

# PARLIAMENTARY DEBATES

HOUSE OF COMMONS  
OFFICIAL REPORT

Fifth Delegated Legislation Committee

## DRAFT GREENHOUSE GAS EMISSIONS TRADING SCHEME (AMENDMENT) (NO. 2) ORDER 2023

*Tuesday 21 November 2023*

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**Saturday 25 November 2023**

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**The Committee consisted of the following Members:**

*Chair:* SIR GARY STREETER

- |  |   |
|--|---|
| † Bailey, Shaun ( <i>West Bromwich West</i> ) (Con)        | Osamor, Kate ( <i>Edmonton</i> ) (Lab/Co-op)                          |
| † Byrne, Liam ( <i>Birmingham, Hodge Hill</i> ) (Lab)      | † Stuart, Graham ( <i>Minister for Energy Security and Net Zero</i> ) |
| † Creasy, Stella ( <i>Walthamstow</i> ) (Lab/Co-op)        | Twist, Liz ( <i>Blaydon</i> ) (Lab)                                   |
| † Doyle-Price, Jackie ( <i>Thurrock</i> ) (Con)            | † Vara, Shailesh ( <i>North West Cambridgeshire</i> ) (Con)           |
| † Evans, Dr Luke ( <i>Bosworth</i> ) (Con)                 | † Wakeford, Christian ( <i>Bury South</i> ) (Lab)                     |
| † Fletcher, Mark ( <i>Bolsover</i> ) (Con)                 | † Whitehead, Dr Alan ( <i>Southampton, Test</i> ) (Lab)               |
| † Fuller, Richard ( <i>North East Bedfordshire</i> ) (Con) | Dominic Stockbridge, <i>Committee Clerk</i>                           |
| † Green, Chris ( <i>Bolton West</i> ) (Con)                | † <b>attended the Committee</b>                                       |
| † Harrison, Trudy ( <i>Copeland</i> ) (Con)                |   |
| † Henry, Darren ( <i>Broxtowe</i> ) (Con)                  |   |
| † Maskell, Rachael ( <i>York Central</i> ) (Lab/Co-op)     |   |

# Fifth Delegated Legislation Committee

Tuesday 21 November 2023

[SIR GARY STREETER *in the Chair*]

## Draft Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023

2.30 pm

**The Minister for Energy Security and Net Zero (Graham Stuart):** I beg to move,

That the Committee has considered the draft Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023.

It is a great pleasure to serve under your chairmanship, Sir Gary, and to be with colleagues from across the House on this clearly brilliantly whipped Committee.

The UK emissions trading scheme—the UK ETS—was established under the Climate Change Act 2008 by the Greenhouse Gas Emissions Trading Scheme Order 2020 as a UK-wide greenhouse gas emissions trading scheme to encourage cost-effective emissions reductions, contributing to the UK’s emissions reduction targets and net zero goal. The scheme is run by the UK ETS Authority, a joint body comprising the UK Government and the devolved Governments—we are all in this together. Our aim is to be predictable and responsible guardians of the scheme and its markets. In so doing, we will ensure that the scheme remains a cornerstone of our ambitious climate policy.

**Shailesh Vara** (North West Cambridgeshire) (Con): My right hon. Friend mentions that the UK Government are working with the devolved assemblies. Given that the Northern Ireland Assembly is not working at the moment—or not sitting, anyway—are there other mechanisms in place to ensure that the civil servants in Northern Ireland are dealing with this matter and co-operating so that we can move forward as four nations?

**Graham Stuart:** My right hon. Friend, with his customary acuity, will have noticed that the draft order does not apply to Northern Ireland. As it happens, there are not counterparties in Northern Ireland to which these particular provisions apply, but energy in general is devolved to Northern Ireland, and it is up to Northern Ireland to take care of it.

The statutory instrument will implement a number of necessary changes and improvements to the UK ETS. The changes relating to aviation free allocation rules and to the treatment of electricity generators follow the announcements made by the UK ETS Authority in July, in our response to last year’s consultation on developing the UK ETS. The final change remedies an inconsistency with free allocation and carbon capture at UK ETS installations.

