETS are made. For details of the proposed decision-making process, please refer to Section 3 of this FOA.

### **Note on Registry Administrator role and Memorandum of Understanding (MoU)**

Under the EU ETS, the EA was the national administrator of the EU ETS Registry for the UK, responsible for the maintenance and administration of the UK national registry section within the EU Registry.

Under the UK ETS, a new UK Registry has been set up with a Registry Administrator required to maintain and administrate the UK Registry, an online database that keeps track of the ownership of allowances held in electronic accounts. The statutory instrument has been drafted on the basis of a joint and concurrent appointment of all regulators as Registry Administrator, however in practice, initially the EA is best placed to carry out the role on a UK wide basis whilst the market is established due to its experience in this regard.

Therefore, a Memorandum of Understanding was drafted and agreed between the four national regulators (the EA,

SEPA, NRW, NIEA and OPRED) setting out that the EA will carry out the Registry Administrator role on behalf of the others on a UK-wide basis. This MoU establishes how the Registry Administrator role will be fulfilled, including responsibilities of each national regulator with regard to Registry Administrator functions.

The UK ETS Authority will interface with the Registry Administrator, including providing instruction as required. The Registry Administrator will also be required on an ongoing basis to provide the UK ETS Authority with reports and information.

Details of how the UK ETS Authority will interact with the Registry Administrator have been developed in the UK ETS Authority Terms of Reference and Operating Procedures. The concordat agreed between the parties refers to these Terms of Reference where necessary and considers the relationship between the UK ETS Authority and Registry Administrator functions as a component of the UK ETS Common Framework.

## **Detailed overview of areas where no further action is thought to be needed**

New legislation is required to establish the rules, scope and operation of a UK ETS, and a separate (non-legislative) Common Framework is required to establish governance arrangements for the scheme.

In a few areas, the organisations or bodies which will fulfil functions in the UK ETS Common Framework will

operate in a similar way to how they exercised functions of the EU ETS governance framework. No further common rules are thought to be needed in these areas, although existing ones will be maintained.

## **The environmental regulators**

Under the EU ETS the regulators (EA, SEPA, NRW, NIEA and OPRED) were responsible for ensuring compliance and system integrity. The powers and obligations of the regulators are established in the following legislation:

- The Greenhouse Gas Regulations 2012
- The Climate Change Act 2008 (CCA)
- The Environment Act 1995
- The Pollution Prevention and Control Act 1999

Under the UK ETS, the role of the four regulators under the EU system will continue, and UK ETS legislation provides for the environmental regulators to monitor and enforce the scheme rules as required, ensuring the compliance of operators with scheme requirements.

## **The Financial Conduct Authority (FCA)**

Under the EU ETS, EU financial regulations relevant for ensuring the financial integrity of the system are monitored and enforced in the UK by the FCA.

Under the UK ETS, the Recognised Auction Platforms (Amendment) Regulations 2020 enshrines an oversight role for the Financial Conduct Authority (FCA) such

that the FCA can monitor the auctioning process and secondary market trading to prevent market abuse and ensure the effectiveness of the system. The legislation ensures that UK emissions allowances are subject to the relevant regulatory oversight and treatment as Financial Instruments.

## **The UK Courts**

In England and Wales, the First Tier Tribunal considers appeals by participants against the Regulators. In Northern Ireland, the Planning Appeals Commission consider appeals. In Scotland, Scottish Ministers considered appeals under the EU ETS and the Scottish Land Court consider appeals under the UK ETS.

Challenges against the legality of the rules can be brought by way of judicial review in the domestic courts, with the Supreme Court as the highest court of appeal.

The UK ETS will function within the UK's jurisdiction, with the relevant UK courts having replaced the CJEU as the overall judicial authority (under the EU ETS, the CJEU is the ultimate judicial authority for the EU ETS). The First Tier Tribunal and the Planning Appeals Commission would continue their existing roles. In Scotland, the Scottish Land Court is the appeals body, as Scottish Ministers cannot be both the appeals body and Administrator of the ETS. UK ETS participants are able to challenge the rules of the UK ETS or decisions made by the UK ETS Authority by Judicial Review.

## Note on the Climate Change Committee

The CCA requires that the Climate Change Committee (CCC) perform an advisory and reporting role on the Government's emission reduction targets. As part of this role, the CCC provides independent advice on policy designed to meet these targets. The role of the CCC, as established in legislation under the CCA, is expected to continue. No additional legislation is needed but this provision is a component of decision-making structures within this Common Framework.

# OPERATIONAL DETAIL

## SECTION 3: PROPOSED OPERATIONAL ELEMENTS OF FRAMEWORK

### Decision making

**This section outlines principles for how the four governments should approach decision making under a UK ETS, and what types of decisions are likely to be required. It also provides suggested escalation routes for avoiding and resolving disagreements and disputes.**

The governance arrangements within this Common Framework support effective policy decisions to ensure the scheme achieves the UK's decarbonisation goals, whilst respecting reserved and devolved competence.

Given the interdependence with devolved elements of the ETS, including in areas where the UKG views powers as reserved, UKG has committed to discuss with the Scottish Government, Welsh Government, and DAERA any policy decisions, scheme interventions, or proposals to change the administration of the scheme, before decisions are taken by the UKG. Responsibility for the final decision relating to policy decisions in reserved areas will be taken by the UKG. As is the case more generally, where the UKG proposes legislation on a devolved matter, it is required by convention that consent is sought from the Scottish Parliament, Senedd Cymru, and NI Assembly to the legislation through an LCM (Legislative Consent Motion) for primary legislation or a SICM (Statutory Instrument Consent Motion) for secondary legislation as relevant and that where consent is not granted the relevant UK legislation should be amended as a consequence.

Decisions relating to the scheme design, scope, review process and operation of the UK ETS will need to be taken over the lifetime of the UK ETS. Broadly, decisions which will require consideration and approval by the UK ETS Authority are expected to be:

### **Policy decisions and subsequent legislation required to implement policy change**

UK ETS policy decisions relating to key changes to the design or scope of the scheme. These may include, amongst other things, the scope (gases, sectors,

qualification threshold and related exclusions/opt-outs etc.), the emissions cap and trajectory, the duration and phases, reviews of the scheme (trigger points, timing, scale, process for changes), the obligations on participants (permits, conditions, reporting, surrender of allowances), the creation of allowances, establishing a UK Registry, appointing an administrator for the scheme, establishing enforcement regimes (monitoring compliance, appeals), auctioning rules and the design and introduction of market stability mechanisms.

Examples of specific policy decisions include:

- **Changing the cap.** The total number of allowances in the scheme (i.e. the maximum level of emissions permitted) would be set out as a number in secondary legislation (under the CCA) in UK Parliament and the devolved legislatures. Any changes to this number (even as a result of a planned review) would require amendments to that legislation in all four legislatures.
- **Changing the Auction Reserve Price (ARP).** Under a UK ETS, the ARP would be the minimum price at which an auction allowance could clear. The ARP and the methodology used for calculating this price would be set out in secondary legislation (under the FA). Any changes to the ARP or the methodology for calculating it would require amendments to that legislation.

Although legislating would be the result of a policy decision, the legislation required to implement agreed policy decisions would require separate approval through the UK ETS governance process and would be subject to the standard clearance processes in each legislature before being implemented by the UK government and devolved governments.

## **Scheme interventions**

Scheme interventions provided for under the secondary legislation will require Ministerial sign-off before being implemented. These decisions will be delegated within the legislative underpinning and will not require changes to the UK ETS legislation itself. These are usually decisions which could have implications for the operation of the overall scheme and are expected to be far less frequent than the operational decisions made by the environmental regulators. They are likely to include decisions which, under the EU ETS, would have required sign-off by the European Commission.

Examples of scheme interventions include:

- **Activation of the Cost Containment Mechanism (CCM).** The CCM is a price stability mechanism which allows intervention to increase the number of allowances available for auction in the system once a predefined threshold for allowance prices has been met. A decision would be required to determine whether allowances should be injected into the system, the quantity of allowances to be



injected and the source of these allowances (from future auction pots, the New Entrants Reserve, or a separate reserve).

- **Management of in-phase reviews.** The planned secondary legislation to be made under the CCA will allow for in-phase reviews of the UK ETS to take place when appropriate. The management of an in-phase review will not require amendments to the secondary legislation but would be carried out by the national authorities (UK Government, Scottish Government, Welsh Government and the DAERA) jointly and may require ministerial approval before the review begins.

## **Rule enforcement and scheme administration**

Day-to-day rule enforcement and administration of the UK ETS will be carried out by the regulators: EA, SEPA, NRW, NIEA and OPRED. In setting up the UK ETS, the relevant National Authorities will decide which decisions the regulators are empowered to make and assign relevant roles and responsibilities in secondary legislation. This includes the power to amend any designation or assignment of roles and responsibilities.

Examples of rule enforcement and scheme administration include:

- Imposing fines on participants

- Changing the account status of registry accounts (expected to be carried out by the Registry Administrator)

The decision-making process and dispute resolution mechanism process described in this FOA will include **policy decisions, related legislation, and scheme interventions**. The day-to-day operational decisions expected to be made by the regulators are outside the scope of the decision-making process described in this section. The power of the regulators to make day-to-day decisions regarding the operation of the UK ETS and the relevant roles and responsibilities to carry out this function has been set out in secondary legislation.

