Dear Gillian,

**RE: EU ETS – EU EXIT REGULATIONS**

I am writing in response to your letter of 09 October regarding the EU Exit Regulations which I have recommended for consideration by the Committee, in the event of a ‘no deal’ EU Exit.

In advance of my colleague, the Minister for Rural Affairs & Environment’s Committee appearance on 24 October, I am happy to respond to the questions that you have asked, and these are set out in the annex to this letter.

I would like to reiterate the Scottish Government’s continued concerns at the UK Government’s handling of the EU exit negotiations regarding sectors covered by the EU Emissions Trading System (EU ETS). This is a concern shared by my counterparts in the Welsh Government.

It is a matter of deep regret that in over two years since the EU Exit referendum, there has been no formal ministerial discussion between the UK Government and the devolved administrations on the UK’s approach to negotiating future participation in the EU ETS. This is in spite of the Scottish Government’s repeated requests of the UK Government, where the UK Government has been unwilling to host discussions.

This is of particular concern to the Committee given that emissions trading is a devolved matter which has always been delivered on the basis of shared agreement between the different governments and legislatures. The approach taken by the UK Government, and its unwillingness to host Ministerial discussions, raises important questions on the accountability of any future arrangements to the Scottish Parliament.
As set out in my letter to the Committee of 02 October, it is our responsibility to ensure that devolved law continues to function on and after EU withdrawal, despite the disastrous consequences of a ‘no deal’ EU Exit. It is the Scottish Government’s preference to remain within the EU Emissions Trading System. Participation in the EU ETS forms an important element of our Climate Change Plan. Retaining access to the world’s largest carbon market affords the most cost effective route to decarbonisation of energy intensive industries and the power sector, whilst ensuring appropriate protections to ensure a level playing field for competitiveness and to protect those sectors at risk of carbon leakage.

Continued membership of the EU ETS in phase IV would also allow industry to access a potential €9bn worth of innovation funding to support decarbonisation through demonstration of technologies such as carbon capture and storage. This is something that will be lost if we leave the EU ETS, with no guarantees of equivalent funding from the UK Government.

The approach pioneered by the EU ETS is now likely to be replicated more widely as part of the Paris Agreement under Article 6, which is developing global mechanisms for linking carbon markets. Given its historic support for emissions trading, it would be wrong for the UK Government to walk away from its commitment to carbon markets at precisely the moment when EU ETS reforms are starting to deliver a strong carbon price signal, and at the point when other major economies such as China are developing carbon markets.

The Scottish Government believes that it is essential to retain accountability to devolved legislatures and governments whatever future arrangements are decided upon by the UK Government in its negotiations on future participation in the EU ETS, or domestic alternatives. There should also be full consultation with sectors affected. That is essential to ensure that emissions reductions from industry and the power sector continue to meet our climate targets, whilst ensuring the continued competitiveness of key sectors of our economy, and protection against carbon leakage.

Yours,

ROSEANNA CUNNINGHAM
Reply to Questions from the Scottish Parliament

Timing

Q.1. The notification records that the 28 days for Scottish Parliament scrutiny referred to in the agreed protocol have not been given. Since the UK Government does not intend to lay this SI until 14 November, can the Scottish Government advise why consent is required by 29 October?

The UK Government’s letter requested a response from the Scottish Government by 29 October. A holding response was sent to the UK Government making it aware that this timescale does not allow the Scottish Parliament the 28 days in the SI Protocol to consider the UK SI, and therefore the Scottish Government cannot commit to respond by the 29 October.

Q.2. What would be the consequences of the Scottish Parliament failing to report to the Scottish Government by 29 October?

The Cabinet Secretary has made the UK Government aware that the 29 October does not allow the Scottish Parliament the 28 days in the SI Protocol to consider the UK SI. However the UK Government intends to lay the UK SI on the 14 November, which does allow exactly 28 days for the Scottish Parliament to scrutinise the SI according to the SI Protocol.

Q.3. What would be the consequences of the Scottish Government failing to report to the UK Government by 29 October?

The UK Government has requested a reply from the Scottish Government by 29 October, in good time before the planned laying date of this UK SI on 14 November. The Scottish Government has made the UK Government aware that the timescale requested for response does not allow the Scottish Parliament the 28 days as per Protocol to consider the UK SI. The Scottish Government wishes to respond to the UK Government in advance of 14 November.

Identification of legislation with deficiencies

Q.4. The notification states that the EU ETS is established by over 54 pieces of legislation. The only piece of UK legislation mentioned in the notification is the UK Greenhouse Gas Regulations 2012. Is that the only piece of legislation which the proposed SI will change? If there are others, please specify them.

