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By email to ukets.consultationresponses@energysecurity.gov.uk

Response to consultation on “UK ETS Future Markets Policy”

Dear Sir or Madam

Fuels Industry UK represents the eight main oil refining and marketing companies operating in the UK. The Fuels Industry UK member companies – bp, Essar, Esso Petroleum, Petrolneos, Phillips 66, Prax Refining, Shell, and Valero – are together responsible for the sourcing and supply of product meeting over 85% of UK inland demand, accounting for a third of total primary UK energy (based on the Department of Energy Security and Net Zero Digest of UK Energy Statistics 2022).

The refining and downstream oil sector is vital in supporting UK economic activity. It provides a secure supply of affordable energy for road and rail transport, aviation, and marine applications, as well as for commercial and domestic heating. It also supplies base fluids for use in lubricants, bitumen for use in road surfacing, and graphite for use in electric vehicle batteries and as electrodes in steel and aluminium manufacture.

The sector is poised to play a central role in enabling a Net Zero future by leading deployment of at-scale decarbonisation technologies to reduce our own emissions and those of others. It also brings expertise in delivery of large scale, complex and capital-intensive projects. Maintaining and accelerating such investment to support the Net Zero transition means the UK needs to be a globally competitive place to invest. However, the UK is now at risk of being left behind, due to domestic disadvantages and international incentives.

The UK has higher carbon and energy costs than most competitor countries, poorer incentives to develop low carbon technologies, and a policy environment that does not offer sufficient investor certainty. Consequently, the risks of carbon leakage and deindustrialisation are increasing steadily.

Fuels Industry UK believes strongly that the UK government should seek urgently to mitigate against future carbon leakage risk, acting on domestic policy measures alongside international and multilateral action. This includes a properly designed and effective UK Emissions Trading Scheme (ETS) that allows UK companies to compete with international competition, now and in the future. With that in mind, future market policy should include the following:

- A properly designed, effective and rapid cost containment mechanism (CCM) should be used to ensure that decarbonisation signals remain in place whilst not unduly penalising UK companies who are exposed to carbon leakage risk.
- A supply adjustment mechanism (SAM) should address long term allowance supply and demand imbalances that may prevent correctly functioning market price discovery and provide certainty for long term investment decisions.
- An auction reserve price (ARP) is not required if there is a SAM in place together with an effective CCM.
- Currently the CCM threshold is too high for the UK to remain a competitive place to do business. The application of the CCM should be automatic, rather than discretionary to provide certainty for UK operators.

Fuels Industry UK welcomes the opportunity to respond to the consultation on proposals for future market measures in the UK ETS. Our responses to the questions posed in the consultation document are given in Attachment 1.

Yours sincerely



Chris Gould

Energy Transition Lead, Fuels Industry UK

Appendix 1: Fuels Industry UK Response

1. Do you agree with the key risks we have identified? (Yes/No). Please provide any supporting evidence in your response.

No

While Fuels Industry UK agrees with Risks 1 and 3, we have concerns regarding the analysis of Risk 2.

While we agree from a decarbonisation point of view, a sudden significant and sustained price decrease could deter investment in decarbonisation, it does not recognise the wider impact on the emitting businesses themselves. A sudden drop-in activity leading to lower ETS allowance prices is likely to lead to a significant loss in revenue and financial viability for the business. This would also be the case in the example of higher energy costs presented in Risk 2. Therefore, increasing ETS allowance prices and compliance costs is likely to put further financial strain on the businesses concerned, with a potential for the business to close. This can have significant unintended consequences, such as a loss of Energy Resilience or indigenous UK manufacturing capability.

There needs to be recognition that short term pricing doesn't materially impact large scale investments which often have decade long return on investments¹; these decisions involve analysis of the relevant supply and demand balances over the medium to long term². Risk 2 is not seen as a significant risk to decarbonisation projects being developed.

Risk 2 would appear to preclude an event such as a novel and low-cost decarbonisation route being developed, which would reduce allowance costs; in this case having a means to keep prices above the market cost of decarbonisation is unreasonable if the market cost of decarbonisation falls rapidly.

