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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) Order 2025 (draft)

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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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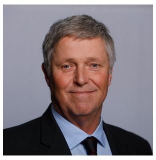

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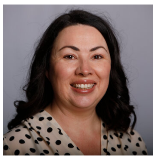

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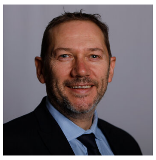

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Introduction

1. The Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2025 (draft) was laid before the Scottish Parliament on 3 December 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 4 December 2024, the Acting Cabinet Secretary for Net Zero and Energy, Gillian Martin MSP, lodged motion S6M-15731, proposing that the Committee recommends the draft Order be approved.

3. This instrument will make changes to permanent cessation policy in 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 create an incentive to decarbonise.

4. The UK ETS involves some amount of free allocation of allowances to various businesses as a means of ensuring they are not at a disadvantage when competing with firms in other jurisdictions, and preventing carbon leakage (businesses relocating to jurisdictions with lesser environmental regulations). Many businesses receive free allocations, and a Free Allocation Review has been held in recent years.

5. The permanent cessation policy in the UK ETS applies to operators of installations and participants in the scheme who stop carrying out regulated activities permanently. This policy ensures that operators are no longer required to comply with obligations under the UK ETS once they cease operations, provided certain conditions are met. Currently, the permanent cessation policy means that when there is permanent cessation of some level of activity within a business, operators can benefit from a surplus of free allowances during the year in which the cessation occurred.

6. The main changes made by this instrument are set out in the policy note and include:

   - Permanent cessations, free allocations: the volume of free allocation which an operator is entitled to in the final year in which operations are carried out at one or more sub-installation is calculated by reference to the level of activity at the relevant sub-installation in that year (the "final year rule"). To facilitate this, amendments are made to UK ETS legislation requiring operators to prepare an activity level report in respect of the final year in which operations are carried out at a sub-installation. That activity level report will be used to recalculate the volume of free allocation the operator is entitled to in the final year in which operations are carried out at a sub-installation and any overallocation must be returned in accordance with existing scheme rules.

   - The SI changes the permanent cessation policy so that the level of allowances given in the final year of operation would be based on actual activity levels for that final year, as opposed to average levels of activity. This would mean that the free allocation in their final year is proportionate to their activity levels.

- This instrument includes an exception to the final year rule in circumstances in which the permanent cessation of operations at a sub-installation is part of a series of changes which result in a material increase in the carbon efficiency of activities which continue to be carried out at the installation.

- The SI also involves an exemption to the new rules so that if the business can prove that the cessation of activity will ultimately result in more carbon efficient operations, they can retain the free allowances. An example of this is when an older piece of equipment ceases activity and is replaced by a more efficient new piece of equipment. Participants closing for decarbonisation will therefore be able to retain the full entitlement, subject to sufficient evidence being provided.

- Permanent cessations, definitions: This instrument also amends the circumstances in which an installation or sub-installation has “ceased operation” for the purposes of the UK ETS Order.

- Permanent cessations, operator notifications: This instrument also introduces a requirement for the operators to notify the relevant scheme regulator of circumstances in which regulated activities cease to be carried out at an installation by the end of the scheme year in which the cessation occurs and confirm whether the operator intends for one or more regulated activities to resume at the installation. Operators are similarly required to provide details of a cessation of operations in respect of sub-installation in annual activity level reports.

Delegated Powers and Law Reform (DPLR) Committee consideration

7. The DPLR Committee considered the instrument on 10 December and reported on it in its 76th Report, 2024. The DPLR Committee made no recommendations in relation to the instrument.

Net Zero, Energy and Transport Committee consideration

8. At its meeting on 14 January 2025, the Committee took evidence on the draft Order from:

- Gillian Martin, Acting Cabinet Secretary for Net Zero and Energy, Scottish Government
- Nanjika Nasiiro, Unit Head for Net Zero Economy and Carbon Markets, Scottish Government
- Mariana Cover, Emissions Trading Scheme Team Leader, Scottish Government
- Kenneth MacDermid, Head of Critical Energy Infrastructure, 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 14 January 2025

10. In her opening remarks, the Acting Cabinet Secretary explained that free allowances are granted to sectors at risk of carbon leakage—where emissions are offshored due to regulatory costs. Following a joint consultation between December 2023 and March 2024, the Scottish Government and other UK nations proposed adjustments to ensure that businesses ceasing operations do not retain excess allowances, preventing unintended financial gains. The instrument implements these adjustments and also updates the definition of permanent cessations, addressing situations in which temporary cessations become permanent, to ensure clarity and consistency in the allocation process.

11. She also explained that the new rules require final-year emissions reporting for permanently ceasing operations, enabling regulators to reclaim excess allowances and align allocations with actual emissions. An exemption will apply to operators transitioning to lower-carbon production methods, such as electrification, to ensure that decarbonisation efforts are not penalised. Once in force, the changes will apply to all operators. The Acting Cabinet Secretary stated that:

> “The new rules are designed to ensure fairness and accuracy in free allocation distribution, ensuring that support is targeted to those sectors that are at risk of carbon leakage. ”[i]

Assignment of free allocations

12. The Committee asked whether the Scottish Government had considered a scenario where a plant ceases operations and those operations are transferred to another plant and the potential impact on emissions. The Acting Cabinet Secretary explained that free allocations are assigned to individual plants. A Scottish

i Net Zero, Energy and Transport Committee, Official Report, 14 January 2025, Col: 3

Government official explained:

> "Free allocations are calculated on a yearly basis. If the activity of a closed sub-installation is passed to another sub-installation under the same operator and that increases the latter's emissions, there is a threshold of 15 per cent for recalculating the free allocations. So, if the activity goes up by more than 15 per cent, the free allocations will be recalculated."[ii]

EU alignment

13. The Committee asked how the rules align with or differ from the EU Emissions Trading System (ETS). The Acting Cabinet Secretary stated that the UK has been adjusting its ETS rules to align more closely with the EU's. She noted that a previous loophole allowed a plant to retain free allocations even after ceasing operations, despite the allocations having value associated with them. This instrument seeks to close that loophole.

Impact assessment

14. The Committee asked what impact assessments had been conducted regarding the instrument's effect on Scottish businesses. The Acting Cabinet Secretary responded that a full impact assessment was not carried out due to a lack of regulatory provision for one. However, she stated that an analysis of changes to permanent cessation rules was published in November 2024 as part of the UK ETS Authority's response to the free allocation review consultation. She emphasised that the instrument aims to prevent plants from retaining valuable free allocations after ceasing operations, addressing criticism of this loophole.

15. The Committee questioned whether the system was becoming too complex for businesses to navigate, citing recent comments on the need for a carbon trading regime that supports both industry and decarbonization. The Acting Cabinet Secretary stated that the ETS exists to prevent carbon leakage and that regulations are necessary to drive decarbonization in high-emitting sectors.

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ii Net Zero, Energy and Transport Committee, Official Report, 14 January 2025, Col: 4

Conclusion

16. Following the conclusion of evidence taking, the Acting Cabinet Secretary moved motion S6M-15731 in her name:

    That the Net Zero, Energy and Transport Committee recommends that the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2025 [draft] be approved.

17. 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) Order 2025 [draft] be approved.