Thank you for your letter dated 16 October 2019 regarding post-Brexit carbon pricing.

Please accept my apologies again for the delayed replies to your previous letters. I regret that the Committee was dissatisfied with the comprehensiveness of our response. I can assure you that the department and I do not view parliamentary scrutiny as an optional extra.

However, I hope you will appreciate that this dossier falls within the Ministerial portfolios of both HM Treasury and BEIS, with an intersect with DExEU; there is a high degree of political sensitivity surrounding both the A50 and Future Economic Partnership (FEP) negotiations; and, that discussions with the European Commission on the implications of A50 extension for the UK's participation in the EU ETS, and the implementation of an interim Carbon Emissions Tax, has very much been an evolving picture.

As a consequence of all of the above, compounded by a change of ministers in May and July, the Exchequer Secretary to the Treasury and I have subsequently done our best to ensure that our responses to your pertinent questions have the fullest responses. As I have said before, the Government is committed to a close role for parliamentary scrutiny as negotiations positions develop and I look forward to working further with the Committee as this process continues.

Energy security in Northern Ireland

The Single Electricity Market (SEM) is an example of North-South cooperation that has benefited consumers and the economies of Northern Ireland and Ireland. The Government is committed to seeking to maintain the SEM in any scenario and will therefore take all possible measures to do so, including in 'no deal'. The UK will continue to work with the Government of Ireland to this end.

I have provided responses to your specific questions below:

- 'Whether there is potential for disruption to electricity supply in Northern Ireland at some point after Day 1 as a result of a 'no deal' Brexit?'

The Department for the Economy (NI), Northern Ireland Utility Regulator and SONI, the Northern Ireland Transmission System Operator, meet regularly to review security of supply and will take action in response to any risks to security of supply if necessary. We do not
foresee a shortfall or disruption to generation capacity in the next few years. Capacity needs in the SEM are managed through the series of one-year head and four-year ahead capacity auctions. This will continue to be the case post exit.

The SEM one-year ahead auction in December 2018 secured just under 2GW of capacity, which ensures that there will be sufficient capacity to meet demand in NI during winter 2019/20.

The four-year ahead capacity auction on 28 March secured 1.9GW of capacity for Northern Ireland, which ensures sufficient capacity to meet expected demand for the year 2022-2023. There are also further capacity auctions planned in late 2019 to secure capacity for future years.

- ‘If so, at what point that disruption might arise, and what steps you are taking to mitigate that risk?’

In the event of a ‘no deal’, EU rules will cease to apply in Northern Ireland, leaving key elements of the SEM outside of the EU legal framework for the Internal Energy Market. We expect the SEM to continue immediately after a ‘no deal’ Brexit. The SEM Committee (SEM-C) and Northern Ireland and Irish regulators released statements in March 2019, setting out “Day 1” arrangements for electricity trading between the SEM and Great Britain and the continued operation of the SEM in a ‘no deal’ scenario.

However, a risk remains that in the longer-term the SEM will be unable to continue and the Northern Ireland market would become separated from that of Ireland. Whether and at what point this may occur is uncertain, however it is deemed very unlikely in the short-medium term.

Government, the Northern Ireland Utility Regulator and SONI are working closely to mitigate risks in Northern Ireland, this includes contingency planning work considering how best to transition to new arrangements if the SEM cannot be maintained.

Ahead of Brexit the Government has taken a number of steps to help facilitate the continuation of the SEM in ‘no deal’ and mitigate risks to the market. These include:

- Developing and announcing fall-back trading arrangements between GB and the SEM to ensure cross border trading can continue on Day 1 when the UK loses access to the existing pan-European market coupling processes, and agreed these arrangements with Ireland;
- Publishing a Technical Notice which provides and collates clear messaging on these and other necessary practical arrangements connected to ‘no deal’, such as the need for market participants to register under the Regulation on Energy Market Integrity and Transparency to avoid disruption to cross-border trade. This forms part of a wider stakeholder engagement effort to support Brexit preparedness, including regular meetings and newsletters to brief market participants;
- Developing and implementing a range of ‘no deal’ statutory instruments to ensure the UK’s energy laws continue to be operable and function effectively after EU exit including enabling the continuation of the SEM and minimising impact on market participants; and
- Announcing our intention to legislate in the event of a ‘no deal’ scenario to enable modification of electricity codes and licences to maintain or restore the SEM if there is a substantial risk that the SEM would cease to operate effectively or if the SEM has ceased to operate effectively. This would allow modifications to be
made in a more streamlined and timely way than under current procedures; a similar provision is in place in Ireland through the Irish "Brexit Omnibus Act".

- **'What measures you intend to put in place to support consumers in Northern Ireland affected by electricity price rises?'**

Fluctuations in wholesale prices are routine, especially when there are changes to market arrangements. However, these fluctuations do not always lead to price rises for NI consumers. Government and the regulators have been working closely with participants to ensure they are prepared for a 'no deal scenario', to limit price rises.

The Operation Yellowhammer assumptions consider the reasonable worst case scenario, and in the unlikely event that this worst case scenario arises and the SEM is unable to continue, we would expect higher and more volatile electricity prices in Northern Ireland as a result of losing the benefits of a more efficient shared market.

The best way of limiting negative impacts on Northern Ireland consumers is to maintain the SEM, and the Government is working to facilitate this in all Brexit scenarios. However, as discussed above, our contingency planning work for the event the SEM cannot continue aims to mitigate any impact on prices as far as possible.

