



UK ETS Free Allocation

Call for Evidence Response
from business

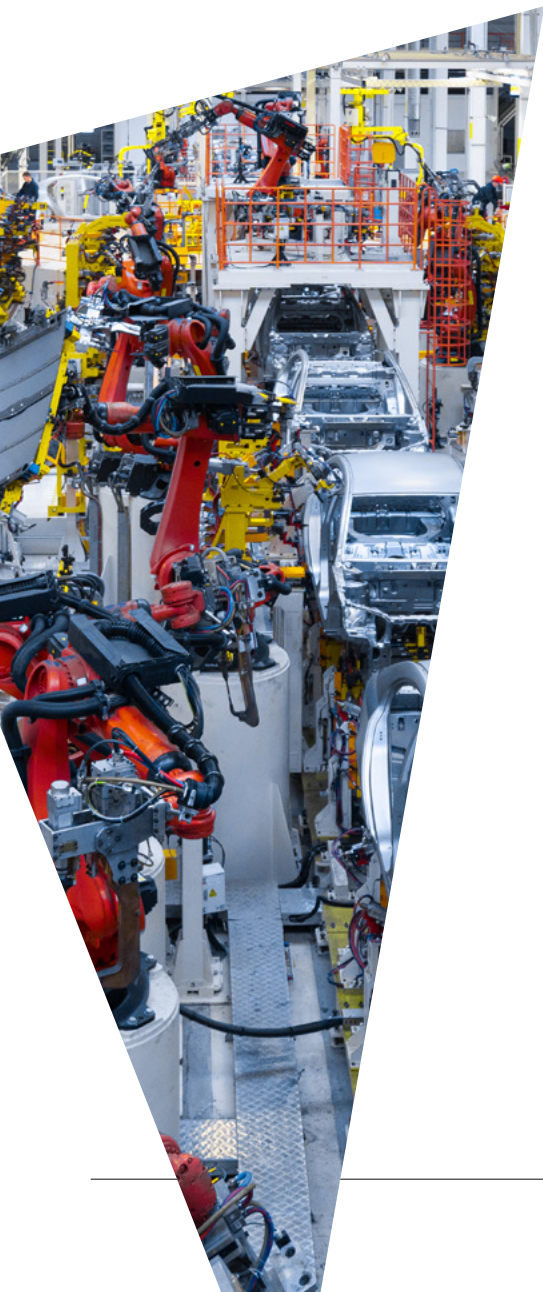
Submitted by
npower Business Solutions
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**Business
Solutions**



Introduction



In the Energy White Paper, published in December 2020, the Department for Business, Energy and Industrial Strategy (BEIS) confirmed the establishment of the UK ETS, which replaced the UK's participation in the EU ETS on 1 January 2021 and has been positioned as 'the world's first net zero cap and trade scheme'.

Alongside ensuring continuity for participants, with the UK ETS, BEIS is also taking the opportunity to develop a scheme with greater ambition, by reducing the cap on emissions allowances by 5% from the UK's expected share of the EU ETS cap. BEIS will also be consulting on setting a net zero consistent cap trajectory later in 2021.

The UK ETS is also continuing to offer free allowances to prevent carbon leakage and to protect UK competitiveness.

However, a 2021 Review of the UK ETS will look to ensure that the scheme evolves and grows to make the most of new opportunities and be compatible with climate commitments. In responding to the consultation,

'The future of UK carbon pricing', the UK Government pointed to some of these areas, such as setting a net zero consistent emissions cap; reviewing the long-term role of free allowances.

As such, in March 2021, BEIS launched a Call for Evidence with respect to free allocation arrangements in the new UK ETS, seeking evidence on how free allocations can better incentivise emissions reduction and protect industry from the risk of carbon leakage.



At npower Business Solutions, we believe the views of businesses - particularly the energy intensive organisations the UK ETS is most relevant for - are represented at all stages of this review and consultation.

This document outlines the feedback from 24 organisations in response to the Call For Evidence, with inputs on:

- The advantages and disadvantages of the current approach to free allocation
- Key questions the Review should discuss and any problems that need addressing
- How to make free allocations fairer and more targeted as allocations are decreased in line with the reduction in the overall cap.

