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Llywodraeth Cymru
Welsh Government

Mike Hedges MS
Chair
Climate Change, Environment and Rural Affairs Committee

SeneddCCERA@senedd.wales

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Dear Mike,

Ahead of my attendance at your committee meeting on 8 October to assist in your scrutiny of The Greenhouse Gas Emissions Trading Scheme Order 2020, I attach responses to your written questions, a summary of the Integrated Impact Assessment and the UK Emissions Trading Scheme (UK ETS) Common Framework Summary document.

The proposed UK ETS scheme delivers on our environmental ambition and leads the development of global carbon markets while providing a smooth transition and certainty to businesses and facilitating linking to the EU system. The Order is progressing well through the four UK legislatures, and has been approved by the Scottish Parliament and the House of Commons.

My officials will provide a technical overview of the UK ETS on 24 September and I look forward to discussing the Order and framework with you on 8 October.

Regards

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Rydym yn croesawu derbyn gohebiaeth yn Gymraeg. Byddwn yn ateb gohebiaeth a dderbynnir yn Gymraeg yn Gymraeg ac ni fydd gohebu yn Gymraeg yn arwain at oedi.

We welcome receiving correspondence in Welsh. Any correspondence received in Welsh will be answered in Welsh and corresponding in Welsh will not lead to a delay in responding.

Greenhouse Gas Emissions Trading Scheme Order 2020

Welsh Government responses to questions from the Climate Change, Environment and Rural Affairs Committee

- 1. Are you content that the Welsh Government has played a full role in the development of the proposed framework? Do you have any concerns about any aspect of the proposals?**

My officials and I have been fully involved in the development of the proposed framework. At official level, there is a robust structure of governance in the form of working groups and a senior officials Board. I had the opportunity to discuss the proposals set out in the consultation document with Ministers from the other Governments before jointly agreeing the consultation text. I also agreed the final policy position, which was reflected in the joint Government response document and progressed via this draft Order.

This scheme delivers on our environmental ambition and leads the development of global carbon markets. It also provides a smooth transition and certainty to businesses and facilitates linking to the EU system.

- 2. How are Welsh interests reflected in the proposals? In particular, how do they reflect the emissions profile in Wales?**

This Welsh Government is committed to tackling climate change. In 2018, the latest year for which data is available, approximately 46% of Wales' emissions were generated by the power, industry and aviation participants in the EU ETS and so it is very much in our interest to continue efforts to decarbonise these activities.

The scheme 'cap', the number of allowances available each year in the scheme, will be reviewed in light of the anticipated advice from the UK Committee on Climate Change, which will ensure the scheme reflects the required emissions profile for Wales to meet its climate targets. I believe the scheme strikes the right balance between incentivising action to decrease emissions in high-carbon Welsh installations and maintaining an environment in which businesses can be competitive.

- 3. What is your response to the suggestion by the UK Committee on Climate Change, set out in Lord Deben's letter of 20 March, that the proposals are "inconsistent with the UK's Net Zero ambitions in some respects, primarily relating to the relatively high level of allowed emissions under the proposed cap"?**

The interim cap we are introducing for the launch of the UK ETS is already more ambitious than what it would have been if we remained in the EU ETS.

However, as stated in the joint Government response, we are fully committed to aligning the longer-term cap with all administrations' Net Zero commitments as soon as possible.

We will be able to progress with this work once we have the UK Committee on Climate Change's (CCC) full published advice in December. We will then swiftly consult on the appropriate longer-term trajectory for the cap and implement changes by January 2023, if possible, and certainly no later than January 2024.

- 4. The Committee is aware that the UK governments have responded to Lord Deben's letter, saying that "it is important to put in place a policy which provides a pragmatic and feasible approach to meeting net zero through the ETS." Do you believe that the proposed cap is set at an appropriate level?**

To reiterate my response to question 3, it is important to note this is an interim cap and a new carbon market.

The initial level of the cap enables a smooth transition for businesses, avoids market shocks and maintains business competitiveness as we deal with the economic recovery from Covid-19 and wider impacts of Brexit. It also signals the direction of travel and gives participants time to prepare for a tighter cap. A significantly tighter cap in the early years of the new market might have resulted in extremely high carbon prices in the early years and undermined the establishment of the new scheme.