Yes the UK Greenhouse Gas Regulations 2012\(^1\) is the only piece of UK legislation fixed by this proposed SI. The purpose of the UK SI is to retain

aspects of the EU ETS that remain operable and remove those which would be inoperable after EU Exit (respectively emissions reporting and surrender of allowances to the EU registry). The changes in the proposed SI are technical. In addition to amendments to the UK 2012 Regulations, the proposed SI will also bring into UK law a number of directly applicable instruments of EU legislation that would otherwise cease to apply to the UK after EU exit, and remove those that no longer apply. These EU Regulations and Decisions need to be brought into UK law to continue to provide the detailed rules for the aspects of the EU ETS that are maintained by the proposed SI. In particular the SI ensures that the Commission Regulation (EU) 601/2012, which sets out the detailed technical rules for participants on how to monitor their emissions (what emission factors to use, the level of accuracy of measurement, the method of measurement) continues to apply.

Identification of deficiencies

Q.5. Has the Scottish Government seen a draft of the proposed SI and, if so, could the Scottish Government let the Committee see this?

The Scottish Government has seen a draft of the proposed UK SI. In many instances, the Scottish Government will not have had sight of a final SI when it notifies the Scottish Parliament. That is why the protocol requires the Scottish Government to advise the Scottish Parliament when the final SI is laid. When the Scottish Government have sight of the final SI, we will check the SI for consistency with the Notification and will write to the Committee as per the protocol.

Q.6. Can the Scottish Government provide more detail (including examples) on the type of deficiency which will be corrected by the proposed SI and what specific amendments are proposed?

The power which the UK will use to make the SI is section 8(1) of the European Union (Withdrawal) Act 2018 and it gives the Minister of the Crown Power to prevent, remedy or mitigate deficiencies arising from the withdrawal of the UK from the EU. The legislation provides that deficiencies include provisions which will no longer be of practical application in relation to the UK, or provisions which are redundant or which confer functions on EU entities which will no longer have functions in that respect under EU law in relation to the UK.

A key deficiency with the UK Regulations 2012 is that it requires participants to surrender EU ETS allowances to the EU Registry equivalent to their annual emissions. Given that in the no-deal scenario the UK will cease to have access to the EU Registry, and that the EU Commission will cease to allocate EU ETS allowances to the UK (either for free allocation or auction), then UK participants could not meet this obligation. As there is an automatic civil penalty levied for failure to surrender allowances, and UK participants cannot fulfil this obligations as a result of a no-deal exit, this deficiency in the UK Regulations 2012 has to be fixed.

The other key amendments made by the UK SI are aimed at ensuring that the obligations for participants to monitor and report their emissions are maintained, and that the detailed rules for doing this, which are set out in Commission Regulations, continue to apply.
Many of the amendments are simple technical amendments to alter current references in the UK and EU legislation made to “member states” to instead read as references to “the competent authority”.

For example, Article 10 of Commission Regulation 601/2012 currently provides “Where a Member State designates more than one competent authority pursuant to Article 18 of Directive 2003/87/EC, it shall coordinate the work of those authorities undertaken pursuant to this Regulation.

Article 10 will be altered by the proposed UK SI to say that where there is more than one competent authority designated in the UK, each competent authority shall coordinate its work undertaken pursuant to this Regulation with the other competent authorities. This new provision is designed to ensure that whether there is more than one competent authority designated in the UK (e.g. one relevant to each devolved government) each authority will be responsible for coordinating its work with the work of other such authorities.

Article 74 will be altered to give competent authorities functions of issuing electronic forms and templates to operators so that they can submit their monitoring plans and emissions reports. The function currently lies with “member states” and that reference will no longer work. Article 10 mentioned above will require that operators work together to minimise the creation of any burden associated with this work e.g. by adopting the same or similar formats for reporting.

**Stakeholder engagement/consultation**

**Q.7.** *The notification mentions that stakeholders’ views have not focused on no-deal scenario arrangements. What stakeholder engagement/consultation have the Scottish and UK Governments undertaken on this proposed SI?*

The Scottish Government has repeatedly requested full Ministerial discussions with the UK Government and other devolved administrations on future participation in the EU ETS, since June 2016. We regret that the UK Government has not yet held such discussions, nor has there been any formal consultation with stakeholders on continued EU ETS participation, or alternative approaches, including a ‘no deal’ scenario. The Scottish Government is clear that a ‘no-deal’ Brexit is extremely irresponsible and would have significant economic and social costs for the UK as a whole – including for energy intensive industries and electricity generators participating in the EU ETS, who rely on certainty on long term frameworks for carbon pricing to guide their investment decisions. The Scottish Government remains clear that the least damaging option for the UK would be to have continued membership of the European Single Market and Customs Union. We also believe that continuing to participate in the EU ETS beyond March 2019 represents the best route for decarbonisation of the traded sector – giving certainty around the emissions reduction cap, and providing appropriate protections for competitiveness, and a level playing field to prevent carbon leakage.
Q.8. What were stakeholders’ views and how have they been taken into account?

