CLIMATE CHANGE ACT 2008

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 3: Trading Schemes

Trading schemes

Section 44: Trading schemes

203. This section provides the relevant national authority (defined in section 47 as the Secretary of State, the Scottish Ministers, the Welsh Ministers or the relevant Northern Ireland department) with the power to set up trading schemes relating to greenhouse gas emissions using secondary legislation.

204. S*ubsection (2)(a)* provides for trading schemes which limit activities that consist of the emission of greenhouse gases, or that directly or indirectly lead to such emissions (for example, "cap and trade schemes" which cap emissions from a particular set of activities and allow trading of emissions within the cap). *Subsection (2)(b)* provides for trading schemes which encourage activities that directly or indirectly lead to a reduction in greenhouse gas emissions or the removal of greenhouse gases from the atmosphere.

Section 45: Activities to which trading schemes may apply

205. This section sets out what activities are regarded as indirectly causing or contributing to greenhouse gas emissions or reductions in greenhouse gas emissions. It also makes provision in relation to the location of activities and emissions covered by this Part.

206. *Subsection (1)* sets out the types of activity which are considered to be indirect causes of, or contributors to, greenhouse gas emissions, such as activities which involve the use of energy or those involving the supply of something the use of which would lead to greenhouse gas emissions. For example, the supply of a heating fuel would be regarded as indirectly causing emissions because it leads to emissions at the point of use by the consumer. *Subsection (2)* provides that reductions in the level of those activities are to be regarded as indirectly causing or contributing to reductions in greenhouse gas emissions.

207. *Subsection (3)* provides that Part 3 of the Act applies to activities carried out in the United Kingdom, regardless of where emissions, or reductions in emissions, actually occur.

Section 46 and Schedule 2: Matters that may or must be provided for in trading schemes

208. *Subsections (1) and (2)* introduce Schedule 2 to the Act, which gives further details about regulations establishing trading schemes. *Subsection (3)* provides that regulations may also contain provision about their application to the Crown.

Schedule 2: Trading schemes

209. *Schedule 2* makes specific provision on what may or must be included in regulations establishing trading schemes. Parts 1 and 2 make provision, respectively, in relation to trading schemes operating to achieve different results; but it is possible to make trading schemes that operate to achieve both types of results by combining different elements of those Parts.

210. *Part 1 of Schedule 2* contains details of what can or must be included in a trading scheme which operates by limiting, or encouraging the limitation of, activities that consist of or lead to emissions of greenhouse gases. For example, the Carbon Reduction Commitment, a proposed scheme to reduce energy use, would be a scheme under Part 1 of Schedule 2.

211. A trading scheme under Part 1 must operate by having trading periods (*paragraph 2*), by defining the activities covered by the scheme (*paragraph 3(1)*) and by specifying scheme "units" (which may be specified by reference to the activities themselves, things consumed or used for their purposes, things produced by the activities or other consequences of the activities) (*paragraph 3(3) and (4)*). The scheme must define the participants covered by it; participants may be defined by reference to criteria (*paragraph 4*).

212. A scheme under Part 1 may provide for allowances to be allocated to participants; allowances represent the right to carry out a specified amount of the activity covered by the scheme. But the regulations cannot provide for allowances to be allocated in return for payment (*paragraph 5*). Any provisions for auctioning allowances would be contained in different legislation (for example, a Finance Act).

213. The scheme rules may require a participant to have or acquire a certain number of allowances to cover his activities in a trading period (*paragraph 6*). A scheme may also allow or require the participant to purchase defined credits to offset his activities, but the regulations can also place limits on the use of credits (*paragraph 7*). A scheme might also operate by requiring payments to be made if the participant did not hold a sufficient number of allowances or credits (*paragraph 8*).

214. A scheme under Part 1 must allow trading in allowances or credits under the scheme, and the scheme must set out the circumstances in which trading will operate. Third parties (who would not otherwise be participants) may also be allowed to trade (*paragraph 9*). A trading scheme may also specify that activities can only be carried out if the participant holds a permit (*paragraph 10*) and may allow recognition of allowances, credits, certificates or other units issued under other trading schemes (whether at domestic, European or international level) (*paragraph 11*).

215. *Part 2 of Schedule 2* contains details of what can or must be included in a trading scheme which operates by encouraging activities that consist of, or that cause or contribute (directly or indirectly) to reductions in greenhouse gas emissions or the removal of greenhouse gases from the atmosphere.

216. A trading scheme under Part 2 must operate by having trading periods (*paragraph 13*), by defining the activities covered by the scheme (*paragraph 14(1)*) and by specifying scheme "units" (which may be specified by reference to the activities themselves, things consumed or used for their purposes, things produced by the activities or other consequences of the activities) (*paragraph 14(3) and (4)*). The scheme must define the participants covered by it; participants can be defined by reference to criteria (*paragraph 15*).

217. A scheme under Part 2 must set targets for participants to achieve in the trading period (*paragraph 16*). They must provide for the issue of certificates to participants; certificates act as evidence of the amount of the activity that has carried on, but can also be used as evidence of the activity of another person. The scheme must require each participant to have, at the end of a trading period, enough certificates to meet his

target (*paragraph 17*), and may provide that a participant who does not have enough certificates should have to make payments (*paragraph 18*).

218. A scheme under Part 2 must allow trading in certificates under the scheme, and the scheme must set out the circumstances in which trading will operate. Third parties (who would not otherwise be participants) may also be allowed to trade (*paragraph 19*). A trading scheme may allow recognition of allowances, credits, certificates or other units issued under other trading schemes (whether at domestic, European or international level) (*paragraph 20*).

219. *Part 3 of Schedule 2* makes provision on the administration and enforcement of trading schemes.

220. The regulations may appoint an administrator of the scheme and impose functions on him; the administrator must be one of the national authorities or a public body, or a combination of any of these (*paragraph 21*). The administrator of a trading scheme is the body which operates the scheme on a day-to-day basis.

221. The regulations can require the disclosure of information to the administrator, national authorities or participants (*paragraph 22*). A scheme may provide for the creation and maintenance of registers to keep track of participants, their obligations, trading and other information in the scheme (*paragraph 23*). The regulations can allow certain information to be published (*paragraph 24*); for example, they might provide for the publication of a list showing participants' performance in the scheme.

222. The scheme can allow the administrator to buy trading units in other schemes, which may be schemes made under the Act or other similar schemes such as the EU Emissions trading scheme (*paragraph 25*). The scheme may also require the payment of charges covering all or part of the costs of the scheme; the charges may be imposed on participants and other people eligible to trade in allowances, credits or certificates (*paragraph 26*).

223. The scheme can include provision setting out how compliance with the scheme is to be monitored and on the keeping of records by participants, the provision of information, audit and the inspection of premises (*paragraph 27*). The scheme can also make further provision for enforcement of the scheme where it is reasonably believed that there has been a failure to comply with the scheme's requirements (*paragraph 28*).

224. The scheme can make provision for the imposition of civil financial penalties or other types of penalty for failure to comply with the scheme rules (*paragraph 29*) and creating criminal offences relating to the scheme (*paragraph 30*). A scheme may also make provision for appeals against decisions and enforcement action, and allow those appeals to be heard by independent appointed persons (*paragraph 31*).