Department for
Business, Energy
& Industrial Strategy

**Department for Business,
Energy & Industrial Strategy**
1 Victoria Street
London
SW1H 0ET

T +44 (0) 20 7215 5000
E enquiries@beis.gov.uk
W www.gov.uk

Darren Jones
Chair of the Business, Energy and Industrial Strategy Committee
House of Commons
London
SW1A 0AA

29 October 2020

Dear Darren

Thank you for your letters dated 9th October and 23rd October, regarding your request for additional information on the UK ETS Common Framework and post-transition period regime for UK carbon pricing. I will respond to each of your questions from both letters in turn below.

UK ETS Common framework – letter dated 9th October

- **By what date will Her Majesty's Government (HMG) provide clarity on whether it intends to implement a standalone UK ETS, or a CET, in the event that a UK ETS linked to the EU ETS cannot be implemented from 1 January 2021?**

  A decision on the future UK carbon pricing scheme will be made and announced as soon as possible ahead of the end of the year. We understand businesses' need for policy certainty and will provide this as soon as we can.

- **Why did HMG decide to hold a consultation on a CET as an alternative option to a UK ETS, despite having previously secured agreement from the devolved administrations to proceed with establishing a UK ETS and to seek legislative approval for this in all four legislatures?**

  The Government remains committed to carbon pricing as a tool to achieve our emissions reduction targets. Developing two fallback options – a standalone UK ETS and a carbon emission tax – provides maximum insurance that government will have a carbon pricing policy in place in all scenarios.

  As part of this we have consulted on and legislated for both alternative policies in case a linking agreement (to which we are open) cannot be reached, which we think was the prudent course and ensures there is certainty that a price on carbon emissions will be maintained in all scenarios, as well as supporting the UK to reach its legally binding carbon targets.

- **What discussions has HMG had with the devolved administrations about its proposals to establish a CET? Does HMG plan to involve the devolved administrations in the choice between establishing a UK ETS or a CET?**
  As part of our close and cooperative working with the Devolved Administrations, their views and concerns have been understood and communicated clearly throughout the process. The decision will be made collectively by UK

Government, with due consideration given to DA views. We will announce the outcome as soon as possible to allow participants to prepare. In the event that a tax was implemented, the government would continue to work with DAs to refine its design. The decision on whether to introduce a CET or a UK ETS in the event a linking agreement is not achieved is a reserved matter.

- **If HMG were to implement a CET, how would the revenues from this be distributed amongst the four nations/administrations?**

  The tax is a reserved policy and revenues would contribute to general expenditure.

- **What work has HMG already undertaken to put in place systems to deliver a UK ETS, and at what cost? Has HMG already undertaken work to put in place systems for delivering a CET, and if so at what cost?**

  HMG has been working with the devolved administrations and regulators for a number of years to develop future carbon pricing policy. The Government entered into a contract for an Emissions Trading registry in July 2019 that will ensure that the UK has the necessary systems for a UK ETS – this system will also provide functionality required under the Kyoto Protocol. The total potential value of this contract is £4.6 million, including maintenance of the system to 2026; however, this may be significantly less depending on whether optional elements within the contract, for example linking the EU ETS registry to the UK registry, are called off or not.

  The Government also awarded a contract for a replacement permitting, monitoring, reporting and verification system in February 2021. This new system is due to be released in late 2021/ early 2022 and will be required and used under either an ETS or a CET (the existing system is a UK owned solution and will be used until the replacement system is ready). The value of this contract is £3.6 million including maintenance of this system to 2026. Both the UK ETS and CET use many of the same systems and processes, including for monitoring and reporting of emissions, meaning that the large majority of systems that businesses interact with will be the same in either scenario.

  We legislated for the CET in Finance Act 2019. This legislation was updated in Finance Act 2020. If the tax is introduced, secondary legislation would also be laid in December in advance of commencement of the tax on 1 January 2021.

- **How does HMG plan to involve the devolved administrations in decisions about setting the cap on allowances and the Auction Reserve Price (for a UK ETS), and in setting the tax rate (for a CET)?**
- **How will HMG work with the devolved administrations to ensure that the UK ETS or CET is commensurate with the various decarbonisation targets set by the devolved administrations between now and 2050?**

  The UKG and Devolved Administrations share a world-leading commitment to ending the UK's contribution to climate change by 2050. In all scenarios we will ensure that an ambitious carbon pricing policy is in place to support the UK's 2050 Net Zero commitment.

In terms of the UK ETS, all four administrations have agreed to consult on ensuring the UK scheme is consistent with our net zero commitment, following CCC advice expected later this year.

The UK ETS Framework Outline Agreement and Concordat set out structures and processes for joint decision-making and dispute resolution under a UK ETS. These are intended to support discussion and agreement on UK ETS policy decisions, including the future level of the emissions cap and the Auction Reserve Price (ARP) and will involve officials and ministers from all four administrations.