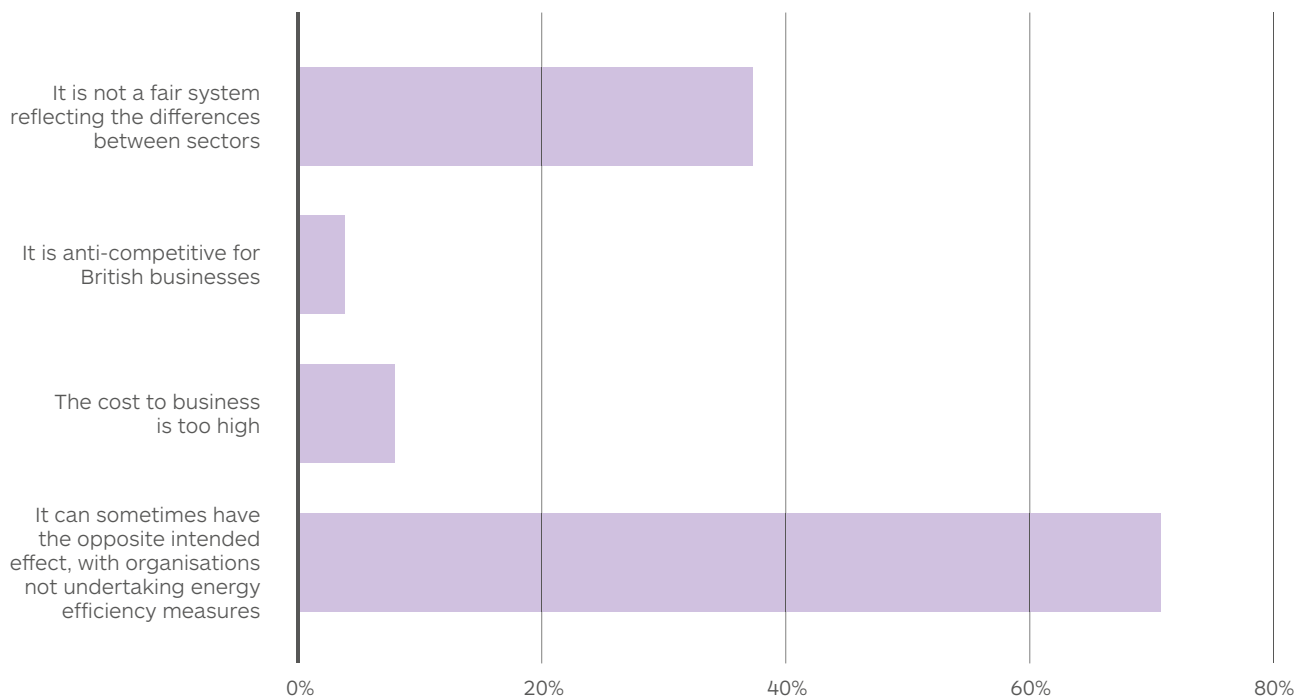
The Views of Business

Finding One - the main issue with current approach to free allocation is that organisations may not take up energy efficiency measures

When asked what the main issues were with the current approach to free allocation, our respondents overwhelmingly responded that the prime problem was that it can have the opposite incentive to not undertake energy efficiency measures.

70 percent of respondents said this was the case, while nearly 40 percent don't believe it is currently a fair system that accurately reflects the differences between energy intensive sectors.

Figure 1: What, if any, are the main issues or problems with the current approach to free allocation?



Other views include that "It doesn't extend far enough back into the production cycle to reflect carbon saving in the upstream process".