- **'What measures you intend to put in place to support electricity suppliers in Northern Ireland, to prevent them reducing spend on system resilience while under economic pressure, or indeed exiting the market as foreseen in the Operation Yellowhammer document?'**

The Government and the Northern Ireland Department for the Economy are actively engaging with a range of market participants, including suppliers, to understand what issues they may face in a 'no deal' scenario and supporting them to take the necessary steps to prepare.

We will to continue this engagement, alongside the Northern Ireland Utility Regulator and SONI to understand any emerging risks and act quickly to mitigate them.

**EU ETS Compliance**

You asked for an explanation of the grounds on which the European Commission decided that the UK will not participate in the EU ETS for 2019 in a 'no deal' scenario. I am unable to speak on behalf of the Commission; however, I can provide my understanding of the Commission’s rationale based on the Government’s engagement. EU Exit date (31 October 2019) is six months before the EU ETS 2019 compliance deadline (30 April 2020). Should the UK leave the EU ETS at the end of October without a deal, then there will be no legal requirement for UK participants to meet their 2019 EU ETS obligations, and no ability for EU to enforce these obligations. There is a concern this poses a risk to the environmental integrity of the system. The EU have pointed to agreement of the Withdrawal Agreement as the best way to provide for an orderly transition for the UK’s participation in the EU ETS. Whilst I regret that it has not been possible to agree a solution to enable continued UK participation in the EU ETS for 2019 in a 'no deal' scenario, I respect the Commission’s decision on this matter.

As you say, a key element of the UK’s carbon price will not have applied to much of 2019 in a ‘no deal’ scenario. However, given that operators are preparing for all scenarios, including potentially meeting 2019 and 2020 ETS compliance obligations in an implementation
period, we would not expect any increase in emissions relative to the counterfactual. We are not aware of evidence that businesses have increased emissions in 2019 in anticipation of a 'no deal' scenario.

You raise the movement of allowances by individual operators from the UK registry to an account they hold in another member state’s registry. Many operators will see this as a sensible precaution against a loss of registry access. This movement of allowances should not, of itself, affect the EU ETS price, and it is important to note that no 2019 allowances have been auctioned by the UK or allocated for free, so these allowances cannot be transferred. It is also worth noting that the ETS price has actually increased from ~€18 to ~€25 in the last year.

**Carbon Emissions Tax**

The Carbon Emissions Tax was designed as a contingency policy for carbon pricing for implementation in the event that the UK would leave the EU without a deal. There is no explicit obligation within the powers taken in Finance Act 2019/20 to consult the Climate Change Committee (CCC) on the Carbon Emissions Tax rate. However, the Government is under a broader legal obligation to consider the CCC’s advice on the progress it is making towards meeting its legally binding carbon reduction commitments. In making their assessment of the extent to which the Government is on track to meet their carbon budget for the relevant period, it is within the gift of the CCC to consider the contributions made by all Government policies that aim to reduce carbon emissions, including the Carbon Emissions Tax. Any recommendations made to the Government about those policies would be given due consideration. HM Treasury keeps all taxes under review.

Budget 2018 confirmed the 2019 Carbon Emissions Rate would be £16/tCO2 and this was subsequently legislated for in Finance Act 2019. We agree, as you set out in your letter, that at this late stage, a review of the 2019 rate would likely give rise to complications for affected businesses. If the UK leaves the EU without a deal on 31 October, Budget 2019 would confirm the 2020 rate, which would apply from 1 January 2020, and the Government would publish a consultation on the Carbon Emissions Tax by the end of the year. This would inform secondary legislation to be laid in 2020.

**Clarification about the International Energy Market**

In relation to your reference to the Internal Energy Market, I would also like to be clear on where we expect the focus to be in relation to the negotiations in energy. The arrangements commonly referred to as the “Internal Energy Market” provide a framework for, amongst other things, the efficient and barrier free trade of energy across borders. In the political declaration, the Government and the EU have set out that we intend to agree a framework for technical cooperation that supports efficient cross border trade of energy and security of supply as far as possible. As a result, we expect this to be the focus of the negotiations.

**Attendance at Energy Council Meetings**

As you are aware, the Government’s policy from 1 September until exit day is for the UK to only attend EU meetings in our interests, particularly relating to UK exit, sovereignty, international relations, security, or finance. DExEU has established a process to carefully consider attendance at all EU meetings within this framework, and I ultimately did not attend the Energy Council because the agenda items did not relate to these areas. However, let me reassure you that maintaining strong relationships with European colleagues in this space is particularly important to me and I will continue to work with our European partners to deliver our shared energy and climate objectives.
Conclusion

I hope the reply above addressed your questions regarding both the EU ETS and an interim Carbon Emissions Tax in a ‘no deal’ scenario.

I am pleased to say that we now have a new agreement with the EU so we can get Brexit done. Subject to Parliamentary approval, the UK will remain in the EU ETS until at least the end of Phase III in line with the Withdrawal Agreement and we stand ready for the commencement of formal linking negotiations.

My counterparts in the devolved administrations and I are busy considering responses to the consultation on the Future of UK Carbon Pricing, and the advice from the Committee on Climate Change (CCC) and discussing final policy decisions ahead of publishing the Government Response later this year. Following an Invitation to Tender (ITT) earlier this year, a contract has been awarded to Trasys International and Athens-based UniSystems Information Technology Systems to build and maintain a UK emissions trading registry and to link to the EU ETS.

Whilst linking will be a matter for the next phase of the negotiations, we remain confident that we are able to deliver a linked ETS for 1 January 2021.

Finally, please accept my apologies again and I would be happy to meet with the Committee with officials for a briefing on these issues.

Yours ever,

[Signature]

RT HON KWASI KWARTENG MP
Minister of State for Business, Energy and Clean Growth

Cc Simon Clarke MP, Exchequer Secretary to the Treasury