The Scottish Government regrets that the UK Government has not consulted on the potential ‘no deal’ scenario, nor on any other scenarios for future participation in the EU ETS, or alternative approaches. Given that the question of whether or not the UK continues to participate in the EU ETS remains a matter for the UK Government in its negotiations with the EU on its future relationship, the Scottish Government is unable to consult on alternative scenarios, and their impacts on Scotland (including ‘no deal’) until this fundamental issue is clarified in the UK’s negotiations with the EU. In spite of two years of pressing for this certainty from the UK Government, we are still being told that ‘all options are on the table’. This makes it impossible for the Scottish Government to consult on the impacts for Scotland when there have been no Ministerial discussions to agree what alternative mechanisms could replace the EU ETS – which would require agreement between all four administrations before any consultation could take place. Moreover, the Scottish Ministers have had no prior discussion on the detail of the ‘no deal’ scenario, or its impact, ahead of the UK Government drafting the SI.

Q.9. Do the detailed options papers developed by the UK Emissions Trading Group (ETG) include options in the event of a no deal scenario? Can more detail of these papers be shared with the Committee now?

The ETG’s detailed options papers do not include options in the event of ‘no deal’ scenario and focus exclusively on the future long term approach, including alternatives to membership of the EU ETS. The ETG did write to the UK Government in August 2018 asking questions about the no-deal scenario. The ETG’s papers are publicly available on their website.²

**Continued monitoring and reporting requirements**

Q.10. Can the Scottish Government provide more detail on which monitoring, reporting and enforcement requirements are proposed to be retained under the proposed SI?

All the current monitoring, reporting and enforcement requirements of the EU ETS will be retained, and will ensure that installations currently participating within the EU ETS will continue to report and verify their emissions to environmental regulators.

Q.11. Will the proposed SI result in any changes to the monitoring, reporting and enforcement requirements referred to in the notification, including:

a) Which bodies or authorities traded sector participants will be accountable to?

Currently, traded sector participants are accountable for the monitoring, reporting and verification of their emissions to environmental regulators in the UK (in Scotland, to SEPA and the Environment Agency in so far as it is the

National Administrator of the UK’s account on the EU Registry), and to the European Commission. Under the SI, participants will remain accountable to environmental regulators in the UK, but will no longer have to report their emissions to the EU Registry, overseen by the European Commission.

b) **Who will be responsible for enforcement after EU exit?**

SEPA will continue to be responsible for enforcement of this SI, after EU exit. SEPA will continue to be able to issue civil penalties for the same offences relating to emissions reporting, but those related to the obligations that are inoperable and have been removed are also removed.

c) **Will the role of SEPA remain exactly as it currently is?**

Yes – SEPA will continue to enforce the monitoring and reporting requirements for Scottish participants. SEPA will continue to issue permits to participants setting out their monitoring plan, participants will continue to have report to SEPA according to their permit, SEPA will continue to review participants’ annual emissions reports and the verification of them by third parties, SEPA will continue to audit sites to check their compliance, and ultimately SEPA will continue to take enforcement action as necessary.

d) **The timing for monitoring and reporting?**

The proposed SI will not make any changes to the timing for monitoring and reporting. Monitoring will remain based on the calendar year, with the deadline for reporting verified emission to the regulator remaining the standard EU ETS deadline of 31 March (the 2018 compliance year is an anomaly – see answer to question 25). The requirements will apply to the 2019 calendar year – covering emissions from 1 Jan 2019 – 31 Dec 2019 with reporting by 31 March 2020, and in the same pattern in subsequent years.

e) **The way in which reported information is published (including how it is made available to the public)?**

Information on is currently reported publically as a result of interaction with the EU Registry. These arrangements will cease in a no-deal scenario and there is likely to be some change to how the information reported is made available to the public.

Q.12. **What would be the impact of not monitoring and reporting emissions according to the current technical rules as a set out in EU regulations?**

If the monitoring and reporting of emissions was no longer carried out according to the current technical rules set out in the EU ETS regulations, this would evidently have an impact on participants. However, the intention of this SI is to maintain the EU rules, with which participants are familiar, and have been long-standing, and where procedures are already in place. This approach should minimise the disruption and avoid introducing further uncertainty following EU exit. Continuing with the current robust EU rules also ensures that data is collected on the same basis, to the same level of accuracy and transparency.
Legal basis for membership of the EU ETS

Q.13. What is the precise legal basis for the UK’s membership of the EU ETS?

The UK is obliged to participate in the EU ETS by virtue of its membership of the European Union. The principal basis on which the EU ETS Directive(s) are established is the Treaty establishing the European Community Article 192(1).

Q.14. Do the European Commission and UK Government consider membership of the EU ETS to be tied to membership of the Single Market?

The UK Government has provided the following response to this question:

“The UK does not believe that membership of the EU ETS and Single Market are tied. The UK has been clear that it is not seeking to be part of the Single Market.