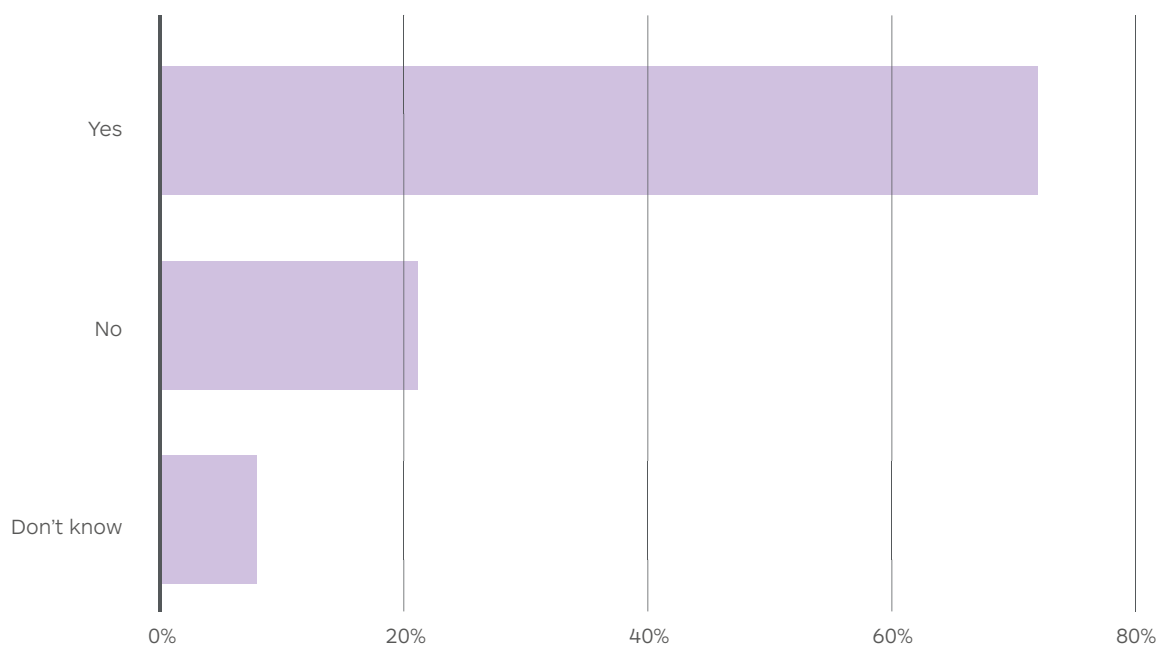


Finding Two - Businesses Support the UK ETS Aligning With Net Zero Goal

We know that a key differentiator with the UK ETS is reducing the cap on emissions allowances by 5% from the UK's expected share of the EU ETS cap. We also understand that the Government will also be consulting on setting a net zero consistent cap trajectory later in 2021.

Our findings show that this is largely welcomed by business, although a relatively significant minority - 20% - will need convincing that this is the right approach for them to maintain competitiveness.

Figure 2: Do you believe that the approach to free allocation outlined in the UK ETS should align with the Net Zero by 2050 goal??



