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By email

Rt Hon Greg Clark, MP
Secretary of State for Business, Energy and Industrial Strategy
1 Victoria Street,
London SW1H 0ET

Rt Hon David Davis, MP
Secretary of State for Exiting the European Union
9 Downing Street
London
SW1A 2AS

Rt Hon Philip Hammond, MP
Chancellor of the Exchequer
11 Downing Street
London
SW1A 2AW

Dear Chancellor and Ministers,

Consequences of Amendment 47 to EU ETS, and UK post BREXIT policy preparation

I want to draw your attention to a recent European Parliament Amendment that could have a profound impact on UK industry sectors participating in the EU ETS. The perceived need by some EU Institutions for Amendment 47 also highlights the lack of UK communication with the EU's Institutions, and a lack of preparedness of UK Government policy surrounding its intentions on future participation in the EU ETS or alternative measures. These communication and policy gaps - especially when under the responsibility of UK Government - are deeply frustrating to ETG Members. Furthermore, all these issues have the potential to destabilise the EU ETS allowance market for all installations across the EU – this being a market in which UK-based traders play a leading role.

Text of Amendment 47 to Commission Proposal for a Regulation of the European Parliament and of the Council amending Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community in view of the implementation of a single global market-based measure to international aviation emissions.

'In order to protect the environmental integrity of the EU emission trading system, aviation operators and other operators in the EU ETS may not use allowances that are issued from 1 January 2018 onwards by a Member State in respect of which there are obligations lapsing for aviation operators and other operators. The legal act referred to in Article 19 shall implement this paragraph.'

/Summary of main points

Summary of main points – see further details in the annex to this letter:

1. The justification for Amendment 47 is to minimise market impacts of BREXIT on the EU ETS. This is a valid concern, but this particular amendment is the wrong solution: it will increase EUA market uncertainty across the EU ETS, and would also have major economic and contractual impacts on both UK and non-UK participants in the EU ETS.
2. If UK participation in the EU ETS was extended until the end of Phase 3, this would neutralise any requirement for Amendment 47, and give more time for a workable post-BREXIT solution for the EU ETS.
3. However, if this extension is not possible, then a workable solution for an EU ETS exit in March 2019 needs to be developed urgently. The ETG is aware of a UK Government counter proposal offering an alternative to Amendment 47 that would eliminate the need for two classes of EUAs.
4. What effect does the recently proposed UK 2-year implementation period have on the EU ETS?

Because of these points, UK ETG Members strongly recommend that the UK government urgently:

- Continues to develop and communicate to EU Institutions, industry and EUA market operators an alternative to Amendment 47 that does not create different allowance categories in the EU ETS;
- Confirms to EU Institutions, EUA markets and UK industry what, if any, arrangements will be made for UK participation in the EU ETS during the BREXIT process, including the type of allowance that can be used for compliance in any replacement UK ETS policy post BREXIT;
- Informs EU Institutions and other Member States of the existence of, and potential continuance post-BREXIT, of the UK's Greenhouse Gas Emission Trading Regulations 2012 that obliges UK installations and aviation operators to comply by surrendering allowances.

These actions above would ensure no mass sale of EUAs on the market; would negate the need for Amendment 47; would help resolve EUA market uncertainty across the EU; and could allow the European Council to propose an alternative recital to explain how and why the EUA supply/demand balance will be affected by BREXIT. A further possible solution proposed by UK Government could involve moving the 2019 surrender date to before the date for free allocation, with both dates being prior to BREXIT. But this would require amendment to the EU ETS Directive, and time before 1 January 2018 is very short. We also now gather that the Council is proposing a revised amendment 47 which adds the words “where necessary” and deletes the start date for when allowances would start to be ‘labelled’. However, it is not clear what circumstances would result in any such action.

Copies go to Claire Perry MP, Minister of State for Climate Change and Industry, BEIS, Richard Harrington MP, Parliamentary Under Secretary of State, Minister for Energy and Industry, BEIS, Robin Walker MP, Minister of State, DEXEU and Andrew Jones MP, Exchequer Secretary to HM Treasury.