The Government is considering all factors in relation to the UK’s future participation, or otherwise, in the EU ETS, in consultation with stakeholders. Future participation, or otherwise, in the EU ETS remains a matter for negotiation.”

Q.15. Does the Scottish Government share that view?

The Scottish Government wishes to remain part of the Single Market and to continue to participate in the EU ETS.

Q.16. What precedents are there for non-EU membership of the EU ETS?

Membership of the EU ETS is not limited to EU member states – it also applies to members of the European Economic Area (Iceland, Liechtenstein and Norway) as a result of the EEA Agreement. There is also provision under Article 25 of the ETS Directive for linking of the EU ETS to other independent greenhouse gas emissions trading systems in third countries such that their allowances are mutually recognisable and transferable. To date, only the Swiss have linked their independent emissions trading system to the EU ETS following lengthy negotiations and an International Agreement. International relations, including relations with territories outside the UK, the EU and their institutions and other international organisations are reserved matters.

Timing of Regulations with regard to trading phases and annual cycles

Q.17. Is it the UK Government’s intention for the proposed SI to come into force on 29th March 2019 i.e. immediately following the UK exiting the EU?
We understand that the UK Government intends that the SI would come into force on the date immediately following the UK's exit from the EU, only in the event of 'no-deal' being reached.

Q.18. What implications does the timing of the SI have for the participation in annual cycles of the EU ETS, regarding purchasing and surrendering allowances?

The deadlines for purchasing and surrendering allowances for 2018 calendar year emissions are unaffected. These were moved forward by a 2017 amendment to the UK Greenhouse Gas Emissions Trading Regulations 2012 to ensure that UK participants would be required to surrender allowances before 29 March 2019 (previously this date would have been in April 2019). This 'no deal' SI will have no effect on the purchasing and surrendering of allowances for the 2018 calendar year. The no deal SI will remove the allowance provisions from the annual compliance cycle for 2019 emissions onwards.

Q.19. Is it the case that the ‘compliance cycle’ for the ETS means that the UK will have left the EU before its businesses are required to report their annual 2018 emissions (31 March 2019) or to surrender the appropriate number of allowances (30 April 2019)?

No. For the 2018 compliance year covering emissions in the 2018 calendar year, UK participants in the EU ETS will be required to report their emissions by 11 March 2019, and surrender their allowances by 15 March 2019. The deadlines were brought forward for the 2018 compliance year as explained in answer to question 18, to ensure they occur before EU Exit.

Q.20. If companies have allowances that could be traded are they prevented from doing so?

The UK Government has provided the following answer to this question: “Advice on this will be included in a forthcoming No Deal Technical Notice covering the EU ETS.”

Q.21. The EU ETS is in the middle of its third trading phase which runs until the end of 2020. Has the Scottish Government explored the possibility with the UK Government of UK participants remaining in the scheme until the end of Phase 3?

The UK Government has already agreed with the EU as part of its draft Withdrawal Agreement (February 2018), that the EU ETS Directive(s) would continue to apply within the UK in respect of greenhouse gases emitted during the last year of the implementation/transition period (2020). This aligns with the end of Phase 3 of the EU ETS. The Scottish Government supports this approach to ensure the minimum disruption and greatest certainty for EU ETS participants. The Scottish Government understands the UK and EU negotiators are still discussing the final legal text for the Agreement.

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Implications for businesses

Q.22. *A number of institutions participate in the EU ETS for commodity trading purposes, such as banks and hedge funds. Has the Scottish Government undertaken any assessment of the levels of participation of the financial sector in Scotland in the EU ETS and the impact of leaving the EU in a no deal scenario?*

A commodity trader participating in the EU ETS can be based in any country worldwide, as long as it has an EU Registry account based in any member state. After EU exit, it would therefore still be possible for a trader, based in Scotland, to open an account in another member state’s registry to allow them to continue to trade within the EU ETS. However if the UK were to leave the EU ETS then there would be no legal basis for an installation in the UK to surrender EU allowances to cover any of its emissions in the UK after the date of EU exit.

The Scottish Government has not undertaken an assessment of the level of participation of the financial sector in Scotland in the EU ETS and the impact of leaving the EU in a no deal scenario, given that we are confident that traders can continue to participate in the market as outlined above, should they wish to.

We have sought further information from the UK Government on its intended approach to this matter, since no information has been provided to accompany the laying of this SI. The UK Government has provided the following answer to this question:

“No such assessment has been undertaken. The UK Government has worked with the Financial Conduct Authority (FCA) to identify the position holders in the UK of EU allowances (which may include Scottish financial institutions) and they will be made aware of the forthcoming publication of a No Deal Technical Notice covering the EU ETS.”