There is no discussion within the consultation on the risk of speculative activity on the functioning of the UK ETS allowance system³. Financial entities with little or no link to physical emissions in the UK can potentially purchase, retain, and sell UK allowances in substantial quantities, in order to gain financially from the UK ETS system⁴. The mechanisms proposed in the consultation do little to mitigate

¹ <https://www.investopedia.com/terms/c/capital-investment.asp>

² <https://www.conocophillips.com/sustainability/managing-climate-related-risks/strategy/near-medium-long-term-risks/>

³ <https://euractiv.com/section/emissions-trading-scheme/news/politically-driven-eu-carbon-market-needs-more-transparency-analysts-agree/>

⁴ <https://kraneshares.com/krbn/>

downside pricing risk on allowances, increasing, rather than reducing incentives for ongoing speculative activity. We understand the UK Government did not find a risk of speculation in the UK ETS in their December 2023 review⁵; however, we would be grateful to see the evidence behind this assertion.

The impacts of ongoing speculative activity should be carefully considered and managed by DESNZ in order to avoid unintended consequences and reduce the attractiveness of the UK in which to operate and invest. This should be before 2028, the time suggested in the 2023 review.

In summary, there needs to be a recognition and analysis that Risk 2 as presented is overly simplistic and overly concerned with decarbonisation signals rather than the wider societal issues.

2. Are there any alternative risks to those listed above that the Authority should consider? (Yes/No). Please provide any supporting evidence in your response.

Fuels Industry UK's view is that there are additional risks evident throughout the consultation.

The first risk is a policy risk; the consultation describes competing ideas of "allowing price discovery to happen in the market" and "the price needs to be maintained to drive decarbonisation". The latter is problematic when the UK ETS price is driven to the level to drive decarbonisation before the means to effectively decarbonise are in place; for example, business models and market access to CCUS or low carbon hydrogen. The increased costs relative to international competitors drives businesses to close before investments can be made.

The second risk is a speculation risk, which can have a significant impact on the functioning of the UK ETS allowance system. Financial entities with little or no link to physical emissions in the UK can potentially purchase, retain, and sell UK allowances in substantial quantities, in order to gain financially from the UK ETS system. The impacts of these should be carefully considered and managed by DESNZ in order to avoid unintended consequences and reduce the attractiveness of the UK in which to operate and invest. We understand the UK Government did not find a risk of speculation in the UK ETS in their December 2023 review⁶; however, we would be grateful to see the evidence behind this assertion. The

⁵ <https://assets.publishing.service.gov.uk/media/657c79201c0c2a001318ce63/uk-ets-2023-review.pdf>

⁶ <https://assets.publishing.service.gov.uk/media/657c79201c0c2a001318ce63/uk-ets-2023-review.pdf>

impacts of ongoing speculative activity should be carefully considered and managed by DESNZ in order to avoid unintended consequences and reduce the attractiveness of the UK in which to operate and invest. This should be before 2028, the time suggested in the 2023 review.

3. Do you believe that the UK ETS would benefit from the introduction of a supply adjustment mechanism to address demand shift with long-term impacts risk? (Yes/ No). Please explain the reasons for your response.

Yes

Fuels Industry UK agrees that the UK ETS would benefit from the introduction of a supply adjustment mechanism to address demand shift. This mechanism ensures that the UK ETS operates in a coherent and predictable fashion to encourage investment in decarbonisation as well as providing certainty over costs for emitting businesses in the UK.

However, there is a presumption inherent in the consultation document that allowances will be in excess in the future, and this may not necessarily be the case. For example, delays in large scale decarbonisation projects including the UK clusters and the application of AR5⁷ may mean that the supply and demand balance could be significantly tighter than expected. This also needs to be considered and appropriate mechanisms put in place to address this risk.

There is no discussion within the consultation on the risk of speculative activity on the functioning of the UK ETS allowance system. Financial entities with little or no link to physical emissions in the UK can potentially purchase, retain, and sell UK allowances in substantial quantities, in order to gain financially from the UK ETS system. The mechanisms proposed in the consultation do little to mitigate downside pricing risk on allowances, increasing, rather than reducing incentives for ongoing speculative activity. The impacts of these should be carefully considered and managed by DESNZ in order to avoid unintended consequences and reduce the attractiveness of the UK in which to operate and invest.

⁷ <https://www.gov.uk/government/collections/contracts-for-difference-cfd-allocation-round-5>

4. If so, do you have a preference for a) a quantity-triggered supply adjustment mechanism or b) a price-triggered supply adjustment mechanism, as the best means of addressing this risk? Please give your reasons for your preference and response.

Fuels Industry UK's preference is for b) a price-triggered supply adjustment.

As outlined in the consultation, this is consistent with the approach taken in the majority other jurisdictions.