The Parties have chosen to establish a joint UK ETS. To ensure the effective operation of the scheme as a whole, all decisions relating to the system design, scope, review process, and operation of the UK ETS should therefore be considered at a UK-wide level.

## **Divergence**

The majority of decisions required under the UK ETS will apply across all national authorities. However, all governments will be able to raise proposals for divergence through the UK ETS Governance structure.

The UK ETS Governance structure will allow for such proposals to be considered on a UK-wide basis. The process for considering proposals for divergence within the scheme should be considered using the same

process as for UK-wide decisions. Proposals will be assessed against an evidence base which considers their potential impact on the functioning of the UK ETS as a shared scheme, including consideration of potential economic impact and implications for the UK internal market. In line with the decision-making process and governance principles outlined later in this section, assessments of the potential impact of ETS policy proposals on the UK internal market should be shared with all parties involved in decision-making by the ETS Working Group (further detail on the role of the Working Group is set out under “decision-making process” below).

The primary legislation under which the UK ETS is set up (the CCA and the FA) determines where responsibility for final clearance of decisions relating to a UK ETS sits.

### **Climate Change Act (2008)**

Under the CCA, the Secretary of State, the Scottish Ministers, the Welsh Ministers, and the relevant Northern Ireland Department (DAERA) may make provision by regulations for trading schemes relating to GHGs. Decisions relating to the elements of a UK-wide ETS set out in CCA provisions must therefore be made by all Parties jointly.

**Responsibility for final sign-off of these decisions lies jointly with the DESNZ Secretary of State (jointly with the Secretary of State for Transport for matters affecting aviation) and the relevant Ministers in**

## **the Scottish Government, Welsh Government, and DAERA.**

### **Finance Act (2020)**

Fiscal, economic, monetary and tax policy and financial market regulation are reserved matters. The elements of the UK ETS which UKG deems to fall under these policy areas (the allocation of allowances in return for consideration, the rules and process for auctioning and price management mechanisms) will be set out in secondary legislation passed under the FA.

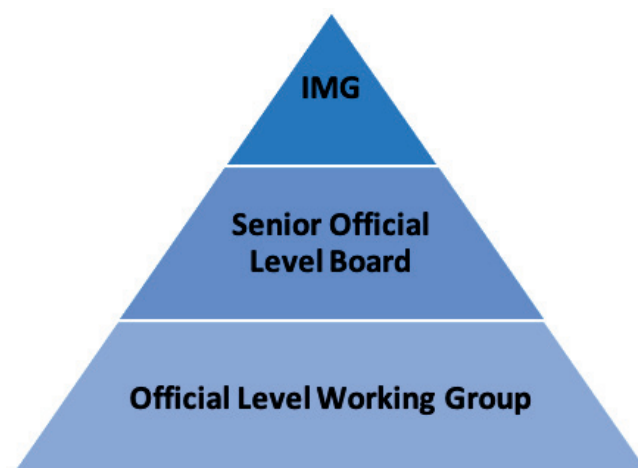
**Responsibility for final sign-off of decisions relating to the elements of a UK-wide ETS set out in FA provisions will lie with the Chancellor of the Exchequer where relating to reserved matters.**

Regardless of where ultimate responsibility for decisions sits, the UK ETS is being designed by the Parties and is a joint policy. Consequently, the proposed governance process for a UK ETS provides a structure in which all decisions relating to a UK ETS can be considered at a UK-wide level. **Policy decisions, related legislation and scheme interventions** relating to all areas of the UK ETS should be considered on a UK-wide basis using the proposed decision-making process described in this section.

# Decision-making process

## 1. Overview of Governance structure

The basic Governance structure for a UK ETS is illustrated by the pyramid opposite. An overview of the roles and functions of each level will be explained in more detail later in this section:



### ETS Official Level Working Group (“Working Group”)

Whilst this group pre-dates the creation of the Common Framework, it will function, among other things, as the working group for the Common Framework. The operation of the group is set out below. Wherever possible, policy should be developed collaboratively and agreement should be reached on a recommendation at the Working Group, which includes officials from all Parties. Further detail on the operation of the Working Group is set out in the UK ETS Concordat and UK ETS Authority Terms of Reference.

### Senior Official Level Board (“the Board”)

The Board level of the UK ETS Governance structure comprises SCS (Deputy Director and Director) representation at a Board level from all Parties. This board also pre-dates the creation of the Common Framework, but will function, among other things, as the senior official group for the Common Framework.

The operation of the group is set out below. The function of the Board is to approve decisions reached by the Working Group, where necessary, and to act as a route for resolving disagreement at the Working Group. Further detail on the operation of the Board is set out in the UK ETS Concordat and UK ETS Authority Terms of Reference.

### **Net Zero, Energy and Climate Change Inter-Ministerial Group (IMG)**

The Ministerial level of the UK ETS Governance structure would provide final approval of decisions reached by the Board and would act as a route for resolving disagreement where agreement cannot be reached by the Board. The IMG will comply with best practice as envisaged in the Intergovernmental Relations Review. Terms of reference can be found at: <https://www.gov.uk/government/publications/interministerial-group-for-net-zero-energy-and-climate-change-terms-of-reference>.

IMG meetings on the UK ETS will be quorate when attended by one lead Minister representing each of the governments. Additional ministers may be invited to participate in discussions and lead on decisions on policies which fall within their portfolios. The DESNZ Minister will ordinarily lead discussions on behalf of the UKG. HMT and DfT Ministers may decide to attend as appropriate and should receive standing invitations to ministerial meetings to discuss the UK ETS.

During UK ETS policy development, ministerial engagement between UKG, the Scottish Government, the Welsh Government, and DAERA took place through Energy and Climate quadrilaterals. Regular ministerial engagement on policy development and operational matters is continuing now that the scheme is operational. In the initial years there will be some UK ETS policy development on specific aspects (reviewing the cap, Free Allocation, linking) which will require ad-hoc ministerial engagement. The first whole scheme review in 2023 and consideration of future evolution of the UK ETS will also require ministerial engagement. Therefore, the wider energy and climate/net zero engagement structures should provide the opportunity to discuss matters related to the UK ETS on a regular basis as needed.

During periods of UK ETS policy development (for example during planned scheme review points), more frequent ministerial engagement may be required. Ministerial engagement structures should therefore allow sufficient flexibility for increased engagement, where this is required.

The process of proposing a recommendation through the three layers of the pyramid is intended to provide a high-level structure in which decision making can take place. In some instances, it is expected that the process will be iterative and work may be remitted back to lower levels for rework or development, before being provided to Ministers for final sign off. Decisions on resolved issues,

concerns, and disagreements will be respected and upheld throughout this process.

## 2. UK ETS governance principles

The process for decision-making under a UK ETS may vary depending on the type of decision required. However, the following principles should be applied to all decisions required relating to the rules, scope, review, and operation of a UK ETS.

- Proposals relating to all areas of UK ETS policy should be considered using the joint governance process, and according to the Common Framework principles agreed at JMC (EN) in October 2017.
- The Four National Authorities are committed to, wherever possible, developing policy and taking decisions jointly. Where the Four National Authorities agree that an individual legislature holds exclusive legislative or executive competence over a particular matter, that administration will not exercise that competence to take a decision unilaterally without first having discussed it with all other governments. Where exclusive competence is disputed, the Four National Authorities shall consider this, and where appropriate seek legal advice and the view of the devolved legislatures. Where a competency dispute cannot be resolved by any of the three tiers of the UK ETS Authority governance structure (ETS Working Group, ETS Senior Official Board, and Net Zero IMG), it



becomes a formal dispute, and shall be subject to the formal dispute resolution process set out at paragraphs 39-40 of the Concordat.

- When taking decisions, the Four National Authorities will ensure that at least 2 weeks are allowed for internal clearance processes within all Four National Authorities, unless agreed by all Four National Authorities that an expedited process is required in a particular instance.
- The Four National Authorities will endeavour to ensure market and legislative stability throughout the agreed ETS phases. The Four National Authorities should adhere to planned review points and ensure that wherever possible significant legislative and policy changes are aligned with these planned review points. The UK ETS shall be governed to ensure full accountability of the Four National Authorities to their respective legislatures. This will include regular reporting to those legislatures and responding to any scrutiny initiated by those legislatures. All four Parties will work jointly to respond to scrutiny from any individual legislature.
- The Four National Authorities are legally required to seek and take into account advice from their statutory advisors, the Climate Change Committee, prior to laying legislation, including on any matters relating in particular, but not limited to, scope

(gases, sectors, qualification threshold and related exclusions/opt-outs etc.), the emissions cap and trajectory, the duration and phases, reviews of the scheme (trigger points, timing, scale, process for changes).

