PRESS STATEMENT

12 October 2020

A linked UK ETS key for UK's cost-effective transition to net zero

The European Federation of Energy Traders (EFET)[1] firmly believes that a well-functioning UK ETS closely linked with the EU ETS from the outset constitutes the most cost-effective means of achieving the UK's target for net zero carbon emissions by 2050.

In our response to the latest HM Treasury's consultation on the Carbon Emissions Tax (CET), we have reiterated that a UK ETS closely linked to the EU ETS should be the basis for UK carbon pricing from January 2021. A UK ETS closely linked to the EU ETS enables UK installations to continue to benefit from the wider, liquid market in EU allowances and to better manage their business risks. Linkage to the EU ETS also maintains a level playing field for UK and EU installations while continuing to deliver on the UK and EU's ambitious decarbonisation targets.

A standalone UK ETS or the CET would not deliver these benefits and would bring a number of adverse consequences not only for the UK carbon market but also for the GB power market, ultimately resulting in higher power prices for consumers. More specifically:

- A standalone UK ETS would not be able to deliver a sufficient level of liquidity for the market to operate efficiently;
- UK installations would find it harder to manage the risks of a less liquid market in UK emissions allowances or to predict and manage a tax set annually and subject to regular review;
- In the power sector, a standalone UK ETS or CET will inevitably translate into lower power market liquidity, higher risk-management costs and ultimately to higher power prices for consumers than a linked UK ETS.

In addition to cost effective emissions reduction, and the benefits of maintaining a level playing field for UK and EU installations, a linked UK ETS will bring revenues to the government from ETS auctions to finance decarbonisation initiatives in the UK, as well as well as to support UK's economic recovery from the coronavirus-induced economic crisis.

Establishment of a linked UK ETS to reinforce UK's commitment to be a leader in the global transition towards climate neutrality

Last year UK committed to a legally binding target of net zero emissions by 2050 reaffirming its ambition to be a leader in the global transition towards climate neutrality. While next year the UK will host COP 26 in 2021, where a particular focus will be placed on Article 6, providing

[1] The European Federation of Energy Traders (EFET) promotes competition, transparency and open access in the European energy sector. We build trust in power and gas markets across Europe, so that they may underpin a sustainable and secure energy supply and enable the transition to a carbon neutral economy. We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information: www.efet.org.

for the use of international carbon markets for achieving the emissions reduction targets set by the Parties.

Linking between emissions trading systems internationally will play a key role in mitigating the risks of carbon leakage, and preventing distortions to international trade, especially in the products of energy intensive industries. Unlike emissions trading schemes, carbon taxes are less amendable to international linkages (whether with the EU or other global carbon markets) or enabling trade of carbon reduction credits.

Introduction of a UK ETS and a timely establishment of a Linking Agreement between the UK ETS and the EU ETS would therefore evidence and reinforce the UK's commitment to deploying market-based mechanisms to achieve cost-effective decarbonisation in the country, as well as UK's commitment to play a leading role in the transition to net zero at global level.

The most optimal method for setting a CET would be fixing it ex ante based on forward EUA prices

In the event that a Carbon Emissions Tax is introduced from January 2021, it must be fixed either ex ante based on forward EUA prices or ex post based on outturn EUA prices.[2]

We believe that the most optimal method for setting tax emission allowances and adjusting them would be linking indicative prices to average EUA forward (if this methodology was introduced in its simplest form). A simplified average forward price methodology – without the proposed uplift (premium) and any subsequent adjustment - would allow installations to predict the level of the tax in the subsequent year and provide the ability to manage the risk of changes to the task via the forward markets.

As an alternative, if Government wants to maintain a close link to the outturn EUA allowance prices during the year, the tax could be linked directly to the average spot auction prices, but without the setting of an indicative forward rate and premium. This mirroring of outturn prices in the EU ETS auctions would also, in turn, allow UK installations to hedge their risks more easily via trading in the EUA futures and spot markets.

We strongly advise against the hybrid approach proposed in the HMT public consultation on the CET – with an unknown fixed premium and the adjustment mechanism – as it would make it harder to predict and manage the carbon price risks.

Additionally, while recognising that the treatment of negative emissions technologies will be the subject of further review, we believe that, subject to recognised high standards of integrity (including on permanence and additionality), verified carbon removal credits from nature-based solutions could be explored as a compliance pathway within the CET.

We reiterate that the market needs long-term regulatory predictability and visibility of carbon pricing beyond 2020, as companies trade forward on the curve up to three years and beyond with maturities for the next eight years available. Currently, participants to the UK energy market lack visibility of carbon pricing as of 1 January 2021 and are therefore unable to properly hedge their carbon risk in the longer term.

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[2] For further information, see EFET response to HMT Consultation on Carbon Emissions Tax: https://efet.org/Files/Documents/Emissions%20and%20RES/Emissions%20trading/EFET_response_HMT%20Consultation_UK%20carbon%20tax_clean.pdf