UK ETS prices rather than the number of allowances in circulation are the key concern for market participants and approach b) directly addresses that. UK ETS price certainty is key for both investment in decarbonisation and emitting business.

As the consultation acknowledges, the price impact of a quantity triggered SAM is less certain and is indirect than specific price triggers. We do not agree with the statement regarding the principle of price discovery as certainty of ETS allowance price is fundamental to both decarbonisation investment and the viability of emitter businesses.

In the absence of a properly redesigned, effective, and rapid cost containment mechanism (CCM), then the price triggered supply adjustment mechanism offers a potential alternative. If the CCM is designed and used appropriately (i.e. as in the US West Coast system with defined actions and prices) then a SAM can be used to adjust the supply within the "guard rails" provided by an effective CCM. However, we ascertain that to date the CCM has not been effective in providing certainty for emitters.

5. Do you agree with the Authority's minded-to position on the introduction of a quantity-triggered SAM? (Yes/ No). Please give your reasons for your response.

No

As outlined in the consultation, this is consistent with the approach taken in the majority other jurisdictions.

UK ETS prices rather than the number of allowances in circulation are the key concern for market participants and approach b) directly addresses that. UK ETS price certainty is key for both investment in decarbonisation and emitting business.

As the consultation acknowledges, the price impact of a quantity triggered SAM is less certain and is indirect than specific price triggers. We do not agree with the

statement regarding the principle of price discovery as certainty of ETS allowance price is fundamental to both decarbonisation investment and the viability of emitter businesses.

In the absence of a properly redesigned, effective, and rapid cost containment mechanism (CCM), then the price triggered supply adjustment mechanism offers a potential alternative. If the CCM is designed and used appropriately (i.e. as in the US West Coast system with defined actions and prices) then a SAM can be used to adjust the supply within the “guard rails” provided by an effective CCM. However, we ascertain that to date the CCM has not been effective in providing certainty for emitters.

6. Do you agree with the proposed approach for calculating the UK ETS TNAC? (Yes/ No) Please give your reasons for your response.

Yes

Fuels Industry UK broadly agrees with the proposed approach for calculating the UK ETS total number of allowances in circulation (TNAC).

However, the number of free allowances provided may be subject to change over the year, particularly if there is a move to dynamic allocation as suggested in the ongoing free allowance consultation⁸.

As we discuss in our response to Q1, there could also be changes in the UK ETS TNAC due to the impact of changes in investor holdings due to speculation activities; for example, responding to market signals such as the shape of the UK ETS Allowance curve relative to a different commodity or interest rate curve⁹.

Therefore, clarification is needed from DESNZ on how changes to free allocation volumes will be considered as this can change through the year.

7. If you disagree with the proposed approach, please suggest an alternative approach and your rationale for this?

Fuels Industry UK broadly agrees with proposed approach, with the caveat asking for clarification on how changes to free allocations issued will be considered, particularly if there is a move to dynamic allocation.

The TNAC could be calculated on a quarterly basis for example, as the number of free allowances is amended based on emitter activity levels.

⁸ <https://www.gov.uk/government/consultations/uk-emissions-trading-scheme-free-allocation-review>

⁹ <https://www.bankofengland.co.uk/statistics/yield-curves>

8. What is your view on what level of surplus constitutes a) an optimum level of surplus in the scheme, that would allow for effective functioning of the market and b) how could this be assessed including in terms of methodology? Please give your reasons and evidence you may have for your response.

As we discuss in our responses to Q4 and Q5, the UK ETS price is of primary importance to investors in decarbonisation and to the emitting businesses rather than the volume of allowances in circulation.

We therefore do not agree that there should be a set volume of surplus credits given; the number of allowances should be adjusted to maintain the UK ETS allowance price within given limits.

There is insufficient data in the analytical annex to determine what would be appropriate in terms of surplus level; we would therefore ask for the evidence on how DESNZ intend to judge and set an appropriate level of surplus.

9. Do you have a view on what level a) the upper quantity trigger threshold and b) the lower quantity trigger threshold should be in a UK ETS SAM? (Yes/ No). Please give your reasons and any evidence to support your response.

As we discuss in our responses to Q4 and Q5, the UK ETS price is of primary importance to investors in decarbonisation and to the emitting businesses rather than the volume of allowances in circulation.

We therefore do not agree that there should be a set volume of surplus credits given; the number of allowances should be adjusted to maintain the UK ETS allowance price within given limits.