- For all proposals, the Four National Authorities should seek to obtain appropriate and relevant evidence to support recommendations reached. Any relevant evidence obtained must be taken into account in reaching a recommendation.
- For policy decisions made under the CCA, policy proposals may be suggested by any of the Four National Authorities and the final decision to implement a particular policy will be taken jointly by the Four National Authorities. Proposals and accompanying evidence should be raised and shared at the earliest opportunity and sufficient time should be given for all parties to engage effectively. In preparation for such a decision, the UKG's position will be confirmed by collective agreement between the relevant UKG departments.
- At ministerial level, DESNZ Ministers, Scottish Ministers, Welsh Ministers, DAERA (and DfT Ministers, where appropriate) will be sighted and engaged in discussions by HMT where a policy decision relating to elements of the policy set out under the FA is being considered. A ministerial-level discussion should constitute a two-way exchange

between HMT and the other Parties, with both UKG, Scottish Ministers, Welsh Ministers, and DAERA allowed sufficient time to consider the decision and raise challenges. Responsibility for final approval of decisions relating to the elements of a UK-wide ETS set out in FA provisions will lie with the Chancellor of the Exchequer in relation to reserved matters. However, HMT Ministers should respond to challenges raised and provide justification for decisions reached.

- As the UKG department responsible for aviation policy, DfT should have the option to attend all Working Group and Board level meetings given the potential impact of decisions made under a UK ETS on aviation.
- Recognising the agreement between the Four National Authorities that the UK ETS is a joint scheme, scheme architecture and operational procedures shall reflect shared ownership and responsibility of the Four National Authorities. Scheme architecture (including IT systems and related data) shall therefore be designed and made to support all Four National Authorities and their regulators to carry out their duties with regards to the UK ETS. Likewise, access to the scheme architecture shall be available equally to all Four National Authorities, notwithstanding commercial confidentiality around specific records. Ministers from the Four National Authorities agree that

DESNZ shall act as the official owners, and contract managers with the IT suppliers, on behalf of all Four National Authorities. Should it be agreed by the Four National Authorities that such an arrangement should be changed, the option of novating the contracts for the IT systems to any of the other National Authorities (and the repercussions of doing so) should be considered.

### **3. Reserved policy areas**

The UK ETS draws on both reserved and devolved competence to establish a single ETS. The elements of a UK ETS that the UKG view as falling within reserved competence are:

- The allocation of allowances in return for consideration
- Auctioning and market rules
- Market stability/pricing mechanisms
- Determining of how auction revenues are used

HMT has decision-making power relating to these policy areas, in relation to reserved issues, as the department is ultimately accountable to the UK Parliament on these matters. HMT, however, should ensure that issues relating to reserved matters are discussed with Scottish Ministers, Welsh Ministers, and DAERA within the governance structure prior to reaching a decision.

HMT will be represented at UK ETS Working Groups, Board meetings and in ministerial discussions. HMT should use these meetings to engage and discuss with DESNZ, Scottish Government, Welsh Government, and DAERA on issues relating to reserved policy areas under the UK ETS.

The example flowcharts in this section draw on examples from different policy areas to illustrate how best-practice decision-making should take place.

#### **4. DfT**

As the UKG department responsible for aviation policy, DfT will have a role in the decision-making process for a UK ETS. DfT should have the option to attend all UK ETS Working Groups and Board meetings, given the potential impact of decisions made under a UK ETS on aviation.

Although aviation policy is largely reserved, the implementation of policy designed to reduce emissions under a UK ETS is a devolved matter, as reflected in both the 2012 regulations and the CCA.

As the inclusion of aviation under the UK ETS is established under the CCA, agreement from the relevant Ministers in the Scottish Government, Welsh Government, and DAERA will also be required.

Given that not all decisions will affect aviation specifically, DfT participation in decision making is qualified by “where appropriate”. DfT will determine their involvement in UK

ETS decision-making based on the extent to which a decision affects aviation matters.

The scope of this Common Framework does not include arrangements relating to the Carbon Offsetting and Reduction Scheme for International Aviation (CORSI A). However, there may be instances where changes to UK ETS secondary legislation as a result of CORSIA need to be considered through UK ETS governance arrangements. DfT is the UKG Department responsible for this policy as an international obligation arising from the Chicago Convention on International Civil Aviation (“the Chicago Convention”). Due to the limitations of the powers under the CCA, the intention at this stage is to implement CORSIA in the UK through an Air Navigation Order under the Civil Aviation Act 1982, making DfT participation essential in these circumstances, although amendments to the UK ETS to ensure the two schemes can operate alongside each other are expected to be required.

## **5. Detailed overview of decision-making process**

Policy decisions and scheme interventions in all policy areas will be considered jointly through the joint governance process. This section will draw on different types of decision to illustrate proposals for decision-making under a UK ETS.

## Working group arrangements and participation

Decisions under a UK ETS will usually arise either:

- As a result of proposals for changes to the scheme following a review of all or part of the UK ETS; or
- As a result of a “trigger point” being reached (e.g. the passing of the threshold for activation of the Cost Containment Mechanism, the introduction of a Supply Adjustment Mechanism or multiple failed auctions).

The Working Group will therefore meet:

- **Regularly** – this may be on a quarterly basis, with the potential to increase meeting frequency in periods of scheme review or policy development; and
- **Ad-hoc** – when a specific requirement for a meeting exists (e.g. as a result of the CCM threshold for activation being passed).

DESNZ, the Scottish Government, the Welsh Government, DAERA, HMT and DfT will have standing invitations to UK ETS Working Group meetings. DfT attendance may not be required for every meeting, but DfT should decide, based on proposed agendas, whether they would like to be represented at the Working Group.

At all UK ETS Working Group and Board meetings, a decision log should be kept to track all decisions made and record points of disagreement.

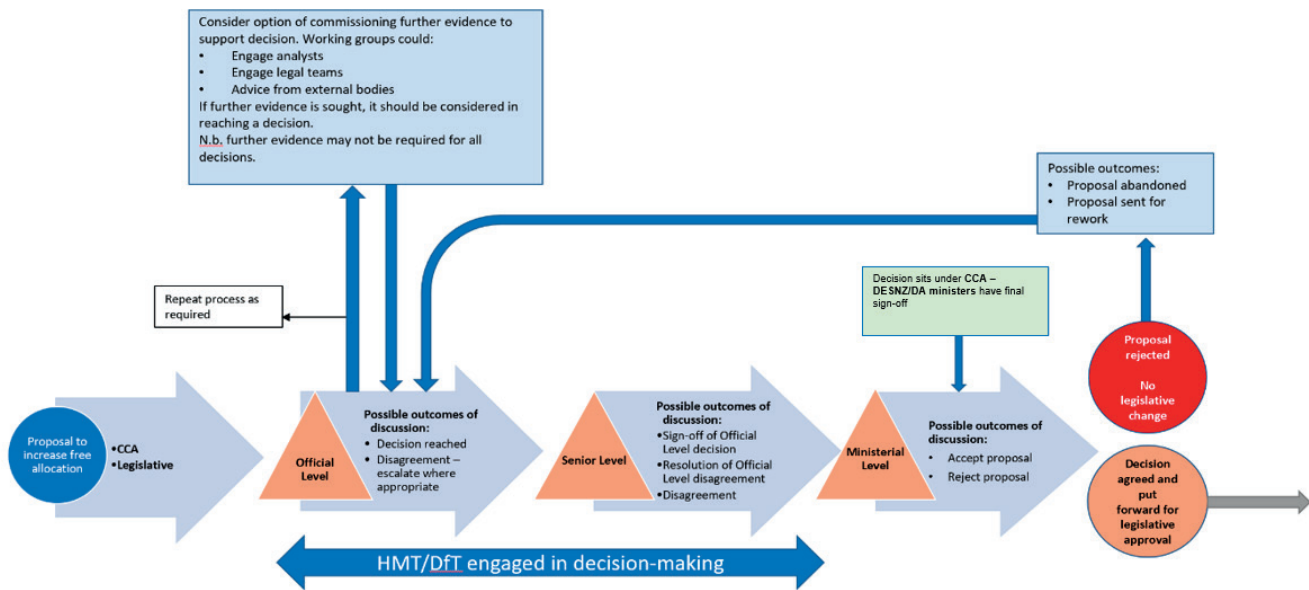
Any of the four governments may act as secretariat for Working Group and Board meetings, Initially, DESNZ will be secretariat for UK ETS Working Group and Board meetings, with the option to review this arrangement after one year of these UK ETS governance arrangements being in place.

### Visual summary of decision-making process

The flowcharts and descriptions below illustrate how best practice decision making should take place under a UK ETS for different categories of decision. The flowcharts used to illustrate the decision-making process can also be found at Annex 2.

### Example 1: Proposal to increase free allocation

**Decision 1: Free Allocation**  
 Climate Change Act  
 Policy decision requiring legislative change



The flowchart below illustrates the proposed decision-making process for a proposal to increase the number of allowances to be allocated for free.



Initially, the proposal is recognised as:

- Falling under the CCA, given that the secondary legislation will draw on CCA provisions to establish regulations regarding free allocation.
- A policy decision which will result in legislative change, given that to change levels of free allocation, amendments to the secondary legislation laid under the CCA would be required.

The proposal is then considered by the Working Group, **with participation from UKG (DESNZ, HMT and DfT (where appropriate)). Scottish Government, Welsh Government, and DAERA.** All four governments would be involved in discussing the proposal and assessing any evidence commissioned to aid in decision-making. Please refer to the “Evidence gathering” section below for details on the development of an evidence base for decision-making.

