

Huw Irranca-Davies AS/MS
Y Dirprwy Brif Weinidog ac Ysgrifennydd y Cabinet dros
Newid Hinsawdd a Materion Gwledig
Deputy First Minister and Cabinet Secretary for Climate
Change & Rural Affairs



Llywodraeth Cymru
Welsh Government

Ein cyf/Our ref: HIDCC/PO/0354/24

Llŷr Gruffydd MS
Chair
Climate Change, Environment and Infrastructure Committee
Welsh Parliament
Cardiff
Cardiff Bay
CF99 1SN

29 November 2024

Dear Llŷr,

I am writing to inform you the UK Emissions Trading Scheme (ETS) Authority (comprising of the Welsh Government, the UK Government, the Scottish Government, and the Northern Ireland Executive), has published two consultations on the expansion of the UK ETS. The first concerns the expansion of the scheme to include the domestic maritime sector, and the second provides further detail on proposals to recognise non-pipeline transport (NPT) methods, i.e. shipping, road or rail for moving captured carbon into geological storage. Additionally, an initial Authority Response is being published regarding the free allocation treatment and definition of permanent cessations of activity in the scheme.

In July 2023 the Authority confirmed its intention to bring domestic maritime into the scheme from 2026. This will begin with a ship threshold of 5000GT, although there is a commitment to reassess this threshold by 2026. The consultation provides further details on how this expansion will be implemented, giving clarity to drive investment in decarbonisation.

The consultation on NPT follows the Authority's announcement, also last July, that it intends to recognise NPT methods of CO₂ transport. Recognising this within the UK ETS will ensure that operators transporting CO₂ for storage can deduct the amount they send to storage from their reportable emissions, providing economic support for industrial sites without access to pipelines. This is particularly crucial for industry in Wales without suitable storage options such as the South Wales Industrial Cluster. This consultation aims to provide more detail and consult on the regulatory framework required to recognise and implement NPT in the ETS.

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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.

The Authority, along with officials across the Welsh Government, will engage extensively with affected stakeholders to gather views to support final decisions on how the UK ETS will be expanded. These reforms to the UK ETS will require amendments to the Greenhouse Gas Emissions Trading Scheme Order 2020, so the Senedd along with other UK Parliaments will have the opportunity to scrutinise plans once they are finalised.

The initial Authority Response follows proposals to make two technical changes to free allocation rules within the Free Allocation Review consultation released in December 2023. One is to the treatment of permanent cessations and the other is to clarify the definition of a permanent cessation. Free allocations are allowances provided for free to industries with global competitors from countries with less ambitious climate policies. Free allocations are currently the primary policy lever in mitigating carbon leakage.

Under current rules, when permanent cessation of an activity occurs, operators keep free allocations they were entitled to during the final year in which they operated. However, free allocation levels are calculated based on average activity levels within the 5 years prior. These rules can therefore lead to some operators receiving more allowances in their final year than required to mitigate carbon leakage, and in some cases in excess of their reported emissions. The new rules will alter this so that the level of allowances given in the final year of operation would be based on actual activity levels for that final year. An exception to the new rule will be in place for when cessation of an activity occurs for the purposes of decarbonisation e.g., installation of new technology. Participants closing for decarbonisation will therefore be able to retain the full entitlement of free allocation, subject to sufficient evidence being provided. This is in line with maintaining the scheme's incentive to decarbonise. These rule changes will require changes to the legislation, which will be taken in the Greenhouse Gas Emissions Trading Scheme (Amendment) Order 2025. This is currently aimed to be laid in the Senedd in December 2024, with the in-force date in February 2025.

The UK ETS continues to be a highly important policy lever in Wales, providing a vital investment signal in the decarbonisation required to meet our Net Zero goals. The information collected in these consultations will play a crucial role in shaping the expansion of the scheme, ultimately increasing the greenhouse gas emissions included under its emissions cap. Making the changes to free allocation rules will also improve equity and targeting of free allocation in the scheme, ensuring it can be used for participants who need it most. I expect to write again regarding the outcome of the consultations and further policy proposals in the coming months. I am copying this letter to the Chair of the Legislation, Justice and Constitution Committee.

Yours sincerely,



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