Q.23. *What would the financial implications be for industrial users of the EU ETS e.g. Ineos at Grangemouth?*

In the event of ‘no deal’, industrial users of the EU ETS would cease to be required to purchase and surrender allowances within the EU ETS from the 2019 emissions year onwards. If those industrial users held unused allowances within their account, they could open an account in another member state’s registry, allowing them to sell or purchase additional allowances – however, these allowances would no longer be required, or valid, to cover any of their emissions in the UK after the date of EU exit. The Scottish Government is greatly concerned at the uncertainty created by the UK Government’s lack of discussion with the devolved administrations, and lack of consultation with industry, on a long term alternative approach in the event that EU ETS membership is no longer possible. The lack of Ministerial discussion, and the wide range of scenarios that have not been narrowed down, makes it impossible at this stage to model impacts on current EU ETS participants in Scotland.

Q.24. *What would the cost of rising emissions as a result of leaving the EU ETS be?*
The Scottish Government has, since 2016, repeatedly sought formal Ministerial discussion between the UK Government and the other devolved administrations on the impact of the UK potentially leaving the EU ETS. To date, no such discussion has been offered by the UK Government. Given the range of possible scenarios for addressing emissions from the traded sector in the event of leaving the EU ETS, it has not been possible to model the impacts on emissions at this stage. The Scottish Government is very disappointed that the UK Government has refused these discussions, given that regulation of emissions is a devolved matter, with the risk that there is insufficient time to properly design and consult upon alternative mechanisms if needed.

**Implications of the Commission Regulation of 12 February 2018**

Q.25. It is the Committee’s understanding that as a result of the Commission Regulation of 12 February 2018 in preparation for the UK’s potential departure from the EU ETS, UK-issued allowances (previously entirely fungible with other allowances across the scheme) are now geographically denominated. What assessment has the Scottish or UK Government made of the impact of this change on Scottish participants?

The UK Government has provided the following answer to this question:


As a result of agreed changes to Commission Regulation No 389/2013, it is possible that 2019 UK allowances will either be identified with a country code or suspended from being issued to UK operators/aircraft operators. This means that operators may not be able to surrender allowances issued in 2019 to cover 2018 emissions, and they have been warned by regulators to bear this in mind when planning how to meet their 2018 surrender obligation.”

Q.26. Are allowances held by UK participants already at risk of becoming devalued?

The UK Government has provided the following answer to this question:


The value or carbon price for any EU ETS allowances is for the market to decide.”
UK Government Technical Note relating to the EU ETS

Q.27. Is the Scottish Government in discussions with the UK Government regarding when this Technical Note will be published?

The UK Government Technical Notices on the implications of a 'no deal' scenario are a statement of UK Government policy and do not reflect the policy of the Scottish Government. The Scottish Government is not involved in the publication of the Technical Notice, however we have requested the that the UK Government publishes it as soon as possible. We have received, in confidence, provisional indications of when individual notices are to be published.

Q.28. Does the Scottish Government expect to have reviewed this Note and agreed its content before it is published?

The Technical Notices are a statement of UK Government policy not the Scottish Government's - which is that a 'no-deal' Brexit is extremely irresponsible and would have significant economic and social costs for the UK as a whole. The Scottish Government remains clear that the least damaging option for the UK would be to have continued membership of the European Single Market and Customs Union. Given that the notices reflect UK Government policy, where the Scottish Government has had sight of technical notices at the drafting stage our contribution has therefore been limited to ensuring that the notices are factually accurate with regards to Scottish circumstances. In general, we are not made aware of whether any such comments have been taken on board until the day before publication.

Q.29. When does the Scottish Government expect this to be published?

The Scottish Government has asked the UK Government to confirm this information to the Committee, and has received no confirmation from the UK Government on the expected date of publication.

The UK Government has provided the following answer to this question:

“the Technical Notice covering the EU ETS is due to be published shortly.”

Commitment to environmental standards

Q.30. Both the Scottish and UK Governments have committed to maintaining environmental standards after Brexit. Can this commitment be met if there is no replacement or equivalent mechanism in place (including an interim mechanism) by 29th March 2019?

The Scottish Government believes that remaining within the EU ETS is the most cost-effective route to decarbonisation of the energy intensive industrial and power generation sectors. Membership of the EU ETS allows participants access to the world’s largest carbon market, which increases market liquidity and lowers the cost of decarbonisation through price discovery of larger numbers of participants. Membership of the EU ETS also includes provisions to protect sectors at risk of carbon leakage, and ensures a
level playing field through collective effort between member states and across different sectors of the economy. We have repeatedly sought discussions with the UK Government to secure continued participation within the EU ETS, and to discuss the potential implications of leaving it, including replacement mechanisms, to ensure that they maintain environmental standards. The Climate Change (Scotland) Act 2009 will continue to provide the legal framework for domestic emissions reduction. There are also a range of other legal requirements in domestic legislation such as the UK Climate Change Levy (and Carbon Price Support), UK Climate Change Agreements, the Energy Savings Opportunities Scheme, and the Streamlined Energy & Carbon Reporting Requirements which are designed to ensure emissions reduction from sectors currently covered by the EU ETS.