1. At **Working Group level**, the proposal will be considered, and the Working Group will seek to obtain further evidence. Following discussion, either:
  - A recommendation will be agreed and passed to Board level for sign-off; or
  - A recommendation will not be agreed, and the proposal will be escalated to Board level for resolution (please refer to the “Dispute Resolution” section below).

If a recommendation is unanimously agreed at Working Group level, the proposal will then be considered at the Board with a view to signing it off. Again, **DESNZ, the Scottish Government, the Welsh Government, DAERA, HMT and DfT (where appropriate)** will be represented at the Board and involved in discussions on the proposal.

2. At **Board level**, discussion on the proposal will take place and either:

- A Working Group level recommendation will be signed off and passed to Ministers for final clearance;
- A Working Group level disagreement will be resolved and passed to Ministers for final clearance;
- Further evidence will be commissioned, or the proposal will be returned to the Working Group level for further consideration; or
- The recommendation will be passed to Ministers for resolution if the Board cannot agree (please refer to the “Dispute Resolution” section below).

3. At **Ministerial level**, either:

- The proposal will be approved;
- The proposal will not be approved and will be withdrawn;

- The proposal will not be approved and will instead be sent back to the Board or Working Group for further work; or
- Ministers will disagree on whether a proposal should be approved and implemented (please refer to the “Dispute Resolution” section below).

At ministerial level, DESNZ Ministers, Scottish Ministers, Welsh Ministers, the DAERA Minister and HMT Ministers (and DfT Ministers, where appropriate) will be sighted and engaged in discussions. However, as this decision falls under the **CCA, DESNZ and Scottish Ministers, Welsh Ministers, and DAERA** will be responsible for approval. DESNZ, Scottish Ministers, Welsh Ministers, and the DAERA Minister **must agree on the proposal for it to be approved at ministerial level**. For decisions focusing on the **aviation** policy area of the UK ETS, the UKG position should be agreed by both DESNZ and DfT Ministers.

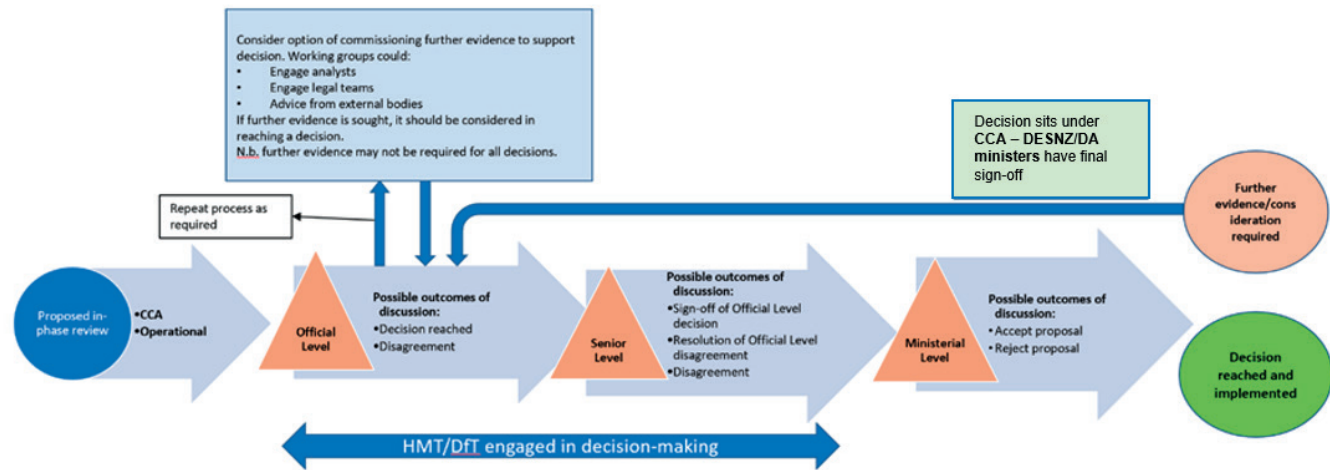
The **legislation** required to implement the policy decision will require additional parliamentary clearances before being made in the UK and devolved legislatures.

## Example 2: Management of an in-phase review

### Decision 2: Management of an in-phase review

Climate Change Act

System intervention (non-legislative)



The flowchart below illustrates the proposed decision-making process for a proposal to initiate an in-phase review:

Initially, the proposal is recognised as:

- Falling under the CCA, given that the secondary legislation will draw on CCA provisions to establish regulations regarding phases and reviews.
- A scheme intervention (non-legislative), given that the ability to initiate an in-phase review at any point is set out in the secondary legislation passed under the CCA; amendments to the secondary legislation are not required.

The proposal is then considered by the Working Group, **with participation from DESNZ, the Scottish Government, Welsh Government, DAERA, HMT, and DfT (where appropriate)**. All participants would be

involved in discussing the proposal and assessing any evidence commissioned to aid in decision-making.

The process for consideration of a non-legislative policy decision follows the same process as for the legislative decision described in **Example 1**. Policy teams should seek to obtain an appropriate evidence base to support recommendations made, and DESNZ, the Scottish Government, the Welsh Government, DAERA, DfT, and HMT should be engaged in discussion at Working Group and Board level.

At Ministerial level, final approval of the policy decision will be the responsibility of DESNZ and Scottish Ministers, Welsh Ministers, and DAERA jointly, given that the proposal falls under the CCA. As above, Ministers from **DESNZ, the Scottish Government, the Welsh Government and DAERA must agree on the proposal in order for it to be approved at ministerial level. For decisions focusing on the aviation policy area of the UK ETS, the UKG position must be agreed by both DESNZ and DfT Ministers.**

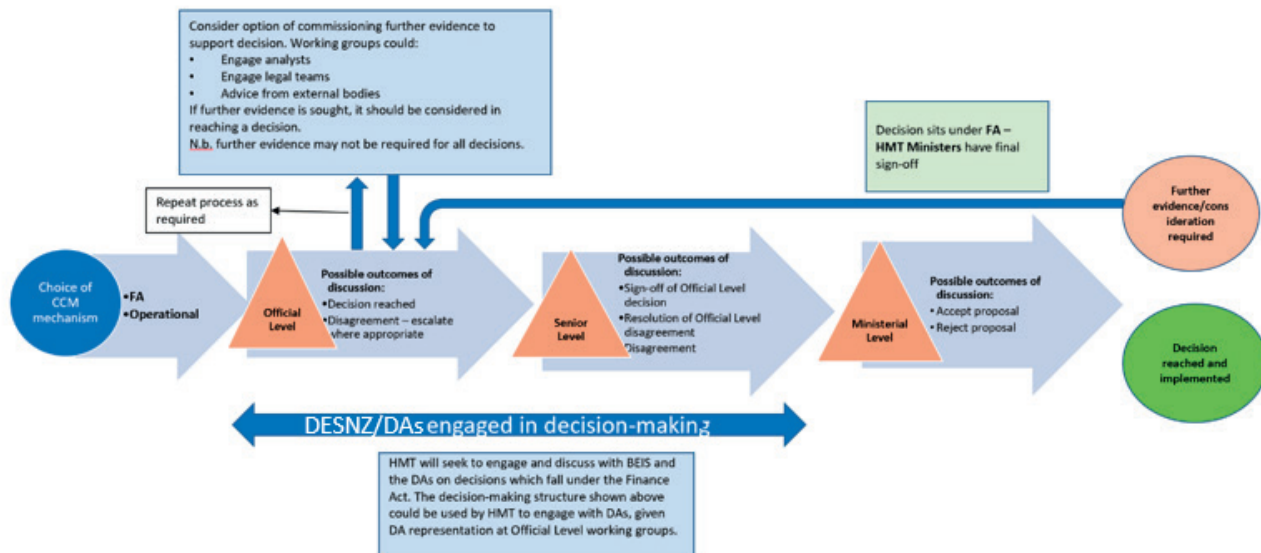
Unlike for the legislative decision described in **Example 1**, no legislative amendments would be required and so if the decision reached at ministerial level was in favour of the proposal, this would result in the proposal being implemented.

### Example 3: Proposal to activate the Cost Containment Mechanism

The flowchart below illustrates the proposed process for reaching a decision on activating the Cost Containment Mechanism. In year one of the UK ETS a meeting to consider the activation of the CCM is triggered if the allowance price is more than two times the average market price of allowances during the two preceding years for more than three consecutive months. If the price rise does not correspond to a change in market fundamentals, the UKG may intervene. A decision may be required over whether to take action to address the price rise through:

- Bringing forward future quantities to be auctioned
- Allowing up to 25% of the remaining allowances in the New Entrants Reserve to be auctioned

#### Decision 3: CCM Activation Finance Act System intervention (non-legislative)



- Allowing a number of allowances from the Reserve to be auctioned if the previous two options cannot address the price rise

Initially, the decision is recognised as:

- Falling under the FA, given that the secondary legislation will draw on FA provisions to establish regulations regarding the Cost Containment Mechanism.
- A scheme intervention (non-legislative), given that the ability to activate the CCM in the case of trigger thresholds being met is set out in the secondary legislation passed under the FA; amendments to the secondary legislation are not required.

The proposal is then considered by the Working Group, with **participation from DESNZ, the Scottish Government, the Welsh Government, DAERA, HMT, and DfT (where appropriate)**. All Parties would be involved in discussing the proposal and assessing any evidence commissioned to aid in decision-making.