10. How reactive should the upper and lower thresholds be, for example should each threshold have a sliding scale of supply adjustment? Please give your reasons and any evidence to support your response.

As we discuss in our responses to Q4 and Q5, the UK ETS price is of primary importance to investors in decarbonisation and to the emitting businesses rather than the volume of allowances in circulation.

We therefore do not agree that there should be a set volume of surplus credits given; the number of allowances should be adjusted to maintain the UK ETS allowance price within given limits.

11. Has the Authority identified all types of triggers that should be considered; or are there any other types of trigger thresholds that should be considered? Please give your reasons for your response.

Fuels Industry UK considers that the triggers should be price, rather than volume based.

We do not have any further comments on the types of triggers that should be used if a volume-based approach is undertaken.

12. Do you agree that relative trigger thresholds would be more appropriate than absolute static thresholds? (Yes/ No). Please give your reasons for your response.

Fuels Industry UK considers that the triggers should be price, rather than volume based.

We cannot comment on whether a relative or an absolute static threshold would be more appropriate in order to give the price stability that is required for the effective operation of the UK ETS scheme.

We would suggest that if a volume-based approach is taken then the method of either relative or absolute triggers is reviewed in the middle of the phase to ensure that it is providing the appropriate price stability required.

13. If you agree, what is your preference – relative trigger threshold values a) as a proportion of the annual UK ETS cap or b) relative to annual auction volume.

Fuels Industry UK considers that the triggers should be price, rather than volume based.

We cannot comment on whether a relative or an absolute static threshold would be more appropriate in order to give the price stability that is required for the effective operation of the UK ETS scheme.

We would suggest that if a volume-based approach is taken then the method of either relative or absolute triggers is reviewed in the middle of the phase to ensure that it is providing the appropriate price stability required.

14. What is your view on what the appropriate level of auction volume adjustment should be? Please give your reasons and any evidence for your response.

Fuels Industry UK considers that the triggers should be price, rather than volume based.

We cannot comment on the appropriate level of auction volume adjustment that would be required in order to give the price stability that is required for the effective operation of the UK ETS scheme.

We would suggest that if a volume-based approach is taken then level of auction volume adjustment s reviewed in the middle of the phase to ensure that it is providing the appropriate price stability required.

15. Do you have a preference for this adjustment to be a percentage of annual auction volume, or other fixed amount, a combination of both or any other metric? Please give your reasons for your response.

Fuels Industry UK considers that the triggers should be price, rather than volume based.

We cannot comment on the appropriate level of auction volume adjustment that would be required in order to give the price stability that is required for the effective operation of the UK ETS scheme.

We would suggest that if a volume-based approach is taken then level of auction volume adjustment s reviewed in the middle of the phase to ensure that it is providing the appropriate price stability required.

16. Do you agree with the proposed TNAC publication timing of post compliance in spring? (Yes/ No). If not, please explain your reasons.

No

As discussed in our responses to Q6 and Q7, the number of allowances in circulation will change through the year, especially if a dynamic approach is taken to issuing free allowances.

The publication of TNAC volumes at one moment in time may give an inaccurate indication of the volumes in circulation through the entire year, causing confusion and potentially incorrect signals to the market.

We would therefore recommend a quarterly approach to any publication of volume data. This would minimise the administrative burden to all while providing greater accuracy to participants.

17. What is your view on auction supply adjustment timings if the SAM is activated? Please give details of your preferred timings and rationale for this.

The number of allowances in circulation may change particularly if a dynamic approach is taken to the issuing of free allowances. Therefore, the timings on an annual basis may not fully consider changes to the number of allowances in circulation in any one calendar year and may cause market changes in their own right.

A more frequent review of auction volumes possibly quarterly may reduce this risk whilst managing the administrative burden for government and market participants.

However, we note that the consultation does not refer to any other potential options (for example there are no similar questions regarding a price-based SAM) and would ask if the minded to position is, in reality, a final position.

18. Should auction volume require adjustment due to SAM activation, do you agree that the Authority should endeavour to preserve approximate equal auction volume distribution in the time period affected by this adjustment? (Yes/ No). Please give your reasons for your response.

The number of allowances in circulation may change particularly if a dynamic approach is taken to the issuing of free allowances. Therefore, the timings on an annual basis may not fully consider changes to the number of allowances in circulation in any one calendar year and may cause market changes in their own right.