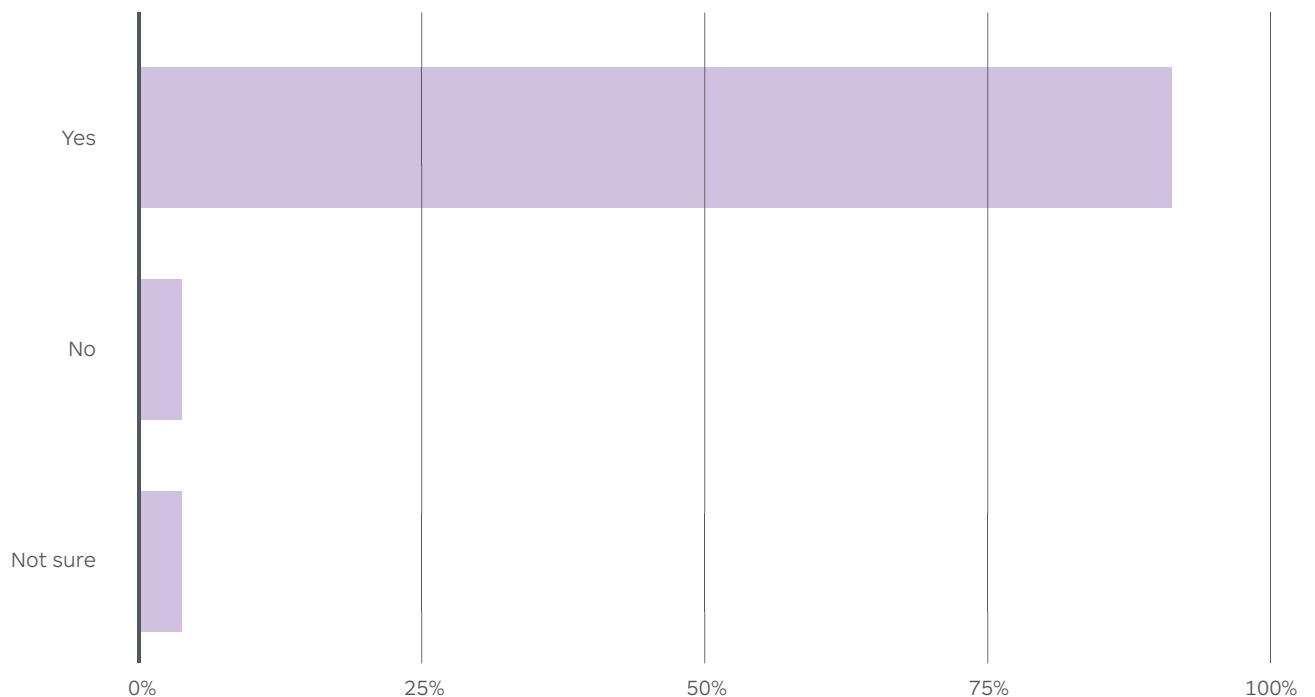


Finding Three - Carbon Leakage - A Fair Solution Needed For All

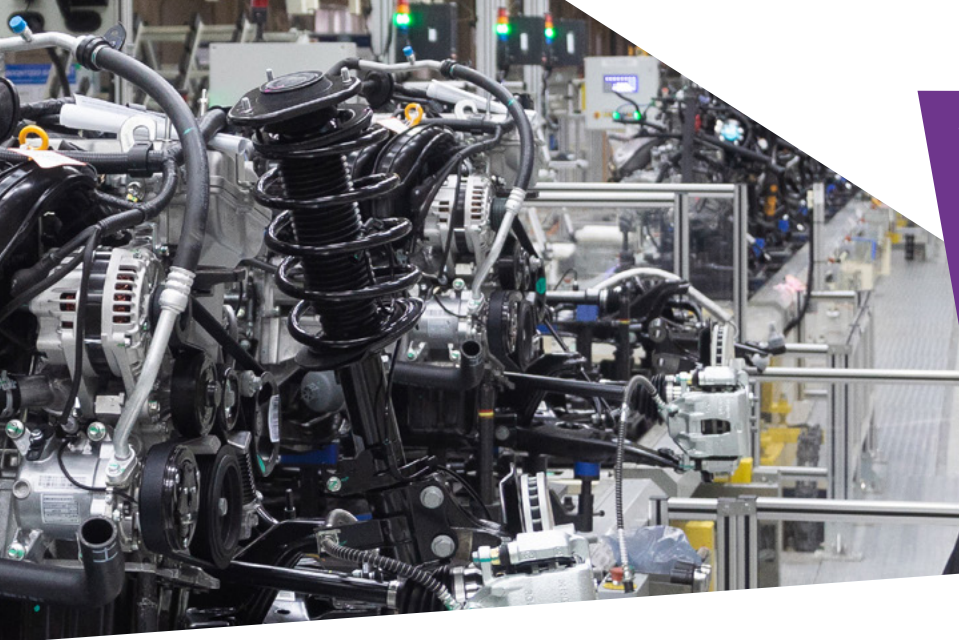
Of the businesses we spoke to, one in six experiences carbon leakage. However, almost all (91%) were unanimous in their view that there

should be alternative carbon leakage protection measures to ensure that carbon intensive imports face the same carbon costs as domestic products.

Figure 3: Do you believe that there should be alternative carbon leakage protection measures to ensure that carbon intensive imports face the same carbon costs as domestic products?



Other views include that “It doesn’t extend far enough back into the production cycle to reflect carbon saving in the upstream process”.



We need a fair approach, which moves towards total use along a defined taper, that is applied internationally.

Importantly, there were several specific views on what a fair solution would be for UK business that also helps meet the UK's climate targets

These include:

"We need a fair approach, which moves towards total use along a defined taper, that is applied internationally."

"Yes there should be levelling up between imports and domestic goods, but not at the expense of tit for tat surcharges - this needs to be agreed beyond the domestic market on a more global trading partners basis."

"Increased funding for energy saving measures."

"Understanding that digital services transcend national boundaries."

"Combination of technological solutions."

"Further subsidies to encourage carbon leakage reduction."

"More streamlining of the various schemes would help."

"Imported products should be subject to a tariff where the production has incurred higher emissions due to less stringent regulation or similar."

"A carbon tax on imports that mirrors production and transport related emissions"

"It should align with EU policy but examine where differences occur."





Conclusion

This insight from some of the businesses the UK ETS will directly impact is designed to provide additional guidance for BEIS as it pulls together the evidence around free allocation and conducts its review.

As this shows, while the majority of businesses are behind the alignment of the UK ETS with the Net Zero goal, it also highlights one of the main issues with the current system of free allocation is that it can actually have the opposite intended effect, and encourage organisations to not implement energy efficiency measures. This is something that will need to be addressed if our climate targets are to be met.

Our discussions with business also reiterated that the UK scheme must ensure competitiveness is not compromised, and that any measures around carbon leakage should ensure that imports face the same costs as domestic products.

Overall, there is great support for a more ambitious scheme that supports the UK's climate targets. Businesses just need to be reassured that their voices are being heard during any review and consultation process.

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