- 5. In the Explanatory Memorandum (EM) accompanying the Order, you accept that "It may be necessary to adjust the cap further to ensure it is in line with our net zero ambitions. The UK Committee on Climate Change (CCC) will be providing advice on a pathway to net zero in December (2020) and we have committed to consult on any changes to the cap within 9 months and implement required changes by 1 January 2023 if possible and at the latest by 1 January 2024." Does this delay pose a risk to the likelihood the Welsh Government will meet its 2030 interim target for emissions reduction?**

No, it will not be too late to adjust. From the outset the UK ETS will show greater climate ambition than remaining in the EU ETS, with the cap initially set 5% tighter. This will immediately support compliance with our second Carbon Budget (2021-2025) and signal our intent for future revisions.

Implementing a new, net zero consistent cap by 2023 is possible but ambitious. The commitment to implement no later than 2024 is a backstop in the event we cannot progress with developing proposals, consulting, providing notice to the market and legislating as quickly as we have planned. In December, the CCC are advising on our third Carbon Budget (2026-2030) and 2030 interim target in

addition to advising on the ETS cap, therefore the statutory advice and supporting evidence on which we will take all decisions will be consistent.

6. How will the Senedd be involved in scrutinising the effectiveness of the scheme in future? What provisions are contained within the proposals in relation to this matter?

Clause 17 of the Order provides for two whole-system reviews. These will involve reporting on the performance of the scheme, including whether it is achieving the policy intent. Our report will be available to the Senedd to scrutinise. Any recommended major policy changes will then require consultation and legislation and I will be available to discuss these with you and take account of your input, before agreeing final proposals with the Ministers from the other Governments. Any required legislation will also be laid in all four legislatures.

7. Clause 17 of the Order sets out a review mechanism for the ETS. This consists of the ETS Authority (one or more of the UK governments) reviewing its own scheme and making recommendations to itself. Why do you believe this is an appropriate review mechanism? How will the UK governments ensure a degree of independence in the review process?

Before setting up a trading scheme, the Climate Change Act 2008 places a duty on national authorities to obtain, and take into account, the advice of the Committee on Climate Change, and to consult with those likely to be affected by the regulations. Each legislature will also have the opportunity to consider the published progress reports and recommendations, and any comments or recommendations you have will be taken into account. As part of reviewing the scheme, consideration will be given by the Welsh Ministers (as part of the UK ETS Authority) as to whether the UK ETS is consistent with targets and budgets set under Welsh legislation.

The Senedd has a role to play in scrutinising legislation relating to Welsh carbon budgets and targets laid under the Environment (Wales) Act 2016, which is the wider picture the UK ETS has been designed to contribute to.

8. The Order sets out that reviews must be concluded by 31 December 2023 and 31 December 2028. Can you explain why this timeline has been chosen? Can you explain how this will complement the timelines for carbon budgeting and interim targets set out in Welsh legislation?

The reviews need to look back at the operation and effectiveness of the scheme and to look forward at potential changes.

Given this is a new scheme, there needs to be a reasonable length of time for it to bed in before we can draw robust conclusions from any evaluation. If the review results in proposals for scheme changes, the most appropriate time to

introduce them would be at the start of the second allocation period. Developing proposals by December 2023 provides sufficient foresight of changes to the market and allows time to consult, finalise detailed proposals, draft legislation, undergo scrutiny, prepare operationally and implement changes on 1 January 2026.

The same is true for evaluating the second allocation period by 31 December 2028 to determine whether changes are necessary for the next full phase of the scheme, from 1 January 2031.

Additionally, the reviews are exactly in line with the EU ETS Phase IV reviews and the Paris Agreement Global Stocktake efforts. Aligning the review points with the EU ETS is beneficial in the event the scheme is linked to the EU system. Aligning them with the Global Stocktake dates ensures the UK ETS remains aligned with global ambitions on carbon.

Each consecutive carbon budget is set 5 years before the start of the 5 year budget period. Therefore, the 2023 review and forward looking recommendations will take account of the 2026-2030 carbon budget. Similarly, the 2028 review and recommendations will consider the 2031-2035 carbon budget.

9. Do you have any concerns about the governance arrangements arising from the framework, including arbitration arrangements in the case of disputes?

We are finalising the governance arrangements for the framework within the Framework Outline Agreement and Concordat. However, unlike many other emerging frameworks, the roles for Welsh Ministers are defined within the legislation. Therefore, the Concordat is in large part a means of operationalising the governance requirements.