Q.31. The notification states that “The EU ETS is predicated on the polluter pays principle by requiring the traded sector to account for their CO2 emissions. The approach in the UK SI ensures that the traded sector remains accountable in the event of no-deal, by continuing to monitor and report their emissions.” Given that the notification recognises that the key delivery mechanism of the EU ETS (i.e. the purchasing and surrendering of allowances) will cease as a result of the proposed changes, how will continued monitoring and reporting of emissions alone ensure that the traded sector remains accountable for their emissions as required by the polluter-pays principle?

The Scottish Government is deeply concerned that the UK SI does not contain any further information on potential alternative mechanisms to ensure emissions reduction within the UK in the event of a ‘no deal’ scenario. The Scottish Government has repeatedly sought Ministerial discussions with the UK Government and devolved administrations to consider the development of potential alternative mechanisms to incentivise and require emissions reduction, but these discussions have not been offered by the UK Government. The Scottish Government has also reiterated that any new arrangements must continue to ensure the accountability to the Scottish Parliament and respect the devolution settlement, and that they must not undermine the competitiveness of Scottish industry, or a level playing field for emissions reduction with the EU and the rest of the UK.

Assessment of options for an EU ETS replacement (including interim arrangements)

Q.32. What is the Scottish Government’s policy preference regarding the continuation of the emissions trading?

The Scottish Government believes that remaining within the EU ETS is the most cost-effective route to decarbonisation of the energy intensive industrial and power generation sectors. Membership of the EU ETS allows participants access to the world’s largest carbon market, which increases market liquidity and lowers the cost of decarbonisation through price discovery of larger numbers of participants. It also offers access to a potential €9bn\(^4\) worth of innovation funding to support industry in decarbonisation through

\(^4\) At October 2018 EU ETS prices of €20 per allowance and 450m allowances in the Fund
demonstration of technologies such as carbon capture and storage – funding which would be lost to Scottish industry were we to leave the EU ETS.

Membership of the EU ETS also includes provisions to protect sectors at risk of carbon leakage, and ensures a level playing field through collective effort between member states and across different sectors of the economy. In the longer term under the Paris Agreement, Article 6 provisions, we expect to see the emergence of a global carbon market through new mechanisms, with countries either considering or implementing an ETS including: New Zealand, South Korea, Mexico, China, and the US states of California, Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York State, Rhode Island, Vermont and Canadian provinces of Quebec and Ontario. The Scottish Government believes it would be a mistake for the UK to turn its back on the largest current carbon market in the world at precisely the moment when the Paris agreement is developing mechanisms for linking carbon markets more widely.

Q.33. Does the Scottish Government have a view, in the event of a no deal scenario, on whether the relevant Scottish and UK authorities have the capacity to mirror the workings of the EU ETS?

The Scottish Government has, since 2016, repeatedly sought Ministerial discussion between the UK Government and the other devolved administrations on the impact of the UK potentially leaving the EU ETS. To date, no such discussion has been offered by the UK Government. The Scottish Government is very disappointed that the UK Government has refused these discussions, given that regulation of emissions is a devolved matter, with the risk that there is insufficient time to properly design and consult upon alternative mechanisms if needed. The Scottish Government has already set out to the UK Government its clear view that the provisions of Part 3 of the Climate Change Act 2008, provide a legal basis for establishing emissions trading schemes within the UK, and that these provisions – which ensure accountability to the Scottish Parliament – should be the basis for any future development of alternative emissions trading arrangements within the UK in the event that participation in the EU ETS is no longer possible.

Q.34. If continued membership of the EU ETS is not a viable option following the UK’s exit from the EU, what options are available to replicate its functions?

As set out in the answer to question 33 Part 3 of the Climate Change Act 2008 provides a legal basis for establishing emissions trading schemes within the UK, and ensures that they are accountable to the devolved legislatures, and require their consent. A domestic ETS within the UK would not be able to replicate access to the wider EU carbon market without it being linked to the EU market (as is the case with the Swiss ETS). As also set out above, Article 25 of the EU ETS Directive makes provision for the linking of the EU ETS to other greenhouse gas emissions trading systems in third countries. International relations, including relations with territories outside the UK, the EU and their institutions and other international organisations are reserved matters.
Q.35. Can the Scottish Government provide more detail on why its policy preference is to continue with UK wide arrangements?

