Extending the UK ETS Cap beyond 2030 (link)

Fuels Industry UK Response

1.1.) Do you agree with the Authority's minded to position, as presented above, that the UK Emissions Trading Scheme should be extended into a Phase II to follow directly on from Phase I? (Y/N) Please explain your answer.

No,

Based on the information presented, it appears this consultation has not considered other options before reaching a minded to position of continuing with the UK ETS scheme. Other policy options for achieving decarbonisation (not at the expense of UK industry) should have been identified and described, and been subjected to prior consultation(s) before reaching the minded to position.

On that basis we do not agree with the Authority's minded to position of continuing the ETS scheme without considering other options, and would like the government to consider what options may be available before reaching a "minded to" position.

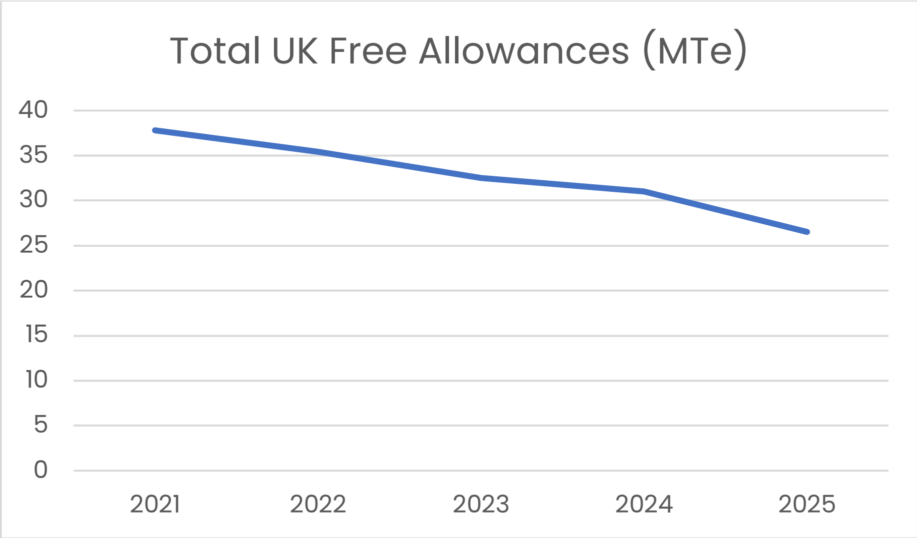
As a scheme, the UK ETS (and the EU ETS before it) have been a tool to reduce UK territorial GHG emissions. Their mechanisms are well understood by stakeholders and provide the basis for a trading scheme, although a number of improvements to operation of the scheme could be made.

However, our current view is that the UK ETS has been decarbonising the UK largely through deindustrialisation. UK Free Allowance Allocations (FAAs) between 2021 and 2025 were reduced from 37 million Tes to 26 million Tes (see chart below). Since no benchmark changes were made during this period, the reduction of FAAs is due to production scaling back or business exiting the UK (mostly steel and fertilisers), this is deindustrialisation.

Carbon costs have been cited in many closure announcements (Steel at Port Talbot and Scunthorpe, Fertilisers at Billingham and Ince, Chemicals at Wilton and Grangemouth, Refining at Grangemouth) that are responsible for the reduction in free allocation from 2021 onwards.

Furthermore, we note that the ETS authority has failed to provide a form of cost containment in the 2021/22/23 price run up adding to deindustrialisation. Whilst failure to address Covid impacts on Historic Activity Level (HAL) allocations or make progress on other proposals such as dynamic allocation weakens confidence in this scheme delivering decarbonisation without deindustrialisation.

Chart: Allocations reflect lower activity in energy intensive and trade exposed sectors



Source: https://www.gov.uk/government/publications/uk-ets-allocation-table-for-operators-of-installations

Additionally, we think it is important to address the issue that the UK ETS focus on reducing UK territorial emissions has effectively led to offshoring emissions and therefore not providing genuine global GHG emissions savings required to meet net zero targets. The CCC July 2024 progress report (fig 1.9) displays growing import emissions whilst consumption emissions fall by half the total emissions rate, this provides evidence that ETS is not delivering on its policy aim of reducing global carbon emissions. More attention needs to be concentrated on how the ETS is driving down global GHG emissions without driving deindustrialisation.