The Concordat establishes as an agreed principle that the final decision to implement a particular policy under the Climate Change Act (including the level of the emissions cap) will be taken jointly by the Four National Authorities, and requires that the four national authorities take into account a number of considerations when considering future policy changes to ensure the scheme continues to balance climate ambition and protect business competitiveness, including the various decarbonisation targets of the devolved administrations. The four national authorities are also legally obliged to take into account the advice of the Committee on Climate Change (CCC) when setting the cap level.

Future decisions on the ARP will also be considered by all four administrations using the joint governance process established in the Concordat. The Concordat establishes that responsibility for final sign-off and timing of decisions relating to the elements of a UK-wide emissions trading system set out in Finance Act provisions will lie with the Chancellor (HMT). Therefore, because the ARP will be established in legislation under the Finance Act, at ministerial level HMT will be responsible for the final decision.

The tax is reserved and so the final decision on the tax rate would be for the Chancellor, however we would remain committed to regular engagement and cooperation with the devolved administrations. The UK Government would seek to work with the Devolved Administrations to refine the design and implementation of the tax, and would of course want to hear the views of the devolved administrations on the future trajectory of the CET rate.

The CET would support the UK's world-leading climate ambition, which is shared by the Devolved Administrations through their targets. The UK government is committed to continuing to engage with the DAs on the tax.

- **Is the Government's intention for the UK ETS Common Framework to be active by the end of the transition period? If not, what interim arrangements will be in place for this policy area?**

  Yes, it is the Government's intention is for the UK ETS Common Framework to be active by the end of the transition period, should it be decided that a UK ETS will be the Government's post-transition period carbon pricing option.

- **Please explain the relationship between the UK ETS Common Framework and retained EU legislation.**

The retained Greenhouse Gas Emissions Trading Scheme 2012 regulations (the 2012 regulations) will continue to have a role next year to ensure compliance with EU ETS requirements related to 2020 emissions. They will also continue to be the legislative basis on which Northern Ireland electricity generators will remain in the EU ETS as required by the Northern Ireland Protocol. To this end, secondary legislation will shortly be laid in the UK Parliament to ensure that the 2012 regulations continue for this purpose.

The 2012 regulations may also form the basis of a CET, if chosen, using powers contained in the Finance Act 2019 to make necessary amendments. This will not prevent the 2012 regulations continuing to function for the purposes of 2020 EU ETS compliance or the Northern Ireland Protocol.

- **To what extent will the UK ETS Framework allow for regulatory divergence/flexibility across the UK nations? What would be the potential impact of such divergence?**

  The UK ETS is designed to operate on a UK-wide basis, and therefore the rules for operators need to apply consistently across the UK to ensure the integrity of the system.

  Nonetheless, any proposals for policy divergence between administrations will be considered by the four administrations jointly, using the agreed governance process that will be established in the UK ETS concordat. Any areas in which divergence is proposed will be considered by all parties to the concordat considering any potential impact on the functioning of the UK Internal Market, in line with the Common frameworks principles agreed at JMC(EN).

  The impact of any proposals for divergence would need to be assessed on a case by case basis.

- **How will any mechanisms for dispute resolution, management of divergence and review work in practice? What opportunity will there be for parliamentary scrutiny?**

  The UK ETS Concordat will provide more detail on the structures for decision making and dispute resolution, including how proposals for divergence will be considered by the four administrations.

  If differing opinions cannot be resolved through official and ministerial level discussion, the disagreement shall be subject to the formal dispute avoidance and resolution process set out in the overarching Memorandum of Understanding (MoU) on Devolution. This process is currently being developed as part of the Intergovernmental Relations Review (IGRR), and the UK ETS Concordat will be updated in line with this as appropriate.

  In the UK ETS Concordat, the UK Government and Devolved Administrations commit to ensuring regular reporting to their respective legislatures and responding to any scrutiny initiated by those legislatures. The exact processes through which the national authorities will engage with Parliaments on future policy developments will be set out in the UK ETS Authority Terms of Reference, which are currently in development.

- **Can you set out in more detail which sector stakeholders and experts you have engaged with, and what form this engagement has taken? Which stakeholders received a copy of the Summary Framework? How have you engaged with stakeholders and experts in the devolved nations?**

  The Government and Devolved Administrations formally consulted in May 2019 on the design of a UK ETS. We received over 130 responses to the consultation including from organisations in all the main energy-intensive industries, power and aviation sector and prominent expert groups. The Government and Devolved Administration project partners also held a series of consultation events in England and all the Devolved Administrations. We have since maintained our ongoing engagement with national organisations and businesses across the UK.

  Regarding the Summary Framework, this has been shared with the UK and devolved parliaments, but not with sector stakeholders.