On aviation, the SI will cap the total amount of aviation free allocation that operators are eligible to receive at 100% of their verified emissions.

The SI makes technical changes to free allocation rules regarding the electricity generator classification for industrial installations—a minority sport, if ever there were one. It will amend the electricity generator classification to consider only electricity exports in the baseline period, instead of all electricity exports since 2005, allowing operators to change their installation’s electricity generator classification if they have put a stop to the export of electricity. Electricity exports representing no more than 5% of the total produced will also be excluded from consideration in this classification.

The SI will amend the electricity generator definition to exclude installations that have produced electricity for sale if that electricity was produced by means of a high-quality combined heat and power plant operating as part of an operator’s industrial activity. That will limit reductions in free allocation entitlements and provide further encouragement for industrial operators to achieve improved efficiency for their combined heat and power plants.

The SI makes an operational amendment to the electricity generator classification to allow electricity generators to be eligible for free allowances after the application date if they can demonstrate that they produced measurable heat by means of high-efficiency co-generation during the allocation period.

The SI remedies an inconsistency in legislation to make it clear that carbon capture and other types of regulated activity may be carried out on the site of the same installation. It will allow provision of free allowances to industrial installations at the same site as a carbon capture plant.

As the Northern Ireland Assembly is not sitting and cannot consider affirmative legislation, the SI covers only Great Britain. Officials in Northern Ireland have agreed that none of the provisions currently affects operators in Northern Ireland.

These changes will deliver on commitments made by the UK ETS Authority and improve the operation of the scheme. For aviation, the SI will ensure that free allocation is distributed appropriately until full auctioning for the aviation sector begins in 2026. That follows the decision announced in July that aviation free allocation will be phased out by 2026.

On free allocation technical changes, the SI will ensure that installations classed as electricity generators, whose eligibility for free allocation is limited, are able to change their classification if they are no longer exporting electricity. The SI will also ensure that industrial installations with high-quality combined heat and power plants that export excess electricity to the grid are not classified as electricity generators, in order not to limit their eligibility for free allowances.

On the electricity generator operational amendment, the SI will ensure that electricity generators can become eligible for free allowances during an allocation period if they meet the eligibility criteria.

On free allocation rules for carbon capture, the SI will prevent industrial installations from being disqualified from receiving free allowances because they are on the same site as a carbon capture plant—a situation that would pose a risk of disincentivising the uptake of crucial carbon capture technology.

These changes either follow appropriate and comprehensive consultation with stakeholders or did not require consultation. In the “Developing the UK ETS” consultation in 2022, the UK ETS Authority considered what technical improvements could be made to the current aviation free allocation methodology until aviation free allocation is phased out. The responses to the consultation called for an end to over-allocation. The policy intent of aviation free allocation is to mitigate the risk of carbon leakage, and the policy did not intend for aircraft operators to receive more allowances than their verified emissions. To that end, in July the UK ETS Authority announced the decision to cap aviation free allocation at 100% of verified emissions.

In the “Developing the UK ETS” consultation, we considered technical changes to free allocation rules regarding the electricity generator classification. The majority of respondents agreed with our suggested amendments, and the UK ETS Authority announced that it would proceed with changes to the electricity generator classification.

A consultation was not carried out for the CCS free allocation amendment as that is a clarification of existing policy intention and not a change to the policy.

**Richard Fuller** (North East Bedfordshire) (Con): Would the Minister, either now or in summing up the debate, explain a bit about the phrase “free allocation”? On the face of it, if free allocation is to be set at 100% of the sector’s verified emissions, it does not sound like there is a lot of free space. He mentioned that free allocation was originally set at 127% because of concerns about carbon leakage. What has changed so that the Government are now satisfied that cutting it to 100% will not result in carbon leakage?