The Scottish Government has set out in its Climate Change Plan its commitment to working as part of collective efforts to reduce emissions from the industrial and power sectors. The Plan sets out the way in which EU and UK-wide arrangements address the risk of carbon leakage by ensuring a level playing field of regulation to ensure business competitiveness, and access to the greater liquidity of a larger carbon market. In its impact assessments accompanying the revised EU ETS Directive for Phase IV (2021-30), the EU itself conducted an assessment of those sectors that it deemed to be at risk of carbon leakage through their exposure to international trade and carbon intensity. The Commission concluded that if European companies move production to outside of the EU, this could lead to increased emissions globally (in particular if the installations outside of the EU are more carbon intensive, which is often the case). The European Commission drew up the carbon leakage list with the agreement of Member States and the European Parliament and following an impact assessment and extensive consultation with stakeholders across the EU. If the UK were to pursue unilateral measures for emissions reduction in these sectors, without adequate protections afforded by the EU ETS, there would be a risk both of carbon leakage and increased cost of decarbonisation within a smaller traded sector.

Q.36. What are the benefits and risks of developing a replacement scheme at a UK level rather than pursuing a domestic scheme?

We are unable to assess the benefits and risk of development any replacement scheme in the absence of informed discussions and UK wide stakeholder discussions by the UK Government. As set out above, despite repeated requests over the last two years for Ministerial discussions, the UK Government has not been willing to have these. We continue to urge the UK Government to have these discussions and regret that they have not taken place, meaning that there is a real risk of insufficient time to design and consult upon alternatives, and to assess their impacts for emissions reduction in Scotland.

Q.37. has the Scottish Government explored the possibility of Scottish participants seeking their own arrangements e.g. to continue membership of the EU ETS on their own and why has a domestic scheme been discounted?

Given that negotiations on future participation in the EU ETS are being led by the UK Government, and given that the Scottish Government has not been allowed to participate in these negotiations, the Scottish Government has not been able to explore the means by which (if even possible), Scottish participants could continue to participate in the EU ETS on their own. As set out above, despite repeated requests over the last two years for Ministerial discussions, the UK Government has not been willing to have these. We continue to urge the UK Government to have these discussions and regret that they have not taken place, meaning that there is a real risk of insufficient time to design and consult upon alternatives, and to assess their impacts for emissions reduction in Scotland.
Q.38. How does the Scottish Government plan to engage the Scottish Parliament, stakeholders and the general public in developing a replacement mechanism in the event of the UK leaving the EU ETS in March 2019?

This cannot take place until discussions with the UK Government and other devolved administrations have taken place – it is deeply regrettable that these have not. As set out above, the Scottish Government has already set out to the UK Government its belief that Part 3 of the Climate Change Act 2008 provides a legal basis for establishing emissions trading schemes within the UK, and ensures that they are accountable to the devolved legislatures, and require their consent.

Q.39. Have interim arrangements been explored with EU ETS participants which would maintain the carbon price even in the event of no deal?

The Scottish Government does not have power to set carbon price. The UK Government has provided the following answer to this question: “The forthcoming Technical Notice covering the EU ETS will set out plans for carbon pricing in a no deal scenario.”

Q.40. Does the Scottish Government have a view, assuming the UK leaves the EU ETS in March 2019 under a no deal scenario, on the likely timescales for introducing a new mechanism (or pilot mechanism) that will deliver the equivalent level of environmental protection?

Given that, as outlined above, regrettably, these discussions have not taken place with the UK Government, the Scottish Government cannot provide clarity at this stage. We continue to urge the UK Government to have these discussions and regret that they have not taken place. We remain deeply concerned that the cavalier approach taken by the UK Government to the negotiations, and its failure to host Ministerial discussions with all of the devolved administrations, means that there is a real risk of insufficient time to design and consult upon alternatives in the event of ‘no deal’.

Implications for GHG emissions targets and low carbon investment

Q.41. The notification states that The Climate Change Plan (Report on Policies and Proposals covering 2018-32) considers that participation in the EU ETS would contribute 17% towards our targets, and it is not clear what the approach set out in the UK SI would mean for the rate of decarbonisation from the traded sector. What assessment has the Scottish Government undertaken of the potential short, medium and long-term implications of a period of non-membership of the EU ETS for Scotland’s progress towards its statutory climate targets?

The Scottish Government has sought further information from the UK Government on what the approach would mean for decarbonisation rates from the traded sector, since no information has been provided to accompany the laying of this SI.
The EU ETS is the major policy lever in the Climate Change Plan for the energy intensive industrial and power generation sectors. Our view is that remaining within the EU ETS is the most cost-effective route to decarbonisation of these sectors.

The Scottish Government cannot make a full assessment of the impact on Scottish emissions of loss of access to the EU ETS until the UK Government sets out more detail on how alternative arrangements would work in practice. We have already committed to looking again at our current Climate Change Plan after the new Climate Change Bill is finalised.

Q.42. Has the Scottish or UK Government requested or received advice from the Committee on Climate Change, or other advisory bodies on the potential impacts of the UK leaving the EU ETS on national progress towards GHG emission reduction targets?

