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Net Zero, Energy and Transport Committee

Net Zero, Energy and Transport Committee report on the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024

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Contents

Net Zero, Energy and Transport Committee

To consider and report on matters falling within the responsibility of the Cabinet Secretary for Transport and the Cabinet Secretary for Net Zero and Energy, with the exception of matters relating to just transition; and on matters relating to land reform, natural resources and peatland, Scottish Land Commission, Crown Estate Scotland and Royal Botanic Garden within the responsibility of the Cabinet Secretary for Rural Affairs, Land Reform and Islands.

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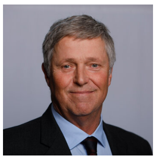

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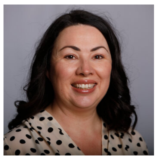

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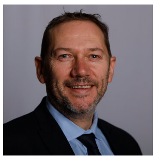

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Introduction

1. The Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 (draft) was laid before the Scottish Parliament on 22 October 2024. The draft instrument was referred to the Net Zero, Energy and Transport Committee for consideration and is subject to the affirmative procedure, meaning it must be approved by the Scottish Parliament before it can come into force.

2. It is for the Net Zero, Energy and Transport Committee to recommend to the Scottish Parliament whether the draft Order should be approved. On 2 October 2024, the Acting Cabinet Secretary for Net Zero and Energy, Gillian Martin MSP, lodged motion S6M-14755, proposing that the Committee recommends the draft Order be approved.

3. The instrument makes various changes to the UK Emissions Trading Scheme (the “UK ETS”). The UK ETS is a system of carbon reduction and trading for UK businesses in energy-intensive sectors, run by the governments of the United Kingdom. It aims to reduce overall emissions by imposing a cost on them and therefore creating a financial incentive to decarbonise.

4. The SI expands the scope of the scheme to carbon dioxide venting in the upstream oil and gas sector, introducing a new type of enforcement notice called a ‘deficit notice’, and making technical changes to the scheme’s penalties.

5. In addition, the policy note states that this instrument will ensure legislative consistency by implementing changes that were previously unable to be made on a UK-wide basis under the Climate Change Act 2008 (CCA) in the absence of a sitting Northern Ireland Assembly.

6. This instrument will also implement the reduction in the total number of allowances available for free allocation, expand the scope of the scheme to flights from Northern Ireland to Switzerland, and extend legislation to Northern Ireland that currently only extends to England, Wales and Scotland.

Delegated Powers and Law Reform (DPLR) Committee consideration

7. At its meeting on 29 October 2024, the DPLR Committee considered the instrument. It made no recommendations about the instrument but noted that the original draft of this instrument was withdrawn on 9 October 2024, and the present version re-laid on 22 October 2024 to correct an error, following a question raised by the Committee with the Scottish Government.

Read the Official Report - 29 October 2024

Net Zero, Energy and Transport Committee consideration

8. At its meeting on 19 November 2024, the Committee took evidence on the draft Order from:

   - Gillian Martin, Acting Cabinet Secretary for Net Zero and Energy, Scottish Government
   - Mariana Cover, Senior Policy Advisor, Scottish Government
   - Nanjika Nasiiro, Head of Just Transition Policy, Scottish Government

9. The evidence taken at the meeting can be read in the Official Report, which is available at the following web page:

   Read the Official Report 19 November 2024

10. In her opening remarks, the Cabinet secretary explained that the emissions trading scheme authority, formed by the four UK nations, is implementing changes to strengthen the Emissions Trading Scheme's (ETS) climate ambition. In June last year, the authority published a response to the consultation on developing the UK ETS, which included a number of commitments which are being implemented through this instrument, these include:

    - amending the cap trajectory so that it is better aligned with net zero targets;
    - covering additional emissions in the upstream oil and gas sector; and
    - improving the penalties process

11. With regards to the cap trajectory, she explained that in 2023 the authority committed to reduce the ETS cap by 30 per cent by 1 January 2024, and that amendment needed approval by the four UK legislatures. Because Northern Ireland did not have a sitting Assembly at the time, the authority used powers reserved to His Majesty's Treasury as a temporary measure to amend the number of allowances to be auctioned from 2024. Now that Northern Ireland has a functioning Assembly, the United Kingdom Government is amending the cap.

12. She also explained that the instrument would amend the industry cap, which limits the number of free allocations and creates a flexible share on the back of the changes to the cap trajectory.

13. The instrument also expands the ETS to cover emissions from CO2 venting in the upstream oil and gas sector. The Cabinet Secretary stated that CO2 venting—releasing emissions through pipes or vents—was not previously included as an ETS-regulated activity. In contrast, the flaring of CO2—burning the gases before releasing them into the atmosphere—is an ETS regulated activity. She noted that the inclusion of venting in the ETS aims to remove any "perverse incentives" for operators to vent gas containing CO2 that, if flared, would be exposed to the ETS carbon price.

14. Finally, she outlined that the instrument will introduce two penalties and amend existing penalties to improve the consistency, proportionality and fairness of the penalty process.

Inclusion of CO2 Venting

15. The Committee asked what the practical effect of expanding the ETS to cover emissions from CO2 venting would be for companies operating in the North Sea basin.

16. The Cabinet Secretary stated that while the practice of venting is not a regular occurrence, currently there is a "perverse incentive" to vent without flaring, to avoid impacting ETS allocation and that the instrument would close this loophole. She said, “We do not want a situation in which CO2 is being vented into the atmosphere, because that essentially has the same effect as flaring. It means that operations will have to be consistent with not venting CO2.”[i]

17. The Committee inquired whether relevant operators will be able to measure venting accurately and if this change to the ETS to cover venting would place an extra burden on them. The Cabinet Secretary clarified that operators are required by law to measure all emissions stemming from their activities and that, in her view, it would not place an additional burden on operators. She said, “In fairness to the oil and gas industry, it is working hard to reduce production emissions. The order is therefore helpful, because those who are reducing their production emissions will save money as a result.”