A more frequent review and adjustment of auction volumes possibly quarterly may reduce this risk whilst managing the administrative burden for government and market participants.

This is particularly relevant in the case of a price driven mechanism, where industries such as electricity or refining will be looking to match their allowances to their emissions closely in time to avoid creating a potential pricing exposure risk¹⁰.

¹⁰ <https://www.investopedia.com/terms/p/pricerisk.asp>

19. In your view, when, in terms of scheme year, should any quantity-triggered SAM be implemented into the UK ETS, meaning the SAM would begin operating the following year post compliance period? Please explain your reasons for your response.

We agree with the view expressed in the consultation regarding the continued smooth running of the scheme and to maintain certainty and predictability to participants.

With this in mind we would ask for as much notice as possible of any changes to the approach taken to any SAM implementation in the UK ETS. However, if a price-driven SAM is implemented then its implementation should be immediately followed following the price trigger to reduce potential pricing exposure risk.

20. Do you have any views on the interactions between any quantity-triggered SAM and the ARP and CCM? Please give your reasons and any evidence for your response.

In Fuel Industry UK's view, a SAM should address long term allowance supply demand imbalances that may prevent correctly functioning market price discovery. A CCM should mitigate market fluctuations due to short term allowance supply demand imbalances, which can cause rapid and significant price rises. An ARP is in effect a means of guaranteeing government income, which may not be aligned with the incentive for decarbonisation.

To work effectively, the CCM has to be fast acting, appropriate and well defined. A SAM can be slower acting, driven by allowance supply demand balances and also well defined. Currently the CCM fails to meet these objectives; the future options proposed are also not aligned with these principles; for example, moving to 6 months' timeframe is not fast, and the 3 times multiplier is higher than this in reality.

These interactions should be better represented in Table 2 of the consultation Analytical Annex.

21. Do you agree with the Authority's assessment of each of the options considered? (Yes/No). Please provide any evidence in support of your answer.

No

Fuels Industry UK does not agree with the assessment of each of the options considered.

The assessment of the ARP in the consultation document recognises prior responses indicating that in the majority of cases it is not needed.

As we indicate in our response to Q2, there are competing ideas of "allowing price discovery to happen in the market" and "the price needs to be maintained to drive decarbonisation". The latter is problematic when the UK ETS price is driven to the level to drive decarbonisation before the means to effectively decarbonise are in place; for example, business models and market access to CCUS or low carbon hydrogen. This drives businesses to close before investments can be made.

22. Are there any alternative options to those listed above that could be implemented by the Authority to address the risk of a sudden, sustained, and significant price decrease in the UK ETS market? If so, please describe how the mechanism functions.

In Fuels Industry UK's view, there needs to be recognition that short term pricing doesn't materially impact large scale investments which often have decade long return on investments; these decisions involve analysis of the relevant UK ETS allowance supply and demand balances over the medium to long term.

SAM is a better mechanism to delivering the market stability required for investment than an ARP.

As we discuss in our responses to Risk 1 above, measures that focus on price stability rather than the volume of allowances in circulation provide greater clarity and stability to investors in decarbonisation technology and emitter companies.

23. Do you agree with the Authority's minded to position to retain the ARP? (Yes/No). Please provide any evidence in support of your answer.

No

The ARP is not required if there is a SAM in place together with an effective CCM. The ARP was originally intended to provide certainty during periods of ETS transition and is no longer required. We also note that historically the ARP has not been triggered with allowance pricing significantly above the ARP level.

24. Do you think that an alternative policy option, such as any of the options previously discussed in this chapter, should be implemented in conjunction with the ARP? (Yes/No). If so, please elaborate.

No

The ARP is not required if there is a SAM in place together with an effective CCM. The ARP was originally intended to provide certainty during periods of ETS transition and is no longer required. We also note that historically the ARP has not been triggered with allowance pricing significantly above the ARP level.

The performance of the UK ETS (and prior to that the EU ETS) in reducing UK emissions to date has been good, achieving the desired objectives¹¹. These schemes have been based on the ARP as the means to achieving price certainty for decarbonisation investment.

There is no clear justification for introducing further methodologies, which make the UK ETS more complex and increase the administrative burden. Unless there is a clear rationale for change, which does not appear to be the case in the consultation, we would question the need for further or additional measures.

25. Do you think the ARP trigger level should be changed? (Yes/No). What level do you think the ARP should be set at? Please provide a rationale for your answer.

