A summary guide to the UK Emissions Trading Scheme
The UK emissions trading scheme is a new policy initiative which forms part of the UK Climate Change Programme. Emissions trading is an approach designed to allow greenhouse gas emission reductions to be made in the most economically efficient way. Emissions trading is already being developed internationally – it is a central part of the Kyoto Protocol, and the European Commission has also proposed that EU-wide trading at company level should start in 2005. The Government is setting up a UK emissions trading scheme to start in 2002. This will allow UK business and other organisations to get early experience of emissions trading. When it starts it will be the world's first economy-wide greenhouse gas trading system.

**How does it work?**

An emissions trading scheme is a way of setting an overall target covering a group of organisations, and then letting those participants decide in a flexible way how to achieve their own target. Because greenhouse gases have the same environmental impact regardless of where they enter the atmosphere, it doesn't matter how much individual organisations emit, as long as the overall target is met. Participants can either:

- *meet* their target by reducing their own emissions;
- reduce their emissions *below* their target and sell or bank the excess emissions allowances; or
- let their emissions remain *above* their target, and buy emissions allowances from other participants.
The best strategy will depend on the price of allowances in the market compared to the costs of making emission reductions. Across the whole scheme, those with lower cost emission reduction opportunities will tend to sell allowances to those with higher cost options thus reducing the overall cost of delivering the environmental benefits. The wider the participation in the scheme the greater these cost reductions are likely to be.

**Who can participate?**
The UK emissions trading scheme is a voluntary scheme that will start in April 2002. There are four main ways to enter:

(i) The Government has agreed to provide a financial incentive for organisations that agree to take on voluntary targets for a five-year period, 2002-2006. Up to £215 million has been made available, equivalent to £30 million per year after tax. Participating organisations will be required to make absolute reductions in emissions against a 1998-2000 baseline. The targets and the level of incentive payment will be set through a competitive bidding process. Each participant will be able to bid in absolute levels of emission reduction at prices set through an auction, to be held in January 2002. The Government will be aiming to obtain the maximum level of reductions for the incentive money. Organisations successfully bidding in the auction will then have to deliver five equal annual emission reductions to qualify for their incentive payments.
(ii) Companies which already have emission or energy targets set through the Climate Change Agreements will be able to use the trading scheme either to help meet their target or to sell any over-achievement if they can do better than their target. Many of the targets set through the Climate Change Agreements are efficiency targets – i.e. relative rather than absolute emission caps – so trading by these companies will be subject to certain restrictions. A “gateway” will control the flow of allowances from this sector into the rest of the trading scheme.

(iii) Organisations will be able to undertake emission-reduction projects and sell the resulting credits into the scheme. These credits can then be used by other participants to meet their targets. A project must be additional to emission reductions that would have been delivered under business as usual.

(iv) Anyone who doesn't want to enter the scheme on the basis of an emissions target or an emissions reduction project can simply open an account in the registry to buy and sell allowances.

**Who can apply for the financial incentive?**
The incentive is available to most businesses and other organisations that are responsible for greenhouse gas emissions within the UK, although some emission sources are not eligible. Ineligible sources include emissions already covered by a Climate Change Agreement and those from electricity generation for usage off-site. Some additional restrictions are set out in the framework document for the scheme. It will be possible for a participant to take on a target based on emissions from one or more other organisations. An energy services company, for example, could join the scheme by taking a single target covering emissions from a number of client sites.
Reporting emissions
A participant's emissions will include both direct emissions – such as those from fossil fuel combustion or other industrial processes – and indirect emissions associated with energy usage. In this way all measures that reduce energy use or emissions will contribute towards delivering the target reductions. Each participant will need to measure and report their initial (baseline) emissions and their annual emissions according to the Government's reporting guidelines. All reported emissions will be subject to independent third-party verification.