The governance structure consists of several levels – official level working groups, the senior Official level Board, then Ministerial level quadrilaterals. The final step, should Ministers fail to agree, would be escalation to the JMC[EN].

However, we are also required to seek advice from the CCC ahead of legislating for trading schemes and, therefore, we will all receive the same independent evidence to support our decisions. Based on this, and the statutory emissions reduction targets we all need to work to, I would anticipate us being closely aligned in our thinking and unlikely to resort to dispute resolution.

10. The response of the four governments to the consultation on the proposed UK ETS said that “55 respondents indicated that they had a UK-wide interest in the operation of the system, whereas 19 indicated England, 8 indicated Scotland, 6 indicated Wales and 2 indicated Northern Ireland. Note that respondents were able to select multiple locations.” In the EM accompanying the Order, you also referred to two stakeholder events

“held in Wales to gather views of interested parties including potential scheme participants.” Are you satisfied that Welsh businesses and stakeholders have been consulted sufficiently?

I’m satisfied we gave interested parties a good opportunity to comment, including issuing alerts on the consultation and invites to our virtual events through NRW’s contact list to all scheme participants in Wales. In reality, many operators choose to issue responses through their trade bodies or other industry representatives.

Given the nature of the scheme, many participants have multiple installations across the UK. It is, therefore, unsurprising only to receive 6 responses from those located only in Wales.

- 11. The EM says that the ETS scheme will incur staffing costs for Natural Resources Wales. However, “it is not anticipated the scheme will result in any additional staff costs compared to” remaining in the EU ETS. Can you confirm that you are satisfied that NRW has sufficient resources to undertake its work as a regulator of the UK ETS in Wales?**

The role of NRW as environmental regulator of the UK ETS is comparable to the role it currently performs under the EU system. Therefore, on the basis the scope will be maintained in the early years, I am confident NRW has sufficient resources. In future, if the scope were to be expanded and significantly more installations or operators came under the scheme, staff resources would be reviewed.

In terms of funding this activity, the regulators charge participants to undertake their regulatory activities and, consequently, NRW would have the facility to cover any future increases in cost.

- 12. In the EM, you explain that, currently, funds generated by the EU ETS scheme are “not hypothecated but contribute to general Treasury coffers”. You go on to say that “an alternative approach the Welsh Government supports for is the establishment of an industrial decarbonisation fund to recycle auction receipts into funding packages for deep decarbonisation of our industries.” Can you confirm whether funds generated by the proposed UK ETS scheme will continue to be returned to the treasury? Can you explain the status of your proposed “alternative approach” for an industrial decarbonisation fund?**

I put forward my strong preference for a fund during Ministerial discussions in the Spring and would expect further discussions with UK Ministers on this aspect over the coming months. The decision on a fund is wrapped up in much wider considerations around the costs of the transition to net zero and has not yet been finalised. I am encouraged the UK Government is open to establishing a

Ministerial forum to discuss policies for net zero and would expect funding options to feature in those discussions.

- 13. The UK Government has undertaken an impact assessment for the Order. The assessment does not consider certain issues that are specific to Wales, such as the impact of the proposals on the Welsh language or an assessment of the measure against the wellbeing goals. Are you content with the impact assessment that has been undertaken?**

The impact assessment was undertaken by BEIS analysts on behalf of the UK scheme and I agreed to its content ahead of publication. An integrated impact assessment was also conducted by my officials and I attach the summary for your information.

- 14. Will the proposed framework have any impact on existing or planned Welsh legislation and/or policies?**

The ETS scheme framework doesn't require changes to any other Welsh legislation. However, it is one of a suite of policies to support industrial decarbonisation and our move away from fossil fuelled power generation. We will consider the scope and impact of the UK ETS when developing future policies in this area.

- 15. In your letter, you refer to a second, more technical Order that is due later this year. Can you clarify when the Committee can expect to see this Order, what it will cover, and the extent to which the Senedd will have an opportunity to scrutinise it?**

We are finalising an Order which will be made using the negative procedure. This will deal with the allocation of free allowances and matters concerning the registry of allowances. Subject to the Order currently laid being approved by the Senedd and other legislatures, we are planning to take both Orders to the Privy Council meeting in November before laying the second Order in each of the UK legislatures for scrutiny.