No

Given that the UK ETS is operating as expected and has been shown to drive decarbonisation, we would question the rationale for changing the ARP level. This is particularly the case if the ARP is increased based on simple political optics rather than having any real impact on the operation of the UK ETS.

¹¹ <https://www.ons.gov.uk/economy/environmentalaccounts/bulletins/ukenvironmentalaccounts/2023>

If the intent is to broadly increase UK ETS allowance prices, then this needs to be carefully considered to ensure that the intent of the UK ETS in encouraging decarbonisation is met, while ensuring that UK businesses remain competitive at an international level. There is also a significant inflationary risk inherent with adjusting the ARP such that it is disconnected from the real market costs of decarbonisation.

26. Do you think the ARP trigger level should remain static or should it evolve over time? If you think it should evolve, how do you think the Authority should design this evolution? Please provide a rationale for your answer.

As we discuss in our response to Q26, the UK ETS is operating effectively at reducing emissions and the ARP has never been triggered.

The UK ETS scheme should only increase the ARP if there is a clear rationale for doing so, such as the scheme no longer driving decarbonisation. There should be no automatic ratchet mechanism for ARP without a clear and obvious rationale, such as the scheme not operating as intended.

The ARP is not required if there is a SAM in place together with an effective CCM. The ARP was originally intended to provide certainty during periods of ETS transition and is no longer required. We also note that historically the ARP has not been triggered with allowance pricing significantly above the ARP level.

27. Do you think the Authority should alter the way an ARP trigger affects auction supply? If so, please explain how you think this should be changed.

No.

The ARP is not required if there is a SAM in place together with an effective CCM. The ARP was originally intended to provide certainty during periods of ETS transition and is no longer required. We also note that historically the ARP has not been triggered with allowance pricing significantly above the ARP level.

To date this has been achieved without the need to trigger the ARP, so there is no evidence that either option would, or would not, be effective.

There is therefore no evidence on which to recommend either option. We would suggest that if the ARP is triggered then the market response is reviewed to ensure the mechanism meets the intent of the UK ETS scheme.

28. Are there any other ways the Authority could alter an ARP to make it more effective? If so, please explain these alterations.

Fuels Industry UK is not aware of any other ways in which the authority could alter an ARP to make it more effective and would ask for clarification on the definition of “more effective”. In particular, is this in the context of further carbon emission reductions or to ensure that UK companies can operate effectively with international competition?

The fundamental rationale for the ARP is to ensure that the UK ETS scheme operates in an effective manner for reducing decarbonisation. This is through stable and competitive allowance prices, allowing businesses to operate and invest effectively.

To date this has been achieved without the need to trigger the ARP, so there is no evidence that either option would, or would not be effective.

There is therefore no evidence on which to recommend additional ways in which the ARP could be altered. We would suggest that if the ARP is triggered then the market response is reviewed to ensure the mechanism meets the intent of the UK ETS scheme.

29. Do you agree with the Authority’s assessment of each of the options considered? (Yes/No). Please provide any evidence in support of your answer.

Yes

Fuels Industry UK agrees with the assessment of each of the options considered. These look to have captured the advantages and disadvantages of the options available.

30. Are there any alternative options to those listed above that could be implemented by the Authority to address the risk of a sudden, sustained, and significant price increase? If so, please describe how the mechanism functions.

Fuels Industry UK is not aware of any alternative options to those above.

As we discuss in our responses to Risk 1 above, measures that focus on price stability rather than the volume of allowances in circulation provide greater clarity and stability to investors in decarbonisation technology and emitter companies.

**31. Do you believe the CCM should be retained with no adjustments? (Yes/No).
Please provide any supporting evidence in your response.**

No

Fuels Industry UK does not believe that the CCM is operating effectively and reduces the attractiveness of the UK as a place to invest relative to other jurisdictions. The UK government has stated their ambition for a 2.5% growth rate in the UK economy ¹², and UK competitiveness is central to this ambition.

The focus of the CCM only on providing signals for decarbonisation misses the wider impacts of such a measure, particularly on emitter companies. The UK needs to be seen as an attractive place for investment, including through the green transition and ETS costs are an important part of the cost base for many industries. Historically the CCM did not address high UK ETS allowance prices over a long period when there was no fundamental rationale for the high prices.

The failure to trigger the CCM in recent years has provided a disincentive for the UK as a place to invest relative to other jurisdictions such as the US or EU.