Structure of the emissions trading scheme
Allocating allowances and credits

Organisations which receive the financial incentive will have emission targets covering each annual compliance period. Organisations will be allocated emissions allowances equal to this target each year, provided they have been in compliance in the previous year. For the first year of the scheme, organisations will receive allowances for the compliance period January to December 2002 in April 2002. For subsequent years, allocation of at least some allowances may be made earlier than this. At the end of each compliance year, organisations will have a three-month reconciliation period to compile their verified emissions report and to undertake any further trading necessary to meet their target. By the end of this period each participant will have demonstrated to the Government that it has sufficient allowances to cover all of its emissions. This form of emissions trading is called “cap and trade”.

Companies entering the scheme through the Climate Change Agreements will not receive allowances up front. At the end of each “milestone year” in which they have targets (every second year starting from 2002) they will receive allowances if they have beaten their target, or they will be able to buy additional allowances if they have not achieved their target. This form of emissions trading is called “baseline and credit”.

Emission reduction projects will only receive credits after the emission reductions have been verified. The rules for projects are being developed separately to those covering the rest of the scheme but the Government hopes to allow projects to start as soon as possible after the trading scheme is up and running.
**Trading allowances**

All allowance holdings will be recorded on a computerised registry. All target-holders will have a compliance account in the registry for their allowances issued by Government. Following each compliance period the Government will check the total holdings in each compliance account and all allowances needed to cover emissions over the preceding year will be retired. Any allowances that remain can be banked for future use or sold. There will be no restriction on banking up to 2007. Participants with absolute emissions targets will also be able to bank any over-achievement of their own target into the Kyoto Protocol commitment period starting in 2008.

Trading emission allowances is no different from trading any other commodity. Anyone who holds an account in the registry will be allowed to buy and sell allowances. Participants in the scheme will be able to trade directly between themselves or through third party brokers.

**Compliance**

If a trading scheme is to deliver the expected environmental benefit there must be a robust compliance mechanism to ensure that it is always preferable for participants to buy allowances rather than miss their targets. The scheme will be equipped with penalties that are sufficiently strong to ensure it operates effectively but are not disproportionate for a voluntary scheme. A participant must be able to demonstrate that it is in compliance in order to receive an incentive payment and a full allocation of allowances the following year.
What do I need to do to join the scheme?

There are several stages leading up to the start of the scheme:

August 2001: Framework document and reporting guidelines published;
August 2001 to December 2001: Pre-registration period to prepare bids for financial incentive;
January 2002: Registration and auction to allocate incentive money;
April 2002: Scheme starts.

Anyone that intends to apply for the financial incentive will need to be ready to take part in the auction in January 2002. To do this they will need information on their baseline emissions over the period 1998-2000, and on the expected cost of emission reductions below this baseline. Before they can start to calculate their baseline data they will need to ensure that they are eligible to participate in the scheme. They will also need to have a list of all the emission sources that they will bring into the scheme, compiled in line with guidance in the framework document and approved by Government. Organisations interested in participation can contact the Government during the pre-registration period to confirm the details of their application and to get their list of emissions sources approved. In addition, if an organisation wants to bring emissions not covered by the Government’s reporting guidelines into the scheme then it will have to ensure that a suitable protocol to measure and report these emissions is developed and approved.

Although there is no obligation to have baseline data fully verified in time for the auction, a participant entering the scheme via the financial incentive route will need to submit verified baseline data before it can receive its first allowance allocation. The Government therefore recommends that organisations start to engage an independent verifier to confirm their baseline emissions data as soon as possible. A list of potential verifiers can be provided by the United Kingdom Accreditation Service (www.ukas.co.uk).
Companies in Climate Change Agreements do not need to take part in the registration process described above. Their first step will be to open an account in the registry anytime after the registry opens in April 2002. They will then be free to start buying allowances. Any allowances placed in this account will contribute towards their targets. If they have beaten their target, they will need to have their performance verified at the end of the milestone periods before any allowances will be issued into their account.

The rules for emission reduction projects are still being developed. When these rules are in place project owners will be able to start the process of gaining approval for their proposals.

Any other participants who wish to buy or sell allowances in the scheme will be free to open an account in the registry anytime after April 2002.

**Where can I get information about the scheme?**
Additional information can be found in the framework document and the reporting guidelines. These can be found on the DEFRA website (www.defra.gov.uk/environment/climatechange/07.htm).

Alternatively, please get in contact with us for general or pre-registration enquiries at:

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