



Mr Llyr Gryffydd MS
Chair, Climate Change, Environment and Infrastructure Committee
Welsh Parliament
Cardiff Bay
CF99 1NA

9 January 2023

By email: SeneddClimate@senedd.wales; Llyr.Gryffydd@senedd.wales

Re: Haven Energy Forum concerns regarding the UK Emissions Trading Scheme

Dear Mr Gryffydd,

As Chair of the Senedd Climate Change, Environment and Infrastructure Committee, we write in order to request your and your Committee's assistance and attention on a matter of importance to Wales' efforts to reduce GHG emissions, whilst supporting jobs and avoiding 'carbon leakage'.

The Haven Energy Forum (HEF) is an organisation made up of the Port of Milford Haven and the principal energy businesses surrounding the Milford Haven Waterway in Pembrokeshire. Since 2010, we have met under the auspices of the HEF to work together, where appropriate, to enhance the safety and operational effectiveness of our facilities, whilst protecting the environment. We also work collectively and engage with stakeholders to promote the importance of the Haven as an area of economic significance.

The Port of Milford Haven and the industrial facilities that it services, are critical to the resilience and security of UK energy. The Milford Haven Waterway constitutes the UK's single largest cluster of energy-related businesses, handling or processing approximately 20% of the UK's energy needs, supporting the employment of 5,000 highly skilled employees in Wales, with many hundreds more throughout the wide supply chain. Our businesses include two LNG terminals that supply a third of the UK's natural gas, one of the UK's six oil refineries that supplies over 14% of the UK's transport fuels, one of Europe's largest and most efficient combined-cycle gas turbine power stations, powering around 4 million homes, and two major fuel storage terminals.

We also believe that our industries have a vital role to play in supporting the 'net zero' transition, decarbonisation and improved energy efficiency with Milford Haven Waterway at the forefront of exciting developments around low-carbon hydrogen and renewable energy. This includes investments such as Dragon LNG's solar farm development, which will install 18,500 solar panels across 14.67 acres providing 9% of site electricity demand;¹ RWE's 'Pembroke Net Zero Centre', which provides a clear pathway to be carbon neutral by 2040, with developments around new innovative technologies, including hydrogen production, Carbon Capture and Storage and floating offshore wind;² and Valero

¹ Dragon LNG, *Ground broken at Dragon LNG marks another step in its energy efficiency and decarbonisation plan*, <https://www.dragonlng.co.uk/general/ground-broken-at-dragon-lng-marks-another-step-in-its-energy-efficiency-and-decarbonisation-plan>, 28 June 2022

² RWE, *Pembroke Net Zero Centre PNZC: a new initiative on RWE's pathway to carbon neutrality*, <https://www.rwe.com/en/research-and-development/project-plans/pembroke-net-zero-centre-pnzc>

Refinery's £120 million investment in a 45MW Combined Heat and Power Cogeneration Unit.³ The creation of the Milford Haven Waterway Future Energy Cluster (MHW FEC) is another key step forward, involving many HEF members and coordinated by the Port of Milford Haven, outlining a vision for a low carbon future for the Waterway.⁴

Whilst HEF members, both independently and collectively, broadly support the Welsh Government's decarbonisation ambitions, we strongly believe that there must be a fair and equitable balance between industry's ability to invest in abatement technologies, whilst continuing to be of vital importance the UK's energy security. Unfortunately, one major area of concern in this regard is the impact of the UK Emissions Trading Scheme (UK ETS) on many of our businesses. Collective concerns exist across the HEF membership, both as to the current operation of the Scheme as well as recent proposals by the UK ETS Authority for the future of the overall ETS cap and the role of free allowances for numerous energy intensive sectors. The HEF is worried about the significant competitive disadvantage that these ramifications are having and will continue to have on the Haven's oil and gas facilities.

This includes:

- Uncompetitive costs versus international peers
Already in the first year of its operation, UK ETS has seen costs far exceed those faced by competitors in other countries and regions, even compared to the EU Emissions Trading Scheme (EU ETS). UK allowance costs have consistently diverged above EU ETS, with the settled differential since the beginning of 2022 being approximately £10 per tonne of carbon. Proposals in the recent UK ETS consultation to cut the allowance cap by 50% in 2024 is a major change not replicated in other countries or regions, and one that will further dramatically undermine UK industrial competitiveness against EU and global peers beyond what is currently being experienced. Higher UK carbon prices will ultimately result in carbon leakage, job losses, reduced security and quantity of supply, as well as leading to higher electricity and gas prices for the end user, as our facilities are unable to compete with global markets. Government should pursue linking the UK ETS to other international schemes and a coordinated approach to cross-border adjustments for third countries to remove this competitive disadvantage as a matter of priority.
- Failings in the Cost Containment Mechanism (CCM)
The CCM has proven itself unable to address unsustainable carbon prices since UK ETS has been in operation, with the UK ETS Authority failing to intervene on the occasions (December 2021 and January 2022) when the CCM was triggered. This is the case in spite of UK ETS having developed a persistent disadvantage against similar cap-and-trade schemes, especially EU ETS (as noted above). The methodology that supports the CCM trigger point also rises exponentially, making it difficult for interventions to occur.
- UK ETS policy is not aligned with decarbonisation technology roll-out
The rising costs associated with the strategic direction of UK ETS gives uncertainty to companies such as ours, who rely on investment from boards and shareholders outside of the UK. This is not least due to a lack of clarity around a regulatory environment that does not currently align with the pace of technological advancements in this area. UK Government support for CCS and low-carbon hydrogen will see clusters sequenced in terms of support, with HyNet and the East Coast clusters scheduled to begin capturing and storing emissions in the mid-2020s. All other clusters will only become eligible for support from 2030 onwards. This disadvantages companies in Milford Haven, who will not be able to access decarbonisation technologies until a CO₂ shipping option is developed to enable carbon capture, whilst still facing increasing UK ETS costs on a much earlier cycle than CCS and blue hydrogen will be available.