18. The Committee asked why venting had not previously been included in the ETS. The Cabinet Secretary provided further information by way of a letter on 26 November. The letter stated that:

> Regarding venting of CO2, the ETS has historically focused on emissions arising from combustion activities. CO2 venting focuses on process emissions arising from non-combustion activities and so has not previously been in scope. Therefore, while we were under the EU ETS, venting of CO2 process emissions in the upstream oil and gas sector was not a regulated activity. After Brexit, venting of CO2 process emissions continued to be excluded as the EU ETS was retained law in the United Kingdom from Brexit (31 January 2020) until 1 January 2021 when it was replaced by the UK ETS.[ii]

Future developments to the ETS

19. The Committee asked whether there would be further moves in the ETS to enhance decarbonisation of the oil and gas sector, and what discussions the Scottish Government has had with the UK Government about this, and the fiscal regime to ensure that decarbonisation continues apace.

20. The Cabinet Secretary stressed the need for a fiscal regime that not only supports the oil and gas industry but also facilitates its transition to net zero. She highlighted the involvement of many oil and gas producers in ScotWind licence options, which are crucial for maintaining the supply chain and workforce in Scotland. The Cabinet

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i Net Zero, Energy and Transport Committee, Official Report , 19 November 2024, Col: 3
ii Letter from the Cabinet Secretary for Net Zero and Energy, 26 November 2024

Secretary argued that discouraging activity in this sector could lead to the relocation of the workforce to other parts of the world, depriving Scotland of the expertise needed to develop ScotWind and other energy industries. She pointed out that Scotland has a strong track record in decarbonisation, thanks to innovative approaches and targeted oil and gas licensing routes. Specifically, she mentioned the Innovation and Targeted Oil & Gas (INTOG) scheme, which allows for the development of floating offshore wind to power existing oil and gas platforms, thereby reducing emissions by replacing diesel with electricity.

21. The Committee asked about the UK Government's responsiveness to the needs of the oil and gas industry, particularly regarding fiscal and regulatory regimes that would support further decarbonisation. The Cabinet Secretary noted that while the government is partially listening, there have been significant concerns from the oil and gas sector about fiscal penalties. She cited the example of Apache withdrawing from the North Sea due to the extension of producer liability (EPL), which affected existing fields rather than new ones. The Cabinet Secretary highlighted the importance of a managed transition to avoid a sharp decline in production and employment. She noted the ongoing demand for natural gas in the UK, which is still used for the majority of heating, and the employment of 58,000 people in the oil and gas sector. She contended that any abrupt changes in the fiscal regime could lead to a precarious drop-off in production, necessitating increased imports and causing job losses. The Cabinet Secretary again emphasised the need for a just transition, ensuring that as the amount of oil and gas available in the UK continental shelf decreases, the transition is managed in a way that creates future jobs in the energy sector, supported by an appropriate fiscal regime.

Carbon Tax

22. The Committee inquired about the status of a carbon tax, referencing previous discussions with the UK Government and comparing it to Norway's approach, which includes both an Emissions Trading System (ETS) and a carbon tax on the oil and gas sector. The Cabinet Secretary responded that in her three months as cabinet secretary, she had not discussed a carbon tax, and it was not mentioned in the UK Government's budget. She mentioned the extended producer liability, which she considers a form of carbon tax on the oil and gas industry and emphasised that any revenue from such taxes should fund net zero activities, such as decarbonising heat in buildings and the gas grid. She also discussed the ongoing work with the UK Government on the carbon border adjustment mechanism to align it with the UK ETS and avoid negative impacts on Scottish exporters.

Penalties

23. The Committee noted that the instrument introduces two new penalties and modifies several existing ones and asked if the regulatory regime has been assessed, and if breaches are expected to be rare exceptions.

24. The Cabinet Secretary explained that the regulatory regime would remain the same, with penalties for operating without a permit, underreporting, and failing to surrender allowances for emissions. She noted that penalties would increase with inflation, providing more incentives to comply with the rules. The Cabinet Secretary was optimistic that breaches would be rare, given the ample warning about the ETS implementation.

25. The Committee inquired about non-compliance figures. The Cabinet Secretary's letter of 26 November includes figures on the levels of non-compliance resulting in a civil penalty under the main ETS since 2021 and states that:

> in the 3 years since the UK ETS started, only 3 civil penalties have been issued to 2 operators, a significantly smaller number than the ETS compliant operators. Most non-compliances do not result in a civil penalty. Non-compliances are generally used where there has been an under surrender of allowances.[iii]

26. While noting the inflationary increase to penalties, the Committee questioned the robustness of the regime given that a £5,000 penalty might not significantly impact large operators. The Cabinet Secretary highlighted additional measures to incentivise decarbonisation, such as the reduction of free allocations, particularly in aviation, where no free allocations will be available after 2026. When asked about potential capacity issues for regulators, the Cabinet Secretary assured the Committee that none were expected, indicating it would be business as usual.

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iii Letter from the Cabinet Secretary for Net Zero and Energy, 26 November 2024

Conclusion

27. Following the conclusion of evidence taking, the Deputy First Minister moved motion S6M-14755 in her name:

That the Net Zero, Energy and Transport Committee recommends that the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 [draft] be approved.

The motion was agreed to without debate or division.

> The Net Zero, Energy and Transport Committee recommends that the Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2024 [draft] be approved.