The process for consideration of a scheme intervention follows the same process as for the legislative decision described in Example 1 and the scheme intervention in Example 2.

Policy teams should seek to obtain an appropriate evidence base to support recommendations made, and DESNZ, Scottish Government, Welsh Government, DAERA, HMT (and DfT, where appropriate) should be

engaged in discussion at Working Group and Board Level. At ministerial level, Ministers from DESNZ, DfT, the Scottish Government, the Welsh Government, and DAERA will be sighted and engaged in discussions.

**The final decision on whether to intervene will be signed off by HMT Ministers**, where relating to reserved matters.

#### **Example 4: Proposal to change the auction success criteria**

The flowchart below illustrates the decision-making process for a proposal to change the auction success criteria.

Initially, the proposal is recognised as:

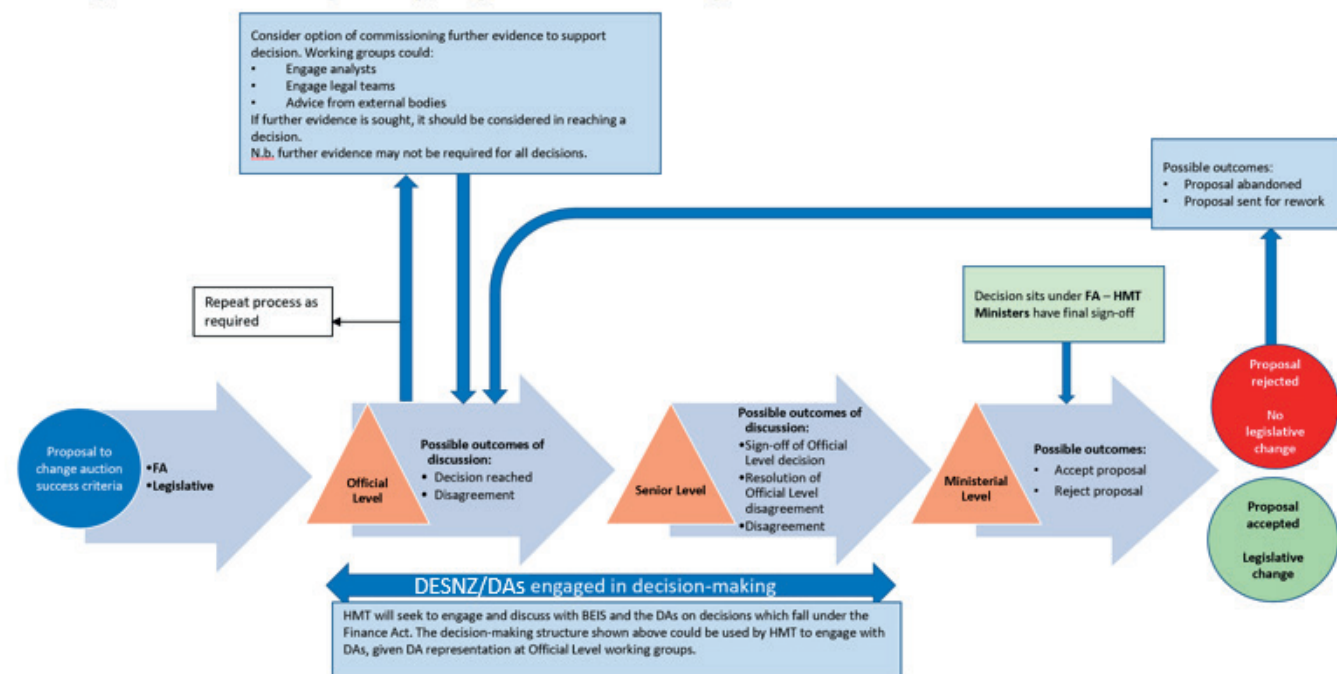
- Falling under the **FA**, given that the secondary legislation will draw on FA provisions to establish regulations regarding phases and reviews.
- A **policy decision requiring a legislative change**, given that to change auction success criteria amendments to the secondary legislation laid under the FA would be required.



## Decision 4: Change Auction Success Criteria

### Finance Act

#### Policy decision requiring legislative change



The decision-making process for Example 4 is broadly the same as illustrated above for the other examples. **HMT should engage DESNZ, the Scottish Government, the Welsh Government, and DAERA (and DfT, where appropriate) in discussions at the Working Group and senior official Board. At ministerial level, Ministers from DESNZ, DfT, the Scottish Government, the Welsh Government, and DAERA will be sighted and engaged in discussions. The final decision will be taken by HMT Ministers, where relating to reserved matters.**

The legislation required to implement the policy decision will require additional parliamentary clearances by UK Parliament before being made.

## 6. Evidence gathering

For decisions considered through the joint governance process, policy teams should seek to gather evidence to support decisions made. The type of evidence base and level of evidence required will be dependent on the decision and policy area, but should broadly constitute consideration of:

- Environmental integrity of the scheme (with specific consideration of impact on carbon budgets and emissions targets) of all four governments
- Implications for industry (e.g. additional burdens for business) and for competitiveness at a national, UK-wide and international level
- Internal Market considerations (particularly where the decision under consideration could result in divergence within the UK)
- Fiscal/revenue implications (including cost to the UKG)
- Urgency of decision required
- Legal and/or political considerations, including parliamentary scrutiny and accountability and the UK's international relations and obligations
- Advice given by statutory bodies such as the UK CCC, or regulators such as EA, SEPA, NIEA, NRW and OPRED

Where evidence is being gathered this will, where possible, be shared between governments.

For the proposed governance structure to operate effectively, it is envisaged that recommendations for the majority of proposals would be considered and agreed by the Working Group. It is therefore essential that an appropriate evidence base is developed at this level. The development of evidence base could be carried out through:

- Commissioning further evidence from analysts
- Commissioning further evidence from legal teams
- Seeking advice from external bodies, in particular the Climate Change Committee
- Engagement with industry (possibly through consultations, working groups etc)

**All evidence commissioned in the decision-making process should be considered and discussed when agreeing a recommendation.**

Evidence base at Board Level (SCS)

- Where agreement cannot be reached by the Working Group, it will be escalated to Board Level (SCS) for review. The Senior Level Group will have the option of seeking further evidence in support of their recommendation. At this level, decision-makers will have access to other sources of information, including consideration of a decision

in the context of interaction with wider government policy across the four nations.

- Where agreement on a recommendation has been reached at Working Group level which passes to the Board level group for sign-off, the Board may decide to obtain further evidence before providing final approval.

## **Roles and responsibilities of each party to the framework**

The roles and responsibilities of the parties are included above under “Decision Making.” Formalised governance processes, including roles and responsibilities of each Party to the Framework, will be captured and agreed in this Framework Outline Agreement and the concordat, which constitutes the non-legislative element of this Common Framework.

## **Roles and responsibilities of existing or new bodies**

Under the UK ETS, the Authority role fulfilled by the European Commission for the EU ETS has been assumed jointly by the Parties in accordance with the governance arrangements described in this document.

The roles and responsibilities of the FCA and the environmental regulators broadly replicate their previous functions under the EU System and therefore no significant changes to governance and reporting

arrangements are required. The advisory role fulfilled by the CCC is also established in legislation under the CCA.

Governance and reporting arrangements between the environmental regulators and the UK ETS Authority have been set out in further detail in the non-legislative elements of the Framework (through this document and the UK ETS Concordat).

## **Monitoring and enforcement**

The rules of a UK ETS are monitored and enforced by the appropriate regulators: EA, SEPA, NRW, NIEA and OPRED. The monitoring and enforcement of relevant financial legislation is carried out by the FCA.

The regulators (EA, NRW, NIEA, SEPA and OPRED) and the FCA performed a monitoring and enforcement role under the EU ETS; their role under the UK ETS is therefore broadly a continuation of that function.

Ministers do not have routine, day-to-day roles in the monitoring and enforcement of the UK ETS. Ministerial approval will be required for specific decisions made, including the activation of pricing mechanisms (CCM) and some decisions on the free allocation of allowances. Ministers maintain oversight of the scheme and can review or raise issues regarding any part of the Framework at any point.

## Review and amendment

It is proposed that an initial review of the Common Framework should take place within 3 months of the conclusion of the first scheme review of the policy in 2023 (which will assess whether the UK ETS is working well and make any changes).

Reviewing the UK ETS governance arrangements (including the Common Framework) shortly after the 2023 review of the scheme provides the parties the opportunity to assess processes for decision making and dispute resolution after a period during which policy decisions resulting from the scheme review are expected to be made. Following an initial review of the Common Framework, a formalised schedule for further reviews will be established.

There is also the potential for ad hoc reviews of the policy, for example if the market is behaving erratically and the price is excessively spiking or dropping.

Trigger points (to trigger an intervention in the scheme if required) have been identified and written into the legislation. These could also be accompanied by ad hoc reviews of the Common Framework, if needed.

## Dispute resolution

For all decisions being made through the joint governance process, disagreement at Working Group level and Board level occurs where one (or more) parties (the UKG (DESNZ, HMT (and DfT where appropriate))),

the Scottish Government, the Welsh Government or DAERA do not agree on a recommendation proposed.