The wider impacts of high ETS costs need to be considered much more widely in the control measures used. A failure to properly address these issues will simply result in UK decarbonisation through deindustrialisation ¹³. It will also add to inflationary pressure in the UK due to the higher costs incurred by UK businesses.

¹² <https://www.gov.uk/government/topical-events/the-growth-plan>

¹³ <https://www.civitas.org.uk/publications/a-short-route-to-deindustrialisation/>

32. Do you believe the current CCM thresholds should remain? (Yes/No). Please provide any supporting evidence.

No

The CCM thresholds are too high for the UK to be seen as a competitive place to do business.

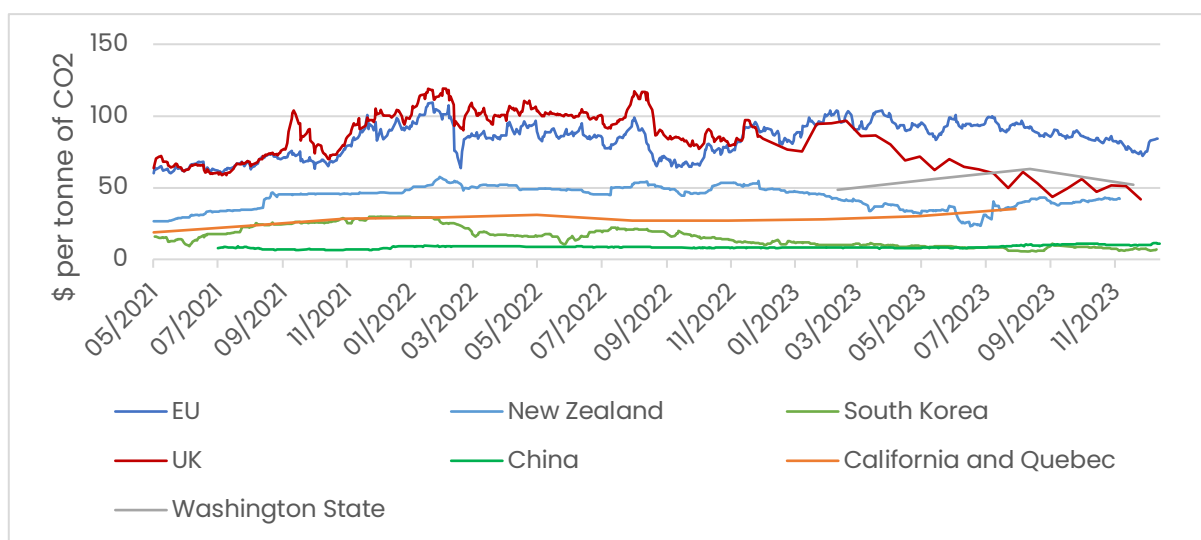


Figure 1: Source Fuels Industry UK Analysis

There is a potential inconsistency in the consultation between the policy document and the analytical annex with regards the application of the CCM. Page 38 of the policy document indicates a calculation based on three times the average price in the preceding two-year period for 6 consecutive months. Page 26 of the analytical annex refers to the "Previous period ending before trigger period". We would welcome clarification on the methodology, as neither would appear to clearly describe how the calculation works in practice.

A CCM should deal with prompt price disconnects – a 2-year comparison and 6-month exceedance requirement does not quickly deal with these requirements so needs to be significantly scaled back.

There needs to be a greater consideration of the cost containment methodologies used in other international jurisdictions such as the US or EU. This creates a level playing field for UK businesses relative to international competition.

We would therefore propose a 2-month period which would covers 4 auctions at significantly higher prices (more than triple that prior period average) which should be more than enough to demonstrate that there is a tightness in the market. However, we still believe this is less effective than a US West Coast style clear cost cone over time approach.

33. If no, should the CCM thresholds be made more reactive by changing the multiplier, trigger period and/or reference period? Please provide any supporting evidence.

Fuels Industry UK agrees that the CCM thresholds should be made more reactive.

To date they have reduced the attractiveness of the UK as a place to invest, with wider societal impacts than simply decarbonisation. A failure to address the CCM will be nothing more than a signal to industry to invest outside of the UK in other jurisdictions.

To work effectively, the CCM has to be fast acting, appropriate and well defined. A SAM can be slower acting, driven by allowance supply demand balances and also well defined. Currently we assert that the CCM fails to meet these objectives; the future options proposed are also not aligned with these principles, a CCM cannot have trigger periods that are longer than the SAM.