The Scottish Government has repeatedly written to the UK Government to express concerns about the impacts of leaving the EU ETS and to ask for Ministerial discussions. In particular the Cabinet Secretary wrote to the then UK Government Minister on 16 May 2017 asking that we jointly request advice from the Committee on Climate Change on the impacts of leaving the EU ETS. The UK Government did not reply and the Committee on Climate Change’s evidence to the Scottish Parliament in March 2018, confirmed that it’s advice on this matter had not been sought.

Nonetheless in 2016 the Committee on Climate Change stated that the UK 2030 target would need to increase from 57% to 61% if we left the EU ETS. The Committee on Climate Change’s most recent Scottish report, published 24 September 2018, states that “The industry sector is strongly dependent on UK-wide policies (e.g. on carbon capture and storage) and EU policies (e.g. the EU Emissions Trading System and F-Gas Regulation)”.

Q.43. The ETS Directive requires a proportion of revenues from auctions to be spent on a defined list of options. The Committee understands that under this requirement the UK Government has allocated funding to low carbon schemes such as the renewable heat incentive. Has the Scottish Government undertaken any assessment of the potential risks of loss of Government revenue from auctions of allowances on funding available for low carbon investment in Scotland?

The Scottish Government has sought further information from the UK Government on its intended approach to this matter in order to enable an assessment of any impacts for Scotland.

The UK Government has provided the following answer to this question:

“No such assessment has been made. The Government is party to the EU ETS directive which states that at least 50 % of auctioning revenues or the

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equivlent in financial value of these revenues should be used by Member
States for climate and energy related purposes. While HMG does not
hypothecate spend, this Government spends more on domestic and
international climate change related activity than it receives through the
EU ETS auctions. Revenue raised through the auctioning of carbon
emissions is remitted to the consolidated fund to support general
expenditure. The Budget and spending review process ensures that these
resources are allocated most efficiently to deliver government objectives.”

Q.44. Given the notification states that the proposed SI will reduce costs for
Scottish participants given they no longer require EU ETS emissions
allowances, has the Scottish Government considered whether this will
create a competitive advantage for carbon-intensive industries, and
whether this may result in knock on environmental or economic impacts
(including on non-participants)?

The Scottish Government has set out in its Climate Change Plan its
commitment to working as part of collective efforts to reduce emissions from
the industrial and power sectors. The Plan sets out the way in which EU and
UK-wide arrangements address the risk of carbon leakage by ensuring a level
playing field of regulation to ensure business competitiveness.

Q.45. How does the SI relate to the provisions in the Climate Change
(Emissions Reduction Targets) (Scotland) Bill on the emissions accounting
(Part 2)? As there will be no carbon credits, is the effect of this that there
is nothing to account for the purposes of assessing progress to targets?

The SI is not directly related to the provisions in the Scottish Climate Change
Bill. The SI relates to the on the ground operation of the EU ETS, which is
implemented through UK legislation (as discussed above). The provisions in
Part 2 of the Bill amend the Climate Change (Scotland) Act 2009 to change
the way that emissions are accounted for when assessing progress to the
targets set by the Act. This emissions accounting framework does not, in any
way, affect the on the ground operation of the ETS.

The Bill makes two main changes to the 2009 Act emissions accounting
framework;

- removes the accounting adjustment that reflects the operation of the
  EU ETS. As set out in the Bill consultation paper, this change is being
  made to increase transparency and accountability and is not related to
  EU Exit. The change is in line with the advice of the CCC.
- establishes a new default limit of zero on the extent to which domestic
  emissions can be offset using international credits purchased by
  Scottish Ministers. The purchase and use of such credits, were
  Parliament to decide to temporarily relax the zero limit in the future,
  could occur under UN (not EU ETS) mechanisms.

Taken collectively, the two changes in the Bill will mean that progress to
targets is assessed on the basis of actual Scottish emissions.

Q.46. What are the implications for delivery of the Climate Change Plan
2018-2032?
The EU ETS is the major policy lever in the Climate Change Plan for the energy intensive industrial and power generation sectors. Our view is that remaining within the EU ETS is the most cost-effective route to decarbonisation of these sectors.

The Scottish Government cannot make a full assessment of the impact on Scottish emissions of loss of access to the EU ETS until the UK Government sets out more detail on how alternative arrangements would work in practice. We have already committed to looking again at our current Climate Change Plan after the new Climate Change Bill is finalised.

Q.47. What are stakeholders views on this? What is the effect for companies which are incorporated elsewhere in the EU but which emit greenhouse gases in Scotland?

Given that there have been no Ministerial discussions on future participation in the EU ETS, nor any consultation led by the UK Government, or involving the devolved administrations, on the range of potential scenarios for remaining in the EU ETS, or developing alternative mechanisms, there has been no formal mechanism to gather stakeholder views on this issue. The Scottish Government, however, clearly set out a continued role for the EU ETS in its 2016 draft Climate Change Plan.