- For example - if the Welsh Government are not in favour of a proposal at Working Group level but UKG, the Scottish Government and DAERA are in favour, the disagreement should be escalated to Board level for resolution if it cannot be resolved in the Working Group.

A dispute occurs where a decision cannot be reached by consensus and attempts to resolve the disagreement have been exhausted (i.e. where a disagreement cannot be resolved within the governance structure). To avoid the occurrence of disputes within the UK ETS governance structure, disagreements should be escalated for resolution in accordance with the process for dispute avoidance described below.

Decision-making for all areas of the UK ETS, including regarding disagreements, requires consideration of potential impact on the following areas before a final decision can be made:

- Environmental integrity of the scheme (with specific consideration of impact on carbon budgets and emissions targets).
- Implications for industry (e.g. additional burdens for business) and for competitiveness at a national, UK-wide and international level.

- Internal Market considerations (particularly where the decision under consideration could result in divergence within the UK).
- Fiscal/revenue implications (including cost to the UKG).
- Urgency of decision required.
- Legal and/or political considerations, including parliamentary scrutiny and accountability and the UK's international relations and obligations.
- Advice given by statutory bodies such as the UK CCC, or regulators such as EA, SEPA, NIEA, NRW and OPRED.

Disagreement is likely to occur when one (or more) Party has concerns over the potential impact of a proposal on one of the areas listed above.

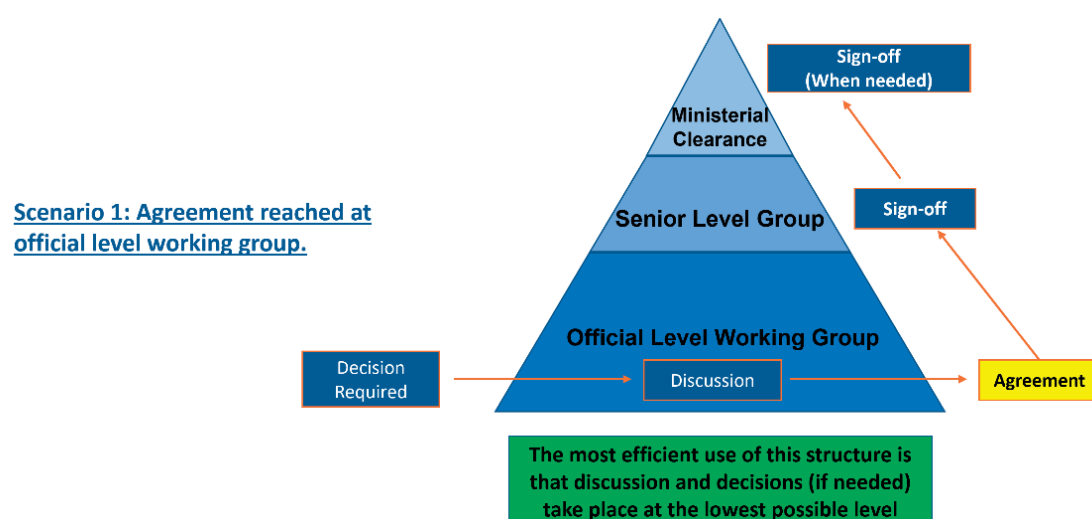
Development of the dispute resolution processes outlined in this section has been informed by Working Group discussions which have explored scenarios which might occur if one (or more) Party disagrees with a proposal being considered by the UK ETS Working Group. The dispute avoidance and resolution processes have been tested during development of the policy prior to the provisional clearance of the Common Framework.



## Dispute avoidance within the UK ETS

### Governance structure

For the most effective use of the governance structure, policy teams should aim to reach agreement to recommendations at Working Group level. This scenario is illustrated in the diagram below; discussion and agreement take place at Working Group level, with the final decision signed off at Board (and then Ministerial) level:



### Timescales for escalation

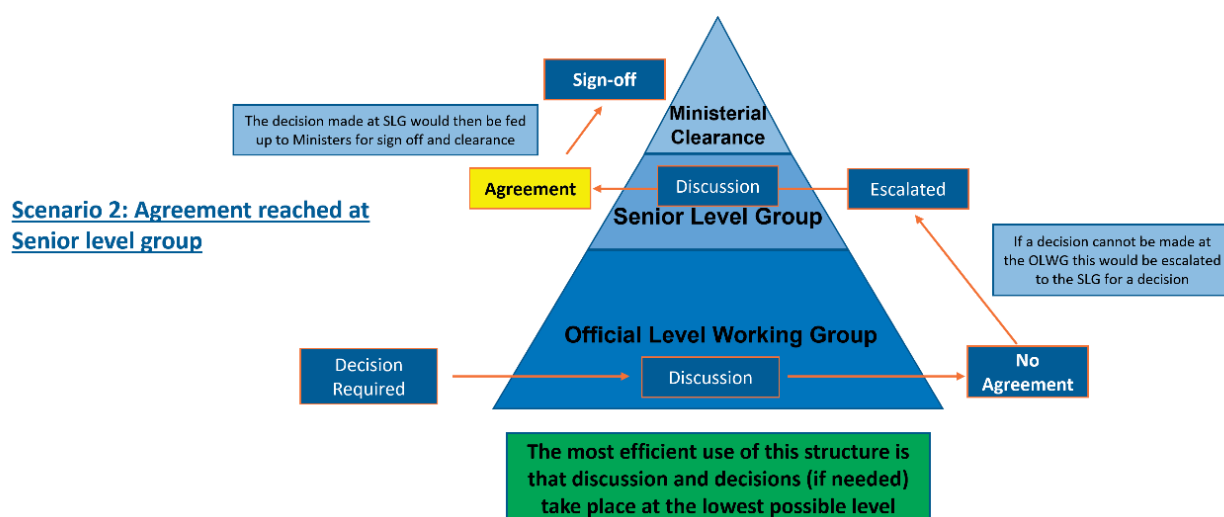
When a proposal is raised at Working Group level, consideration will be given to the urgency of the proposal (i.e. how quickly a decision is required). This assessment will guide timescales for escalation of disagreement within the governance structure, with decisions requiring a more immediate resolution being escalated more quickly.

## Disagreement at Working Group level

Where the Working Group cannot agree at working level, the decision may be escalated to Board level for resolution. There, either:

- The disagreement is discussed and resolved, and the policy proposal is sent for Ministerial sign-off.
- Further evidence is commissioned before the disagreement is discussed and resolved.
- Board level representatives do not agree, and the disagreement is escalated to ministerial level for resolution.

The diagram below represents a scenario where agreement is reached at Board level following disagreement at Working Group level, and then signed off at Ministerial level.



## Board Level disagreement

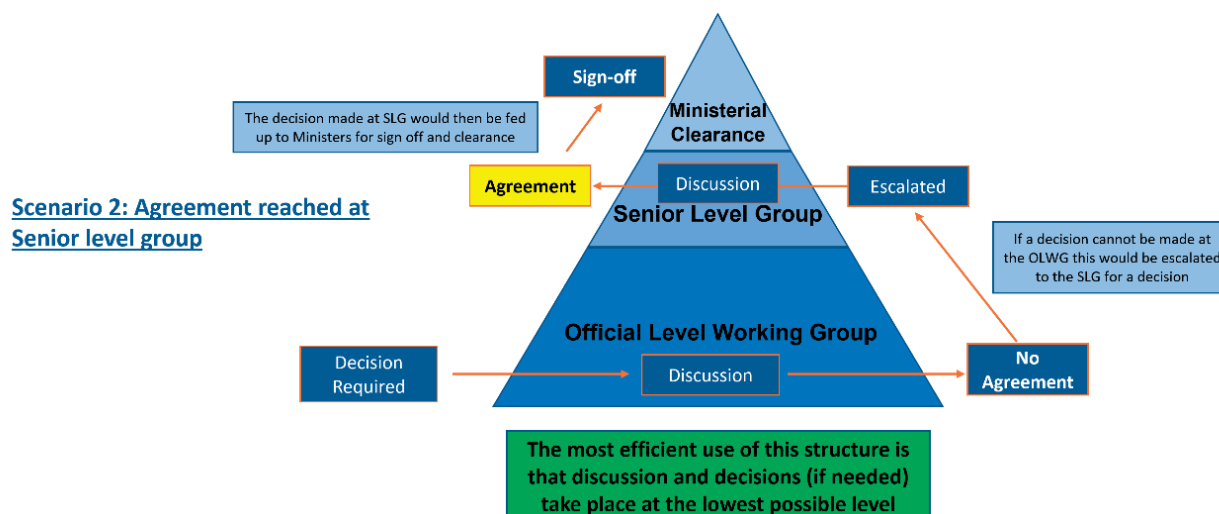
Where agreement cannot be reached at Board Level, the proposal may be escalated to Ministers for resolution. There, either:

- The disagreement is discussed, resolved, and cleared.
- Further evidence is commissioned before the disagreement is discussed and resolved.
- Further evidence is commissioned, and the decision is sent back to the Board for consideration.
- Ministers do not agree on a decision; the issue may be referred to the IGR secretariat as a potential dispute.