We note the comment in the consultation document regarding enacting legislation "when parliamentary time allows". Having considered alternative mechanisms, the government should make converting the then-minded to position to legisisation a priority. This is because the lack of a clear legislative framework from the 1st of January 2030 (now less than 5 years away) creates uncertainty for investors, doing little to promote the governments mission of economic growth and the creation of a green energy superpower.

We also note that there are a significant number of consultations in various states of progress regarding the UK ETS, with most awaiting a response. We recognise that many of these are intended to update and improve the operation of the UK ETS. However, the sheer number of consultations and the lack of a coherent overall strategy on UK ETS do, with similar risks to the government's progress on economic growth and the creation of a green energy superpower. We strongly urge the government to respond to all the outstanding consultations, providing a clear and coherent direction for the future of the UK ETS or alternative scheme.

2.1) Do you have a preference regarding the length of the post 2030-phase? (Y/N) Please explain your answer.

Yes,

If the UK Emissions Trading Scheme were to be extended into Phase II, preference would be for Option 1 (2031 – 2037, short period in line with carbon budget).

Should the UK ETS scheme be continued for the period beyond 2030, we consider that moving to a shorter time frame will be essential to allow for more examination of the schemes effectiveness of delivering on decarbonisation and assessment of the impacts on deindustrialisation. We stress the importance of meaningful engagement on this scheme, highlighting that a 10-year period is too long for industry to wait between any changes or discussions.

We do not perceive the current 10-year period to provide any more investment certainty than a shorter period. General certainty of decarbonisation is driven by the Climate Change Act supported by the Carbon Budgets. From the project investment perspective, 10 years would be too short for the project time horizon. Projects would already have to assume that some form of ETS continues beyond the stated ETS phase lifetime; thereby setting a longer duration for ETS is not required – this is well illustrated by DESNZ's own timelines chart (figure 1) in this consultation. Similarly, among business models where the UK ETS is part of the renumeration process, certainty of projects outcomes would more likely be provided by a change in law or in benchmark provisions within those contracts than the phase duration. Forecasting of carbon price already occurs beyond the stated timeframe of UK ETS.

We note that Figure 1 does not include a "pre-development period" for projects in the Oil and Gas sector. This does not seem a reasonable assumption; all projects including those in the Oil and Gas sector will have a period of project development including estimates of capital requirements and regulatory approval, leading to sanction through a final investment decision (FID).

This is especially the case for oil and gas projects relating to decarbonisation. We would therefore ask government to reconsider this incorrect assumption in their future work.

2.2) Beside the options outlined, are there other durations that should be considered for the length of Phase II? (Y/N) Please explain your answer.

As we discuss in our response to Q 2.1), our preference would be for Option 1 (2031 – 2037, change to alignment with Carbon Budgets).

Future time periods could move to 5 year phases to be consistent with the 5-year timeline of the UK ETS carbon budgets.

Q.3.1) Do you agree with the Authority's minded to position to allow banking of allowances between phases of the Scheme? (Y/N) Please explain your answer.

Yes,

Fuels Industry UK agrees with the Authority's minded to position to allow banking of allowances between phases of the Scheme.

The reasons for allowing banking of allowances are well articulated in the "Context" section in Section 3 of the consultation document, and we agree with them. This includes giving participants greater flexibility to make forward plans, recognising that unexpected events (such as COVID 19) do occur.

We also recognise the market distortions that occurred between Phase I and Phase II of the EU ETS as presented in the Case Study in Section 3 and would strongly discourage the government from making any decisions which could potentially lead of a repeat of these. We note that not "banking" would change UKA's from phase 1 into options (something that has a value that can fluctuate to zero or extremely high when the option expires) not credits.

We also note that there should be no limitations to the allowed carry over level and that carryovers should not reduce Phase II allowances available (by free allocation or auction). As the allocation allowances available reflect the targets set out byt the carbon budgets, if the UK is under it's carbon budget (historically it has) then the head room should be carried forward as the UK pushes for increasingly harder stages of decarbonisation towards net zero.