Yours sincerely,



Paul Dawson, Chair UK ETG

ANNEX TO LETTER FROM UK ETG, “Consequences of Amendment 47 to EU ETS, and UK post BREXIT policy preparation

FURTHER DETAILS ON POINTS 1-4

1. Amendment 47 Justification: The European Parliament believes there is a risk that EU ETS allowances (EUAs) will not be required for UK compliance post BREXIT, and thus will be sold by UK installations into the EUA market. This would de-stabilise it and drive down EUA prices. As a consequence, the European Parliament adopted Amendment 47 in plenary session on the 13 September by 601 votes to 67 ahead of the EU Aviation Trilogue negotiations. From 1 January 2018, Amendment 47 would have the effect that UK-issued EU ETS Allowances¹ (UK EUAs) would be unusable for EU ETS compliance by any EU ETS installation or aviation operator - regardless of whether the holder has an obligation to surrender allowances under UK law. This places serious doubt as to the utility and value of UK issued EUAs. Yet the existence of the UK’s Greenhouse Gas Emission Trading Regulations 2012 (which transposes the EU ETS Directive into UK legislation) negates the need for such an amendment.

Regarding the legal text of Amendment 47, because of:

- the creation of two types of EUAs where previously only one existed will cause trading contract uncertainty regarding EUA delivery post 1/1/2018;
- lack of legal certainty surrounding the term ‘*obligations lapsing*’;
- when exactly EUAs would cease to have compliance validity (given BREXIT is only certain on BREXIT day itself);
- because EUA serial numbers (and thus nationality) are not visible to traders or operators; and
- because Amendment 47 marks a further in-phase EU ETS political intervention;

there is grave uncertainty in EUA markets as to who is holding what allowances, what value they will have, and as to the contractual position of delivery for futures contracts. This all works to the detriment of the EU ETS as a policy instrument.

2. Extension of EU ETS: If the proposed extension to the negotiation period was to include extension of EU ETS participation for the UK to the end of Phase 3, then there would no need for Amendment 47. However, I understand such an extension would require progress on a number of other negotiating items in BREXIT negotiations.
3. On solutions, avoidance of the creation of two classes of EUA - instead of one that currently exists - is key. While a helpful UK counter proposal has been recently developed on these lines, the UK Government could go further and specify what type of allowances can be used for compliance by UK industry participating in any UK version of EU ETS from BREXIT onwards. This is becoming urgent as, if adopted, Amendment 47 would mean that UK installations will be disadvantaged by being unable to use UK-issued free allocation for EU ETS compliance from 1/1/2018. Given that the UK issues some 60 million allowances every year, at the current €7 EUA price,

¹ UK government issued allowances including free allocation, auctioning, and exchange of international credits

there is some €840 million value at risk to UK industry² over 2017 & 2018 without further post BREXIT clarity.

4. UK ETG Members also seek clarification of what an additional ‘implementation period of around two years’³ to the BREXIT negotiations might mean for the UK’s participation in the EU ETS (as mentioned in UK Prime Minister’s Florence speech). Specifically, is the UK Government:
- Proposing to extend EU ETS to the end of Phase 3?
 - Anticipating fungibility between UK-issued EUAs and EU EUAs during this period?
 - Going to specify that, should the UK leave the EU ETS prior to the end of Phase 3, what replacement UK arrangements are under consideration? Particularly given the restrictions of the UK European Union (Withdrawal) Bill - also known as the UK Great Repeal Bill.

² In addition UK Government EUA and EUAA auctions from 1/1/18 may have no buyers, reducing UK potential Government revenue by €741million annually. Source : ICE 2017 UK EUA & EUAA to 1/11/2017 announced actions + estimated volumes for the final three UK 2017 auctions, EUA price assumed at @€7

³ Prime Minister May's speech in Florence on 22 Sept 2017.