- **How does the UK ETS Common Framework relate to the Government's proposals re: the UK Internal Market Bill?**

  There is very limited direct interaction between the UK ETS Common Framework and the UK Internal Market Bill.

- **To what extent are the provisions in the UK ETS Common Framework subject to the outcome of the negotiations on the UK's future relationship with the European Union and negotiations with other trading partners?**

  The UK ETS Framework Outline Agreement and Concordat establish governance arrangements for a UK-wide Emissions Trading System and are not dependent on the outcome of negotiations with the European Union or other trading partners.

Post-transition regime for UK carbon pricing – letter dated 23rd October

- **When will the key decisions about whether to implement a UK-EU linked ETS, a standalone ETS or a Carbon Emissions Tax be made? Please outline how these decisions are being managed between BEIS, HMT, Cabinet Office and any other involved departments. Please explain how the views of affected stakeholders are being taken into account.**

  We are working hard across Government to ensure the UK adopts the best possible carbon pricing scheme to meet our objectives. This decision is being made through a collective process across Government which has ensured that the views of interested departments such as BEIS, HMT, DfT, Cabinet Office, DEFRA and others have been reflected.

  Stakeholder views have also been accounted for in this process. We have used the information gathered from formal consultations, such as last year's 'Future of UK Carbon Pricing' consultation and subsequent publication of the Government Response in June 2020. We have also considered views expressed by stakeholders outside these formal consultations over the last few months.

We understand businesses' need for policy certainty and are aiming to make and announce a decision as soon as possible.

Please also set out:

- **when and how the Government intends to announce its decision on the future carbon pricing regime to the House, including any provisions for legislation and taxes, and the target dates for these to be approved;**

  The Government will announce the future carbon pricing policy as soon as possible after it is made, through the most appropriate means available at the time. The timetable for legislating to established a UK ETS remains on track. The Greenhouse Gas Emissions Trading Scheme Order 2020, which will establish a UK-wide Emissions Trading System (ETS) from January 2021, was approved by the House of Commons in September and was debated in the House of Lords on 27 October 2020. A second Order in Council will amend the Greenhouse Gas Emissions Trading Scheme Order 2020 to include provisions for Free Allocation and the UK ETS Registry and is due to be laid in the UK and devolved parliaments before the end of the transition period.

- **how the Government will engage with and seek the approval of the devolved administrations on the final proposals;**

As part of our close and cooperative working with the Devolved Administrations, their views and concerns have been understood and communicate clearly throughout the process. The decision will be made collectively by UK Government, with due consideration given to DA views. We will announce the outcome as soon as possible to allow participants to prepare.

- **the date by which operational details of the chosen scheme will be provided to businesses so that they can prepare for its adoption;**

The Government and regulators have been in contact with businesses in recent weeks to explain likely next steps with regard to carbon pricing. From an operational perspective, the most important preparatory steps relate to permitting, monitoring, reporting and verification. In these areas there is significant continuity with the existing EU ETS and consistency between approaches under either the UK ETS or CET.

Further guidance will be provided to businesses when the final decision is taken and as the service is implemented throughout 2021.

- **the key milestones to implement and commence operation of the new scheme on a practical level (e.g. IT infrastructure, new registries, human resources);**

As noted above, the most important practical steps to implement and commence the scheme relate to permitting, monitoring, reporting and verification. These processes are supported by the regulators and IT systems that are in place for the current EU ETS.

The Government is also in the final stages of development of a new Emissions Trading Registry. This system will be released in January 2021, with registration of users and allocation of allowances in quarter 2 2021 to avoid unnecessary overlap with the compliance period of the final year of the EU ETS (allowance surrender deadline for 2020 under the EU ETS is April 30 2021).

- **if there are concerns about how a UK ETS will be linked to the EU ETS, set out what those concerns and/or perceived incompatibilities are.**

The "Future Relationship with the EU" document published in February this year sets out that the UK is open to considering a link between a UK ETS and the EU ETS (as Switzerland has done with its ETS), if it suits both sides' interests. An agreement would need to recognise both Parties as sovereign equals, with control of our own domestic laws. A linking agreement could;

a. provide for mutual recognition of allowances, enabling use in either system;
b. establish processes through which relevant information will be exchanged; and
c. set out essential criteria that will ensure that each trading system is suitably compatible with the other to enable the link to operate.

- **if a link to the EU ETS were to be sought, the targeted timetable for securing agreement on this and for the link to come into operation**

An agreement to link a UK ETS to the EU ETS would require negotiation with the EU. I am sure the Committee will understand that the Government cannot comment on a timetable for a linking negotiation while future relationship negotiations with the EU are ongoing.

Thank you again for taking the time to write. I look forward to discussing these issues further with the Committee in the coming weeks.

Kwasi Kwarteng

RT HON KWASI KWARTENG MP
Minister of State for Business, Energy and Clean Growth