**Graham Stuart:** Fundamentally, due to the way the scheme was brought in, the airlines have had more free allocations than their actual emissions. The scheme was designed to cover their emissions until we phased out those allocations, as we are now doing, but they were being over-compensated, based on historical figures that no longer apply. These provisions will ensure that the airlines are not being given free allocations with a commercial value on the market over and above that which they need in order to operate. I hope that answers my hon. Friend’s question.

These alterations to the UK emissions trading scheme will support its role as a key pillar of the UK’s climate policy. They show that we will take action to improve the scheme where necessary, and they continue our record of delivering on our commitments. I commend the draft order to the Committee.

2.38 pm

**Dr Alan Whitehead** (Southampton, Test) (Lab): It is a pleasure to serve under your chairmanship, Sir Gary. Like the Minister, I commend the Committee for the huge turnout this afternoon to consider the SI. I am sure that is because everyone wants to hear at some length the Minister’s comments and, indeed, some of mine, but in case anyone is here because they think there might be a Division, I can assure them—I hope they do not leave now—that there will be no Division. Broadly speaking, we very much agree with these changes to the operation of the ETS. However, I have a number of

questions about the detail of those changes, and I would like to put the SI in a bit of context. I am disappointed that that context is not better represented in the SI.

The context is not just that the UK ETS is up and running and requires minor amendments, but that it is rapidly diverging from the EU ETS. The divergence is such that, in October prices, the permit cost per tonne is £87 in the EU ETS, but £40 in the UK ETS. The EU-UK trade and co-operation agreement, which the UK freely signed, states:

“The Parties shall cooperate on carbon pricing. They shall give serious consideration to linking their respective carbon pricing systems in a way that preserves the integrity of these systems and provides for the possibility to increase their effectiveness.”

No action has been taken so far—[*Interruption.*]

**Shailesh Vara:** Apologies, Sir Gary.

**Dr Whitehead:** That was a particularly stirring ringtone.

**Graham Stuart:** Bringing uniquely to a conclusion the hon. Gentleman’s words.

**Dr Whitehead:** I am afraid not. I distinctly detect that that was part of an overture, not a final movement.

As I said, the agreement states that “the Parties shall cooperate on carbon pricing”, but there is no evidence of such co-operation. Not only that, but the two systems are diverging significantly. Hon. Members may ask whether that matters. It matters a lot in view of what is happening in the EU on the development of carbon border adjustment mechanisms.

**Graham Stuart:** None of which is covered by the order.

**The Chair:** Order. Minister, sedentary interventions are never helpful. May I just ensure that we are talking about the order that the Committee is considering and not the issue generally?

**Dr Whitehead:** Yes indeed, Sir Gary.

**The Chair:** I am reassured. Thank you.

**Dr Whitehead:** The carbon border adjustment mechanism, which is in its first month of operation in the EU, is in danger of pricing our materials—iron, steel, aluminium, fertiliser, electricity, hydrogen and so on—as if they were outside it and should therefore be penalised, unless there is some convergence between the EU ETS and the UK ETS in future. That is a real issue. What plans has the Minister to seek greater convergence between the UK and EU schemes? That is important in the context of the SI.

**The Chair:** Are you making the point that those changes should be in the SI, but are not?

**Dr Whitehead:** I am making the point that there should be some mention of those particular circumstances in the order. For example, the substantial divergence between UK prices and EU prices will potentially have a real effect over time on aviation in Europe and the UK. The order ought therefore to be looked at in that light.

[Dr Whitehead]

As the Minister has said and paragraph 7.4 of the explanatory memorandum explains, at 2021 prices, the free allowances set out for aviation represented 127% of the allowances that ought to have been made. In those circumstances, aviation has had something of a windfall. It has been able to take those free allowances, sell off the difference between 100% and 127% and make the actors in the industry between £50 million and £100 million. I welcome the fact that the allowances are to be capped at 100%, but I worry a little about whether the divergence between UK and EU ETS prices might lead the aviation industry to come back to us in the not too distant future and ask for some of those over-allowances back. We have to work together on the arrangements between boundaries for the UK ETS and EU ETS.