At ministerial level, responsibility for the final resolution of a UK ETS decision is dependent on whether that decision relates to a **reserved or devolved policy area**. Therefore:

- For decisions relating to **devolved policy areas**, a dispute at ministerial level would occur where one (or more) of the DESNZ (and DfT, where appropriate), Scottish, Welsh, or DAERA Ministers do not agree on a decision.
- For decisions relating to **reserved policy areas**, **responsibility for the final sign-off lies with the relevant UKG Minister**. However, should a Minister from UKG or the Scottish Government, the Welsh Government or DAERA dispute a decision in a reserved policy area, this can be escalated to the IGR secretariat (per process described below).

The diagram below represents a scenario where agreement is reached and a decision cleared at ministerial level, following disagreement at Working Group level and Board level:



## Disagreement at ministerial level

If ministers disagree on a decision following escalation through Working Group and Board levels, the disagreement cannot be resolved within the UK ETS governance structure and a potential dispute may be raised through the IGR secretariat. This referral may take place regardless of whether the issue relates to a reserved or devolved matter.

# SECTION 4: PRACTICAL NEXT STEPS AND RELATED ISSUES

## Implementation

This Framework will take effect once agreed by all Parties and approved by Ministers.

Following initial agreement of this FOA by Ministers representing all parties, a concordat was drafted, formalising governance arrangements for the UK ETS.

This FOA will be submitted to portfolio ministers for agreement to be published for legislature scrutiny. Following consideration of scrutiny recommendations, and potential changes to the Framework, this Common Framework will be submitted to Ministers for final sign off.

Legislation to establish the UK ETS was laid in the UK Parliament and Scottish Parliament on 13th July 2020 and in the Senedd and Northern Ireland Assembly on 15th July. This legislation, The Greenhouse Gas Emissions Trading Scheme Order 2020, came into force on 31st December 2020.

# Annex A – Legislation Relevant to UK ETS

The relevant legislation made by the four governments which establishes the UK ETS framework is:

The Greenhouse Gas Emissions Trading Scheme Order 2020. This Order in Council establishes a UK Emissions Trading Scheme to be operational from 1st January 2021. It covers the scope of the scheme, monitoring and reporting requirements, the cap and trajectory and the roles of the regulators in monitoring and enforcing the rules of the scheme.

The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2021

The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2022

The Greenhouse Gas Emissions Trading Scheme Order (Amendment) 2020. This Order in Council amends the Greenhouse Gas Emissions Trading Scheme Order to include provisions for free allocation and the UK ETS registry.

The Greenhouse Gas Emissions Trading Scheme Auctioning Regulations 2021. This regulation establishes rules for the auctioning of emissions allowances and mechanisms to support market stability.

Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2021

## The Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) (No. 2) Regulations 2021

The relevant legislation made by the UK Government which establishes the UK ETS framework is:

The Recognised Auction Platforms (Amendment and Miscellaneous Provisions) Regulations 2021. The regulation is reserved by the UK Government and was made under the Finance Act 2020.

The Recognised Auction Platforms and Greenhouse Gas Emissions Trading Scheme Auctioning (Amendment) Regulations 2021. This sets out the regulations for the trading of emissions allowances in the UK ETS and enshrines an oversight role for the Financial Conduct Authority (FCA).

# Annex B – Outline of technical scope of EU Emissions Trading System

Emissions trading systems work on the ‘cap and trade’ principle, where a cap is set on the total amount of certain greenhouse gases that can be emitted by installations and aircraft covered by the system. Within the cap, participants receive or buy emission allowances which they use to cover their emissions for the year. Trading of allowances arises because participants successful in reducing their emissions will have surplus allowances which they can sell, while participants with excess emissions must purchase additional allowances to cover them. This cap is reduced over time, so that total emissions fall.

- **The cap and trajectory** – the Commission proposes any changes to the cap or trajectory, on which a decision is taken by the European Parliament and Council of the European Union. The cap is a limit on the number of emissions (from installations and aviation) which are permitted within Europe over a trading period (known as a phase). The cap is reduced by a specific percentage (currently 1.74%) each year, known as the trajectory. Allowances equal to the cap are made available to participants every year (1 allowance = 1 tonne of CO<sub>2</sub> equivalent). Operators



must surrender sufficient allowances to cover their emissions for each year or are heavily fined. There are three means to obtain allowances (EUAs): free allocation, Member State auctions, or secondary market, where participants can trade surplus allowances.

- **The free allocation of allowances** - the Commission sets the calculation which determines the number of allowances to be allocated for free and the rules for allocation methodology. Some operators participating in the ETS are eligible for free allocation of allowances because they are at risk of carbon leakage, with amounts set at EU level after an EU wide reconciliation of individual installations' emissions. Principally, the proportion of free allowances given to UK ETS participants depends on the level of risk of carbon leakage (carbon leakage occurs when businesses transfer production to other countries with less stringent emissions constraints).
- **The auction of allowances** – the principal method for distributing allowances to participants is via government auctions. Participants can then trade these allowances between themselves bilaterally or most commonly through secondary markets. The commission determines the distribution of allowances between auction and free allocation pots and sets auction rules and auction success

criteria (circumstances in which auctions are permitted to clear).

- **International credits** – the Commission determines how international credits (e.g. Kyoto protocol units) interact with the EU ETS.
- **Penalties** – the ETS Directive only sets one penalty directly (failure to surrender allowances) but instructs that member states must implement rules on penalties, which the UK did through the GHG Regs 2012. Environmental regulators have the power to impose civil penalties on participants who are in breach of their obligations.
- **Monitoring, Reporting and Verification** – the Commission sets rules and requirements for Monitoring, Reporting and Verification of emissions by operators and 3rd party verifiers. The national regulators assess compliance against the MRV rules on a day-to-day basis.
- **The Registry** – The registry, run by the European Commission, records annual emissions from each ETS participant, all EUA transactions and balances and participants' financial transactions. The national administrator for each Member State (the EA, for the UK) interfaces with the Commission through its portion of the EU Registry to provide information for that purpose.

- **Market Stability Mechanisms** – the EU ETS Market Stability Reserve (MSR) and the Cost Containment Mechanism (CCM) are designed to provide price stability in the system. The Commission determines the conditions or thresholds in which these mechanisms are implemented.
- **Phases and Reviews** – the Directive determines the phase length for the EU ETS; the main parameters of the system are fixed during these phases. The Commission also determines when planned reviews of the system take place and the scope of these reviews.

# Annex C – Primary Legislation: Legal Commentary

## Climate Change Act (2008)

The note below sets out on a topic-by-topic basis, the effect of the various provisions of the CCA in the context of the UK ETS. The existing primary legislation has been used to make provision via secondary legislation (Orders in Council) to establish a UK Emissions Trading Scheme.

### General

The UK ETS is of the type outlined in s44(2)(a) – a scheme that operates by “limiting or encouraging the limitation of activities that consist of the emission of greenhouse gas or that cause or contribute, directly or indirectly, to such emissions”. The relevant provisions in relation to schemes limiting activities are set out in Part 1 and Part 3 of Schedule 2.

The power to make an instrument to put in place a trading scheme relating to GHG emissions is at s44 of the CCA. That power is exercisable by “The relevant national authority” – i.e. the Scottish Ministers, Welsh Ministers, relevant Northern Ireland Department, or the Secretary of State in relation to the legislative competence of their respective Parliament/Assembly (see s 47). Climate Change is within the legislative competence of the Scottish Parliament, the National Assembly for Wales, and the Northern Ireland Assembly. In other words, the

power to make an instrument in relation to the matters set out in Schedule 2 may be exercised by Scottish Government, Welsh Government, and DAERA, to the extent of their legislative competence.

The statutory procedure for putting in place a scheme is set out in Part 3 of Schedule 3 of the CCA. A UK-wide trading scheme must be established by Order in Council (see Paragraph 9 of Part 3, Schedule 3). Pursuant to paragraph 11, before a recommendation may be made to His Majesty in Council to make the Order in Council, a draft of the instrument containing the Order in Council must be laid before, and approved by, a resolution of each House of Parliament and the devolved legislatures.

Sections 51 and 52 of the CCA give the relevant national authority powers to give guidance or directions to the administrator of a trading scheme. To the extent that directions or guidance are to apply on a UK-wide basis, these must be made jointly.

The first instrument is subject to the affirmative procedure pursuant to s48(3)(a).

## **Schedule 2, Part 1 – Schemes Limiting Activities**

### **Trading Period**

Pursuant to paragraph 2 of schedule 2 of the CCA, the instrument must specify the period or periods by reference to which the scheme is to operate. This will need to be agreed by the four governments jointly.

## The Cap and allocation

Pursuant to paragraph 5(2)(a) of schedule 2 of the CCA, the instrument may set a limit on the total amount of the activities for a trading period.

The instrument may also set a limit on the total amount of the allowances to be allocated for the period pursuant to paragraph 5(2)(b) of the CCA. This provision will need to interact with auctioning regulations made under the FA, as a proportion of allowances will need to be allocated for auctioning. The instrument may also provide for the allocation among participants of allowances, pursuant to paragraph 5(1); the method of allocation may be specified in the instrument or provide for it to be determined in accordance with the instrument. We envisage that the vires for free allocation and the new entrants' reserve would come from these provisions.

Prior to making an instrument which sets a limit on the total amount of the activities to which a trading scheme applies for a trading period/periods, a national authority must obtain and take into account the advice to the CCC on the amount of that limit, pursuant to s48(2) of the CCA.

