

Position on Brexit and the EU Emissions Trading System (EU ETS)

23 February 2017

Summary

Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HM Treasury.

This paper sets out our position on the EU Emissions Trading System (ETS) in the context of the UK's intention to leave the European Union (Brexit). It addresses short term issues that may arise during the transition period to Brexit and longer term issues around the future of emissions trading after the UK's exit from the EU. Main points are as follows:

- Energy UK continues to support emissions trading as the most cost-efficient approach to drive greenhouse gas emission reductions across the traded sectors in a way that avoids cross-border distortions, enabling the delivery of affordable, reliable, and sustainable electricity across Europe.
- Energy UK's preference is for the UK to remain within the EU ETS whilst retaining influence over its future development so as to deliver a robust carbon price signal. With the upcoming conclusion of the latest revision of the EU ETS Directive, which the UK Government is engaged in and will agree in due course, the main governance of the EU ETS will be in place until the end of the Phase IV trading period (2021-30).
- However, if the UK is unable to influence the development of the EU ETS to deliver a credible price signal, then alternative options should be explored beyond Phase IV.
- In the short term, a decision from Government on the preferred direction of travel for emissions trading is needed by the second half of 2017 to allow sufficient time for the necessary legal and administrative arrangements to be put in place before the end of March 2019 and for UK EU ETS participants to be briefed appropriately so that they can

prepare to comply. Leaving part-way through a trading Phase would create logistical difficulties for UK participants and uncertainty throughout the EU ETS. It would be less disruptive for all participants for the UK to leave at the end of a trading Phase.

- There are wider political implications that need to be considered with any exit from the EU ETS, including the UK's participation in the scrutiny of any changes to the ongoing ETS Directive revision, the Effort Sharing Regulation and the high-level commitments on EU 2030 Climate and Energy agreements made in October 2014.
- For any emissions trading system adopted by the UK post-Brexit, broad sector coverage is a key principle for the operation of a successful trading scheme and for achieving a liquid market and a robust carbon price signal to support the cost-effective decarbonisation of the GB energy system and other sectors.
- In order to secure the benefits of broad geographical coverage and maintain influence in carbon trading discussions including the EU ETS, we would encourage the Government to pursue a strategy of fostering international linkage discussions with the increasing number of trading schemes that are developing across the world. This would fit with the Government's intention to pursue international trading initiatives more vigorously.

Position statement

Energy UK has supported a strong EU ETS from its initiation because we see this as the most cost-efficient approach to drive greenhouse gas emission reductions across the traded sectors in a way that avoids cross-border distortions, enabling the delivery of affordable, reliable, and sustainable electricity across Europe.

Energy UK's preference is for the UK to remain within the EU ETS whilst retaining influence over its future development so as to deliver a robust carbon price signal. With the upcoming conclusion of the latest revision of the EU ETS Directive, which the UK Government is engaged in and will agree in due course, the main governance of the EU ETS will be in place until the end of the Phase IV trading period (2021-30). There are some other technical elements which the Commission will adopt, such as the use of the low-carbon funding mechanisms, but these will not go through the co-decision process so the UK's future absence from the European institutions would be less significant, so long as the Government continues to contribute to policy development now.

Where the UK's voice may be missed during Phase IV will be in the review of parameters due by 2022 and the Paris Agreement review cycles in 2018/20, 2023/25 and 2028/30. Ultimately, these are likely to be marginal in their impact on individual participants compared to the governance provisions included in the EU ETS Directive, and the UK can retain strong influence through its excellent international climate change diplomacy via the Foreign and Commonwealth Office (FCO) and through the strong analytical capacity of the emissions trading teams within the Department for Business, Energy and Industrial Strategy (BEIS).

However, if the UK is unable to influence the development of the EU ETS to deliver a credible price signal, then alternative options should be explored beyond Phase IV. We hope the revision of the EU ETS Directive, as supported by the UK Government, can help progress towards achieving a robust price signal.

From a political perspective, Energy UK welcomes the UK Government's approach to engage with and fully implement all EU legislation whilst still a Member State, including the ETS Directive. This approach will ensure a more collaborative future relationship on cross-border issues, particularly important for physically networked industries like electricity and gas. In this respect,

the assumption would be that, even if the UK Government chooses to leave the EU ETS, a politically acceptable exit from an EU perspective could mean the UK remaining in the EU ETS until at least the end of Phase IV (end of 2030) given it has made inputs to the System's main governance up until then and has made high-level political commitments to support certain Member States in the 2030 Climate and Energy agreements made in October 2014.

Participation in the EU ETS is not reliant on remaining in the Single Market or the Internal Energy Market (IEM), and there is no obstacle for a non-EEA state to participate in the EU ETS (with the agreement of the EU Member States). Nor is the lack of European Court of Justice (ECJ) jurisdiction a barrier, as Iceland, Liechtenstein and Norway participate in the EU ETS under the Court of Justice of the European Free Trade Association States (EFTA Court), and the UK could use this route or another dispute resolution mechanism to continue participation. Therefore, in principle, there is an option for the UK to simply remain in the EU ETS, irrespective of the UK's wider relationship with the EU. Indeed if the intention is to secure sectoral arrangements with the Single Market, EU ETS participation would almost certainly be seen as a prerequisite for those sectors.