Was the over-allocation by accident or design? If it was by accident, are there any measures under way to try to restore some of the profits that have been made by aviation as it has put those substantial over-allowances into its pockets through trading, or is the Minister content to say that because it is now 100%, it is okay for the future and we will write off the past?

There is a similar issue of potential misallocation in the reclassification of companies that have not exported electricity for quite a while. As the Minister said, they continue to be classified as exporters even if they might not have exported electricity for quite a long time. Clearly, some long-term issues related to that misallocation will effectively be brushed over by the order, but I would like to know whether that has also resulted in free allocations being misapplied to the industry and whether the companies that have halted electricity exports but have been classified as exporters for quite a long time have benefited in an inappropriate way from that misclassification. If so, to what degree?

Although Labour supports getting the classifications right in the order, questions remain about why and how the misclassifications occurred and what action, retrospective or otherwise, the Government will take to ensure that the harm or benefit of them is as small as possible.

Having posed those three questions for the Minister, I confirm that we will not oppose the SI. Indeed, we welcome its clarification of how the UK ETS will move forward.

2.50 pm

**Stella Creasy** (Walthamstow) (Lab/Co-op): It is a pleasure to serve under your chairmanship, Sir Gary. I rise only to ask a few questions, simply because the Minister was so sterling in directing what he was running through that he did not allow me to catch his eye to intervene at the point that his colleagues did. I am sure that was an oversight on my part and that I did not signal strongly enough.

Emissions do not stop at borders, so it is of concern to many of us that the Minister has set out what the SI might do but not clarified how it might interact with other emissions trading schemes, and in particular what the European Union is doing. My hon. Friend the Member for Southampton, Test, was much more eloquent and patient than I will be about the fact that the EU has its own system of trading and that, clearly, whatever we do will interact with that. Could the Minister set out

how those two systems, in particular, will interact? What progress has been made on the commitment in the 2019 TCA that “serious consideration” would be given to linking them? Has he been serious? Has he considered it? The SI does not suggest that, but that does not mean he is not having conversations. Surely he could set that out.

More fundamentally, I wish to speak up for British steel, which will be directly impacted by this legislation; indeed, it has called for the Government to answer questions arising from the SI. I hope that I speak for all of us in the room in saying that we recognise the value to our national security and our climate change objectives of having a national steel industry. I understand the industry’s concerns about this legislation and the fact that, without support, the free allowances will not lead to the sustainability of the British steel industry. I hoped that we might hear some answers today, but the Minister did not mention the word “steel”. I am sure he will wish to correct that in responding to the debate. The industry thinks it will take nine years to decarbonise British steel at this rate; without support, the 2026 deadline could lead to the end of British steel and all the concerns that might arise from that.

In particular, the industry perceives a lack of leadership on the European carbon border adjustment mechanism and how it interacts with the ETS. The Minister did not mention Europe at all. I am sure that was an oversight rather than a deliberate omission. As I said, he did not mention steel either. Again, I am sure that was an oversight rather than a deliberate omission. Will he address both those issues and reassure us that he stands proudly with British steel, just as he recognises that emissions do not stop at borders?

2.52 pm

**Graham Stuart:** I thank hon. Members for their contributions to this debate on pretty technical adjustments to the ETS.

By capping aviation free allocation, we are ensuring that it is distributed appropriately until full auctioning in 2026. The current situation is not deliberate; the policy did not intend for aircraft operators to receive more allowances than their verified emissions. It is noteworthy, though, that those allowances meant that operators were doubly encouraged to invest in cleaner operations, since they were incentivised not only by any savings from investment in more fuel-efficient aircraft, for instance, but by the credits that they received within the ETS. The Government have no plans to claw any of that back.