## Activities

Section 45 sets out overarching principles to guide the determination of whether activities are to be regarded as indirectly causing or contributing to GHG emissions and specifies that Part 3 of the CCA (relating to Trading Schemes) applies to activities carried on in the United

Kingdom, regardless of where the related emissions, reductions or removals of greenhouse gas occur.

The instrument must identify the activities to which the trading scheme applies, pursuant to paragraph 3(1) of schedule 2 of the CCA.

Activities may be identified by reference to any combination of criteria, including by reference to locations at which they are carried on, or by reference to the type of activity carried on. Pursuant to paragraph 3(6), the instrument may make different provisions in relation to different descriptions of activity to which the scheme applies.

## **Units**

The instrument must specify the units of measurement of the activities for the purposes of the scheme, pursuant to paragraph 3(3) of schedule 2.

Units of measurement may, in particular, be specified by reference to the amount in tCO<sub>2</sub>e (tonnes of carbon dioxide equivalent) of the greenhouse gas emissions for which those activities are to be regarded as responsible and as to the method by which that amount is to be measured/calculated.

The instrument will need to set out here which emissions are to be covered by the scheme and how they are to be measured in relation to the activities in scope of the scheme. The gases which are considered “greenhouse gas” for the purposes of the CCA are set out at s92(1).

Gases may be added to that list by Order if certain criteria are satisfied.

## **Participants**

The instrument must identify the persons to whom the trading scheme applies – the “participants”, pursuant to paragraph 4(1) of schedule 2 of the CCA.

There is a wide scope to how the participants of the scheme may be identified under paragraph 4. This paragraph also permits the instrument to provide for persons to cease to be participants in circumstances as specified in the instrument.

This provision could provide vires for an opt-out for ultra-small emitters, setting out which provisions of the instrument apply to excluded installations.

## **Use of allowances**

The instrument may require each participant to have or acquire enough allowances to match the participant’s activities in a trading period, pursuant to paragraph 6 of schedule 2.

The instrument may make provisions permitting participants to carry forward or backward allowances from one trading period to another and may specify limitations for this process.

In particular, the instrument may provide for the expiry of allowances and may enable allowances to be cancelled instead of used for the purposes of a trading scheme.



## Credits

Pursuant to paragraph 7(1) of schedule 2, the instrument may allow participants to offset their activities in a trading period by acquiring credits. Currently, credits are not intended to form part of the scheme.

## Stringency

The instrument must contain provision for ensuring that allowances used by a participant for the purposes of a trading scheme cannot be used by the participant for any other purpose, pursuant to paragraph 6(3) of schedule 2.

## Units under other schemes

Pursuant to paragraph 11 of schedule 2, the instrument may make provision for recognising allowances, credits or certificates under other trading schemes made under Part 1 of Schedule 2 or units under any other trading scheme relating to greenhouse gas emissions.

## Payments

Paragraph 8 of schedule 2 permits provision to be made about payments which participants may be required to make if they do not have or acquire enough allowances or credits to match or offset their activities in a trading period to be incorporated into the instrument.

The amount of the payment may be determined by the administrator or national authority and if a participant fails to make the payment within the specified time, the instrument may make provision for the amount to increase until payment is made.

If the payment provisions provide for payment to be made to a person other than a national authority, they must provide for that person to pay the sums received to the national authority or authorities specified in or determined in accordance with the instrument.

## **Trading**

Pursuant to paragraph 9(1) of schedule 2, the instrument must provide for the participants in a trading scheme to trade in any allowances or credits under the scheme and the circumstances in which trading is permitted.

The instrument may also provide for trading in the allowances by third parties authorised in accordance with the instrument.

## **Permits**

Pursuant to paragraph 10 of schedule 2, the instrument may require participants to hold permits for carrying on activities and may make provision about the issue, variation, transfer, surrender and revocation of permits and also for conditions to be attached to permits.

## **Schedule 2, Part 3 – Administration and Enforcement**

### **The administrator**

A person (from a pre-determined list set out at paragraph 21(3) of schedule 2) may be appointed as administrator of a trading scheme in the instrument and the instrument

may confer or impose functions on the administrator for the purposes of the scheme.

## Information

The instrument may require information (which may be specified in or determined in accordance with the instrument) to be provided to the administrator, national authority or participants or potential participants in the scheme for purposes connected with the scheme, pursuant to paragraph 22 of schedule 2.

This provision gives a broad power for information gathering and sharing in relation to the scheme.

Paragraph 22(3) requires that any request by the administrator pursuant to paragraph 22(2) must be made in writing.

The instrument may provide for information held by or on behalf of the administrator to be disclosed to any other administrator or a national authority.

## Registers

Pursuant to paragraph 23 of schedule 2, the instrument may provide for the creation and maintenance of a register(s) of information relating to a trading scheme.

Notably, registers created pursuant to this provision may include accounts in which allowances, credits, certificates, or other units may be held by the participants, administrator, or others and between which they may be transferred. They may also make provision for the disclosure of information held on or derived from

a register for the purposes of the administration of any other trading scheme (for example, the EU ETS).

## **Publication of information**

The instrument may include provision for the administrator to publish information relating to the scheme or its participants, pursuant to paragraph 24 of schedule 2.

## **Acquisition of units by the administrator**

The instrument may confer powers on the administrator to acquire allowances under another trading scheme or units under other trading schemes relating to greenhouse gases.

## **Charges**

Paragraph 26 of schedule 2 allows the instrument to require the payment by participants or other persons authorised to trade in allowances, credits, or certificates of charges by reference to the costs of operating the scheme. These may be imposed by a national authority, administrator or other person as specified in the instrument.

Where the instrument makes provision for charges to be paid to a person other than a national authority, they must provide for that sum to be paid by that person to the national authority/authorities.

## Monitoring and verification

The instrument may make provision for monitoring compliance with the requirements of a trading scheme and verification of information, pursuant to paragraph 27 of schedule 2.

The power to make an instrument under this provision is broad but lists certain things that the regulations may make provision about, including the audit and verification of information and the inspection of premises.

## Enforcement

The instrument (see paragraph 28 of schedule 2) may make provision for a person (a national authority, a regulator or another person as specified by the instrument), when they reasonably believe there has been a failure to comply with the requirements of a trading scheme to:

- require the production of documents or information,
- question officers of a company,
- enter premises with a warrant, or
- seize documents or records.

## Penalties

The instrument may provide for the imposition of financial or other penalties if a person fails to comply with the requirements of a trading scheme, specifying the amount of any financial penalty or providing for the amount of

the penalty to be determined in accordance with the instrument, pursuant to paragraph 29 of schedule 2.

Where the instrument makes provision for financial penalties to be paid to a person other than a national authority, they must provide for that person to pay the sum to the national authority/authorities specified in the instrument.

## **Offences**

The instrument may create offences relating to trading schemes, pursuant to paragraph 30 of schedule 2.

## **Appeals**

The instrument may confer rights of appeal against decisions made in relation to a trading scheme, and civil penalties imposed, or enforcement action taken for failure to comply with the requirements of a trading scheme.

Where rights of appeal are incorporated into an instrument, they must specify the court, tribunal or person who is to hear and determine appeals in relation to the trading scheme, pursuant to paragraph 31 of schedule 2.

## **Finance Act 2020**

Most of the powers needed to create a UK ETS are in the CCA. Pursuant to s46(1), schedule 2 specifies the matters that must or may be provided for in regulations. However, Schedule 2, paragraph 5(4) specifically states that regulations made under the CCA s44 “may not provide for allowances to be allocated in return for

consideration”. In practice, this means that in order to achieve the policy intent that a UK ETS will include the auctioning of allowances for payment, alternative powers are needed to introduce these regulations.

The auctioning of allowances (i.e. the allocation of allowances in return for consideration) is the default method of allocating allowances within the EU ETS and is intended to be so for the UK ETS. It is the most transparent allocation method and puts into practice the principle that the polluter should pay. Auctioning creates a market-based, and therefore industry-driven, approach to decarbonisation, allowing flexibility that ensures emissions are cut where it costs least to do so. A robust carbon price also promotes investment in clean, low-carbon technologies. This is why auctioning is considered key for any ETS.

To remedy the prohibition created by schedule 2, paragraph 5(4), a power in primary legislation to allocate allowances in return for consideration, or a charging power, is required. Given that there is precedent for a charging power to be incorporated into the FA and considering the potentially significant fiscal impact of auctioning, the FA is the appropriate vehicle for such a power.

## **Auctioning**

Auctioning regulations required for a UK ETS relate to the Auctioning of allowances, the rules of auctions and the responsibilities of the auctioneer, auction platform and

participants. This power therefore needs to come from an FA clause. A Paving Clause was drafted into the Finance Bill in late 2018, which allows for preparatory spending on an auction platform. It does not, however, allow for the sale of allowances and this will, therefore, require additional legislation.

## **Cost containment mechanism**

The Cost Containment Mechanism gives some confidence to the market that any very high price spike that occurs within a year can be mitigated. Pursuant to paragraph 5(4) of the CCA, there is a prohibition on the allocation of allowances in return for consideration. Under the CCM, allowances are injected into the scheme from elsewhere within the cap to increase supply at the present point in time by taking allowances from within the cap, and then auctioning them. Therefore, regulations for the CCM will need to be made under the FA.