CONSULTATION RESPONSE

Response to the extension of the UK ETS cap beyond 2030 consultation

Brussels, 09 April 2025

Key messages

We support changes that will facilitate linking the UK ETS with the EU ETS at the earliest feasible occasion. Linkage would:

- Improve liquidity, price discovery and the ability to attract abatement across a larger area;
- Exempt UK imports of electricity into the EU from the application of EU CBAM, for a more efficient use of cross-border interconnections between the EU and the UK, while preventing renewable curtailments and promoting their uptake in the UK;
- Incentivize the uptake of CCS and allow cross-border CO2 flows, ultimately promoting the development of an international market for CO2 storage services;
- Show commitment to the Paris Agreement and net zero emissions target.

We encourage extending the UK ETS beyond 2030, on a duration matching the EU ETS cycles to facilitate linkage opportunities and any decision implementation.

In addition to this consultation, we encourage the UK ETS Authority and DESNZ to clarify the timelines of other key UK ETS design changes for the current and future phases of the UK ETS, also linked to previous consultations.

Detailed comments

Q.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.

Yes, we agree with extending the UK ETS beyond 2030 with a new phase. The UK ETS plays a crucial role in achieving UK climate protection targets cost-effectively, guaranteeing investor confidence and sufficient flexibility for compliance entities. The scheme also generates significant revenues that can be reinvested in climate and energy projects, further supporting the transition to a low-carbon economy. As such, the UK ETS should smoothly transition into Phase II post-2030.

We encourage extension, while cautioning that the design be well thought out as divergences may lead to competitive distortions between the EU and UK ETS markets and disadvantage British businesses as participants in the smaller market.

We reiterate that the EU ETS and UK ETS should be linked as soon as feasible to provide greater stability and liquidity to market participants. The consultation is also an occasion to evaluate possible linkage and make sure design differences do not impede future linkage efforts.

Additionally, we take the opportunity to encourage the UK ETS Authority and the UK Government to explain how the UK ETS is working to drive down Greenhouse Gas (GHG) emissions overall. We recognise that the scope of the consultation is narrowed to the UK ETS extension and suggest that the Authority and Government also consider the bigger picture, looking at policy options to achieve GHG emissions reduction. We also recommend focusing on the GHG emissions related to UK consumption on top of the UK territorial emissions.

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

Our preference lies with the second option with a length of 10 years. It is a known phase duration by market participants and remains aligned with the EU ETS phase cycles. By lessening the differences between the EU and UK ETS schemes, it allows better chances for linkage with a less complex and lengthy process. In addition, it should be possible for the Authority to adjust the allowance trajectory mid-phase, for example, after 5 years, to provide flexibility for the Authority where required and to align with carbon budget legislation.

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

We reiterate our position for aligned phase lengths between the UK and EU ETSs to keep the door open for possible linkage as set out for serious consideration in the Trade and Cooperation Agreement. Also, any linkage plan should be orderly communicated and with sufficiently long notice (at least 1 year before kick-off).

The duration of the Phase II should be set in the most flexible way. It should provide flexibility to align with any future policy developments, such as the integration of Greenhouse Gas Removals (GGRs) or new sectors and should not impede linkage between the EU and UK trading schemes. In addition, a review cycle could be introduced every 5 years (similar to the EU ETS) to be able to process small adjustments to the UK ETS system.

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, we agree with allowing banking of allowances between phases. As per the EU ETS example, keeping similar structures between the EU and UK ETS facilitates possible linkage.

Banking of allowances is a crucial feature for the effective functioning of the UK ETS.

Firstly, it facilitates long-term planning and investment decisions by firms into emission reduction and removal projects. It is also an effective risk management strategy, allowing companies to hedge against future unexpected regulatory changes or economic conditions.

Secondly, it ensures market stability.

- Banking helps to stabilize allowance prices by allowing companies to hold onto allowances when prices are low and use them when prices are high.
- This reduces price volatility and provides a more predictable market environment.
- It also helps balance the supply and demand for allowances over time, preventing market imbalances that could lead to extreme price fluctuations.

The case study of the EU ETS provided in the consultation is a great example of what happens to the market and allowance prices in the absence of this stability. Banking allowances between phases of the UK ETS should also be allowed for allowances held in reserve, for example, those in a potential Supply Adjustment Mechanism reserve, as long as such a move would ensure that the UK was able to meet its carbon budgets.

It is also important to note that banking of allowances does not compromise the environmental integrity of the UK ETS, as the total cap on emissions remains unchanged. It simply allows for more flexible compliance within the set cap. Overall, banking of allowances enhances the efficiency, stability, and effectiveness of the UK ETS, making it a more robust tool for achieving domestic climate targets.

Contact

Coline Gailleul
Electricity Policy Associate
c.gailleul@energytraderseurope.org

Federico Barbieri
Policy Coordinator Electricity and Carbon Markets
f.barbieri@energytraderseurope.org