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EFET response to HMT Consultation on Carbon Emissions Tax

29 September 2020

The European Federation of Energy Traders (EFET)[1] welcomes the opportunity to contribute to HM Treasury's consultation on the Carbon Emissions Tax (CET). As started in our response to BEIS' consultation on the future of carbon pricing and emissions trading in the UK, as well as the joint letter to BEIS issued by EFET, IETA, Europex and Eurogas, **we firmly believe 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.**

A UK ETS closely linked to the EU ETS should therefore 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.

If a linked UK ETS is not deliverable in the first agreed iteration of the Free Trade Agreement (FTA) it should remain a priority for any future enhancement to the FTA.

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, carbon taxes are less amendable than emissions trading schemes to international linkages (whether with the EU or other global carbon markets) or enabling trade of carbon reduction credits.

In the event that **a Carbon Emissions Tax** is introduced from January 2021 it should, as far as possible, **be linked to EU ETS prices** from the outset, **by way of linking indicative prices to average EUA forward (if this methodology was introduced in its simplest form).** We believe that this is the most optimal method for setting tax emission allowances and adjusting them. 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

[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.

subsequent year and provide the ability to manage the risk of changes to the task via the forward markets.

While we strongly support the above-mentioned methodology, we recognise that Government is also considering linking the tax to observed outturn EUA spot prices 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 advise against the hybrid approach proposed in the public consultation– 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.**

Finally, we would like to urge HMT (in coordination with BEIS) to give further clarity on the UK's future approach to carbon pricing and emissions trading come the end of the transitional arrangement.

We would like to 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.

We would welcome the opportunity to discuss our responses further and we hope to maintain our dialogue on the future of carbon pricing and emissions trading in the UK.