We recognise that issues around Brexit fall into two main categories: **short term** issues that may arise during the transition period to new arrangements; and **longer term** issues around the future of emissions trading post-Brexit.

Short term issues during the transition period to Brexit

If, in its exit negotiations with the EU, the UK Government opts to leave the EU ETS, it could mean disengaging from the System part-way through a calendar compliance year and part-way through a trading Phase. Leaving part-way through a trading Phase would create logistical difficulties for UK participants and uncertainty throughout the EU ETS. It would be less disruptive for all participants for the UK to leave at the end of a trading Phase.

Leaving the EU ETS in April 2019 or even at the end of the current trading period (end of 2020) would raise a list of issues that Energy UK would want to be recognised and discussed by the end of 2017, if this option was to be pursued or indeed was a possible outcome:

- What will UK participants have to do to comply in the course of transition from EU ETS to new arrangements?
- Does the UK need to establish a new registry for allowances to operate after any exit?
- Would emissions have to be verified to the end of any exit? Can we invoke the procedures used in the case of plant closure? Is there potential need for a UK-only mechanism to be in place (e.g. the Government commits to surrender allowances to meet UK emissions for this period)?
- If there were an April 2019 exit, what would the arrangement be for the remainder of EU ETS Phase 3 (through to the end of 2020)?
- What are the impacts on auctioning timetable and volumes?
- Are there any impacts on calculation of the Market Stability Reserve (MSR) due to begin in January 2019?
- How would exit impact allocations for other Member States?

None of the issues look unsurmountable. However, the answers to these questions are likely to be at a level of detail that is beyond the content of the Great Repeal Bill and would need to be set

out within the exit agreement with the EU. Therefore, the Government needs to consider further what can be transferred to UK legislation in the Repeal Bill and what would need EU agreement.

Government would also need to consider the likely impacts on other Member States and the UK's relationship with the European Court of Justice or alternative governance.

Whatever the transition route, a decision on the preferred direction of travel for emissions trading is needed from Government by the second half of 2017 to allow sufficient time for the necessary legal and administrative arrangements to be put in place before the end of March 2019, or even at the end of 2020. EU ETS participants should be briefed appropriately so that they can prepare to comply. The timeline at Annex 1 sets out some key milestones over the next three years.

Long term issues post-Brexit

For the period after the UK's exit from the EU, there is a spectrum of possible climate policy options, all of which would need to be framed by the UK's climate targets and subsequent Carbon Budgets. There is also a general expectation that the UK will want to maintain or improve its international competitiveness, and that cost-effective greenhouse gas abatement and protection from carbon leakage will remain key issues that are likely to feature in the Government's evolving Industrial Strategy.

The following five post-Brexit options have been identified in discussions to date:

- **EU ETS reloaded** – EEA or similar arrangement e.g. Norway.
- **Mirror** – a separate, but linked, UK ETS that mirrors the EU ETS as far as possible.
- **Linked** – a new “improved” UK ETS linked to EU ETS by joint recognition and fungible allowances for compliance. (Cap in line with Carbon Budgets and agreed with the EU. Similar basic architecture and broad coverage but flexibility on detailed design e.g. allocation and leakage criteria, sectors, gases, contribution to EU funds.)
- **Stand-alone** – a new, bespoke ETS designed for domestic purposes (linkage “friendly”).
- **Something else** – non-ETS options, such as a carbon tax, sectoral Climate Change Agreements or direct regulation.

There are pros and cons to the options listed above, with a balancing act required between domestic politics and a continued collaborative relationship with the EU. It will also be necessary to consider the interests of those industries in the EU ETS with strong domestic and non-European markets, who may favour an alternative approach to emissions reduction, versus those with strong markets in Europe who would likely favour staying in the EU ETS in order to secure tariff-free access to the Single Market.

In the longer term, it may be possible to “regionalise” the EU ETS so that non-EU states can have a say on some aspects of the System's design. This would be consistent with the wider context of coordinated actions under the Paris Agreement.

“Something else” may be attractive to some industries in the EU ETS without strong European markets, but not necessarily to electricity producers because a trading mechanism is still regarded as the most cost-effective and certain means to reduce greenhouse gas emissions, in a way which avoids cross-border distortions (which can ultimately determine which plant generates). Also, from a practical point of view, it may be quicker to establish an amended trading scheme than to design and implement an alternative regime based on taxation.

Energy UK considers broad coverage across a range of sectors to be a key principle for the operation of a successful trading scheme and for achieving a liquid market and a robust carbon price signal to support the cost-effective decarbonisation of the GB electricity system. The “EU ETS reloaded”, “Mirror” and “Linked” options appear to offer the best opportunity for achieving broad coverage and would also represent the least significant departure from current arrangements. A “Stand-alone” UK ETS would be unlikely to offer sufficiently broad coverage, particularly in the short term.

In order to progress the options noted above, and to both secure the benefits of broad geographical coverage and maintain influence in carbon trading discussions including the EU ETS, we would encourage the Government to pursue a strategy of fostering international linkage discussions with the increasing number of trading schemes that are developing across the world. Even if the UK remains in the EU ETS, this could amplify the UK’s influence in the System’s future development and would fit well with the Government’s intention to pursue international trading initiatives more vigorously.

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Annex 1