On the overall position of the UK carbon market, the UK ETS is of course a market mechanism. The price of carbon allowances in the UK ETS is set by the market. In line with the net zero cap we announced in July, the supply of emissions allowances entering the market will fall significantly every year from 2024. We are committed to continuing to deliver on these changes, as we have shown, by legislating to amend the supply of allowances over the coming years and publishing an auction calendar.

The hon. Member for Walthamstow mentioned the CBAM. We are closely following developments on the EU CBAM and engaging with the Commission on technical considerations that are relevant to UK manufacturers. As the hon. Lady will know, EU CBAM charging does not start until 2026.



I am nervous of opening up wider matters, although you have been generous, Sir Gary, in allowing discussion of issues that are broader than the technical amendments that the SI makes. If Members want a broad debate on the ETS and its interaction with Europe, there are many opportunities in the parliamentary calendar to do exactly that.

**Dr Whitehead:** Given that the Minister has mentioned the CBAM in response to the inquiry of my hon. Friend the Member for Walthamstow, I want briefly to record that iron and steel are in the first phase of the EU CBAM, and that that may affect UK iron and steel negatively. They could be treated as if they were imports to the EU, similar to iron and steel from India or other parts of the world. That should give substantial pause for thought about how we proceed with the UK ETS.

**Graham Stuart:** The hon. Gentleman is right about that being a substantial prompt for thought, but not on the particular order that the Committee is considering. As hon. Members will know, we ran a consultation earlier this year on domestic measures to mitigate carbon leakage, including consulting on a potential UK CBAM and mandatory product standards.

In answer to the point that the hon. Member for Walthamstow made, our commitment to the UK steel sector is clear. We continue to work closely with industry, including British Steel, to secure a sustainable and competitive future for the sector and its workers. We will continue to fulfil that commitment.

As I said, the UK ETS is a market mechanism, and the price of carbon allowances is set by the market. That continues to be our position.

The UK ETS is a cornerstone of UK climate policy. It is worth noting, to look momentarily at the bigger picture, that since 1990, the UK has cut its emissions by more than any other major economy on the planet. The Government put net zero into law for the first time, and the former Conservative leader, now the Foreign Secretary, was the first leader of a major party to call for a climate Act, which was introduced in 2008. I was proud to serve on the Joint Committee on the Draft Climate Change Bill under the excellent chairmanship of Lord Puttnam.

**Dr Whitehead:** We were both members of that Committee.

**Graham Stuart:** Indeed.

**The Chair:** Shall we return to the SI?

**Graham Stuart:** Yes. The SI sets a cap on emissions in the sectors covered—currently a quarter of the UK's emissions. In doing that, it guarantees that those sectors will reduce their emissions in line with our world-leading net zero target,

Only yesterday, I was in The Hague, not, as some members of the Committee might have thought or hoped, answering for my crimes, but meeting Energy Ministers from the North Seas Energy Cooperation and Kadri Simson, the European Commissioner for Energy. I called for the full implementation of the energy chapter of the TCA and urged the EU to put the same energy into it as we are determined to show. We want the chapter to be fully implemented because, as the hon. Member for Southampton, Test said, we signed up to it in all solemnity.

In July, the UK Government and the devolved Governments, as the joint UK ETS Authority, set out a comprehensive package of reforms to the scheme. It increased the ambition of the UK ETS and set it on a path to net zero. As that package set out, a wide range of changes is required to ensure that the UK ETS remains a key part of the UK's approach to achieving net zero.

We can be proud of our record to date: cutting more emissions than any other major economy on Earth and having the most ambitious nationally determined contribution up to 2030—a 68% reduction on 1990 levels—of any major economy on the planet, far ahead of the EU at 55%, as you will have noted, Sir Gary.

With that, I have probably said enough. I commend the order to the Committee.

**The Chair:** I can confirm that you have said enough.

*Question put and agreed to.*

*Resolved,*

That the Committee has considered the draft Greenhouse Gas Emissions Trading Scheme (Amendment) (No. 2) Order 2023.

3 pm

*Committee rose.*