³ Valero Energy Ltd, *Pembroke Refinery Cogen*, <http://www.pembroke-refinery-cogen.co.uk/>

⁴ Port of Milford Haven, *UK's Energy Capital Maps Out Low Carbon Vision*, <https://www.mhpa.co.uk/news/2022/06/16/uks-energy-capital-maps-out-low-carbon-vision/>, 16 June 2022

- Uncertainty surrounding the future of free allowances
Proposals around free allowances in the UK ETS consultation create severe uncertainty regarding their availability for UK energy intensive industries beyond 2026. Failure to provide long-term access to free allowances would rob many of the businesses around the Haven Waterway of any carbon leakage protection, further undermining competitiveness with the EU and other markets. Phasing out or removing free allowances must only be considered once the Authority has put in place an alternative carbon leakage policy, such as a Carbon Border Adjustment Mechanism (CBAM).
- Loss of free allowances due to events outside industry's control
It is also a concern that free allowance calculations for a number of operators have been impacted by a lack flexibility when industry is affected by extraordinary and unplanned impacts on activity levels. The devastating and exceptional impact of the Covid-19 pandemic on UK ETS obligated sites is one such example. In spite of Covid-19 impacts across 2020 and 2021 not being within industry's ability to control, some sites have nonetheless had or will have free allowances withdrawn, increasing the amount of allowances sites need to buy in the marketplace. This increases the risks of carbon leakage to the UK economy.
- Changes to the CLSL
For LNG facilities specifically, removal from the Carbon Leakage Sector List (CLSL) means UK terminals are placed at a competitive disadvantage compared to European terminals who are permitted to use different regasification technologies and then exacerbated by an inability to access funding opportunities to support the transition to 'net zero'. This appears contrary to the detail of the 'British Energy Security Strategy', which documents LNG as a key component in the UK and European energy security, as well as highlighting the importance of a hydrogen-ready infrastructure. As LNG is generally sold to the most attractive market, the UK is competing with Asian and European markets amongst others. Higher UK carbon prices will ultimately result in reduced security and quantity of supply leading to higher electricity and gas prices for the end user as cargoes are diverted elsewhere in the world.
- Inconsistent interpretation of legislation
When compared to the EU ETS, the UK ETS interpretation of applicable legislation has had a significant negative impact on the financial performance of the LNG import terminal business. This not only impacts businesses now, but will impair our ability to compete with the rapid increase in European LNG terminals, resulting in both carbon leakage and a negative impact on the UK's energy security and diversity of supply. This inconsistency, following a summer of UK terminals aiding the supply of natural gas to the EU via the interconnectors, is counterproductive.

We are already engaged on these matters with the Climate Change Minister, Julie James MS, and have exchanged correspondence with her on the seriousness of the issue. We would also, however, kindly request that your Committee address these issues, which we hope you will agree have ramifications not only for the Milford Haven Waterway, but for industry and people dependent on our sectors across the whole of Wales. The potential consequences for industry in Wales – and the knock-on effects for the UK's energy security and efforts to decarbonise – are ones that we all wish to avoid.

As part of our engagement with your Committee, we would particularly like to invite you and your Committee colleagues to visit Milford Haven to discuss these issues in greater detail. This would include a boat trip on the Haven Waterway, hosted by the Port of Milford Haven, which offers an opportunity for you all to see the scale of the operations in the Pembrokeshire oil and gas sector and potential of our industries to support the move towards 'net zero' as a Cluster.

We look forward to hearing from you. We would welcome any replies to be directed to William James, Manager Public and Government Affairs, Valero Energy Ltd (william.james@valero.com).

Yours sincerely,



Simon Ames
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Dragon LNG



Tom Sawyer
Chief Executive
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Stephen Kenyon
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Hamad Al Samra
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Cc: Ms Janet Finch-Saunders MS, North Wales
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