We would therefore propose a 2-month period which would covers 4 auctions at significantly higher prices (more than triple that prior period average) which should be more than enough to demonstrate that there is a tightness in the market. However, we still believe this is less effective than a US West Coast style clear cost cone over time approach.

There needs to be a greater consideration of the cost containment methodologies used in other international jurisdictions such as the US or EU. All the options presented in the consultation need to be considered and aligned with other jurisdictions as far as possible. This creates a level playing field for UK businesses relative to international competition.

34. Do you believe the CCM trigger methodology should be based on historical comparisons or a fixed price? Please provide any supporting evidence.

Fuels Industry UK has no firm view on this.

However, a fixed price, potentially index linked as in the US West Coast scheme¹⁴, would provide greater certainty for emitter businesses.

There needs to be a greater consideration of the cost containment methodologies used in other international jurisdictions such as the US or EU. All the options presented in the consultation need to be considered and aligned with other jurisdictions as far as possible. This creates a level playing field for UK businesses relative to international competition.

¹⁴ <https://ww2.arb.ca.gov/our-work/programs/cap-and-trade-program>

The wider impacts of high ETS costs need to be considered much more widely in the control measures used. A failure to properly address these issues will simply result in UK decarbonisation through deindustrialisation.

35. Are there alternative methods we should consider when setting the CCM trigger price? Please provide any supporting evidence.

Fuels Industry UK is not aware of any alternative options to those above.

As we discuss in our responses to Risk 1 above, measures that focus on price stability rather than the volume of allowances in circulation provide greater clarity and stability to investors in decarbonisation technology and emitter companies.

There needs to be a greater consideration of the cost containment methodologies used in other international jurisdictions such as the US West Coast or EU. All the options presented in the consultation need to be considered and aligned with other jurisdictions as far as possible. This creates a level playing field for UK businesses relative to international competition.

The wider impacts of high ETS costs need to be considered much more widely in the control measures used. A failure to properly address these issues will simply result in UK decarbonisation through deindustrialisation.

36. Do you believe that the CCM should retain discretion in its decision-making process? (Yes/No). Please provide any supporting evidence.

No

By including an element of discretion in the decision making, the CCM does not provide any certainty for emitter businesses, reducing the attractiveness of the UK as a place in which to invest.

The focus of the CCM only on providing signals for decarbonisation misses the wider impacts of such a measure, particularly on emitter companies. The UK needs to be seen as an attractive place for investment, including through the green transition and ETS costs are an important part of the cost base for many industries.

The failure to trigger the CCM in recent years has provided a disincentive for the UK as a place to invest relative to other jurisdictions such as the US or EU. We do not recognise the comments in the analytical annex that the triggering of the CCM may be “priced in” to deals if it becomes automatic.

The wider impacts of high ETS costs need to be considered much more widely in the control measures used. A failure to properly address these issues will simply result in UK decarbonisation through deindustrialisation.

37. If no, do you believe the CCM should have a fully or partially automated response following a trigger? If so, please describe how this could function.

The CCM response should be fully automated.

This approach is similar to the US West Coast scheme.

This provides greater clarity on the outcomes of a CCM trigger, allowing emitter companies greater certainty over the ultimate costs to their businesses. We note that for a period the CCM did not operate as intended, i.e. keeping costs in the range envisioned when the net zero legislation was enacted based on a calculated economic impact with assumed carbon costs.

However, there should be consideration given to the approach taken in other jurisdictions as well to ensure that the UK can operate on a level playing field with international competitors. Ultimately the price signals are more important than the methodology used including whether it is fully, or partially automated.

38. Are there any other design changes not listed above that would improve the effectiveness of the CCM?

Fuels Industry UK is not aware of any other design changes at this time apart from the need for greater transparency in approach.

Transparency is required in order to lead to predictability of response allowing certainty for investors and emitters.

As we discuss in our responses to Risk 1 above, measures that focus on price stability rather than the volume of allowances in circulation provide greater clarity and stability to investors in decarbonisation technology and emitter companies.

39. Do you have any views on the approach to reserve allowances in the UK ETS or anything you would like the Authority to consider when making decisions on its size and structure?

Fuels Industry UK has no firm views on reserve allowances in the UK ETS.

As we discuss in our responses to Risk 1 above, measures that focus on price stability rather than the volume of allowances in circulation provide greater clarity and stability to investors in decarbonisation technology and emitter companies.