INSIDE ACCESS

CONVERSATIONS WITH GLOBAL LEADERS IN ENERGY & INFRASTRUCTURE

ISSUE 1: DIRK FORRISTER, CEO OF IETA

orrick

INSIDE ACCESS ISSUE 1

THE PROPOSED UK EMISSIONS TRADING SCHEME (UK ETS): DIRK FORRISTER, CEO OF IETA

On 1 June 2020, the Department for Business, Energy & Industrial Strategy (BEIS) and the devolved administrations published a response to their May 2019 consultation on options for carbon pricing in the UK post-Brexit:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/889037/Government_Response_to_Consultation_on_Future_of_UK_Carbon_Pricing.pdf.

The response outlined the following intentions:

- To establish a new UK Emissions Trading Scheme (**UK ETS**), the first phase of which would run from 2021 to 2030. As with the EU Emissions Trading Scheme (**EU ETS**) (which the UK has been a member of since 2005), the proposed UK ETS will be a cap-and-trade system which aims to achieve cost-effective reductions of greenhouse gas emissions.
- To publish a consultation, later in 2020, on the design of a carbon emission tax regime as an alternative to a UK ETS.

In the first of a series of conversations with global industry leaders on key topics, **Orrick partner Edward Humphries** talks with **Dirk Forrister**, **CEO of the International Emissions Trading Association** (**IETA**), about this response and the future of the UK carbon market.

IETA is the voice of business on carbon markets around the world. Established in 1999, IETA's members include global leaders in the electricity, oil/gas, cement, aluminium, chemical, mining, technology, standards, verification, broking, trading, legal, finance, accounting and consulting industries. Its CEO **Dirk Forrister** was previously Managing Director of Natsource, a carbon asset management firm and Chair of the White House Climate Change Taskforce in the Clinton Administration.

Dirk Forrister
CEO of the International Emissions Trading Association (IETA)

Edward Humphries
Partner at Orrick, Herrington & Sutcliffe

For those who are short on time, please refer to the last page for a list of key takeaways from the conversation.

LESSONS LEARNED FROM THE EU ETS

EDWARD HUMPHRIES

Thanks for joining me today, Dirk. I wanted to kick this off with quite an open question – what do you think are some of the key lessons learned from the EU ETS that should be considered when establishing a new UK ETS?

DIRK FORRISTER

Thanks for having me! Generally speaking, it feels like each emissions trading scheme learns from the prior one so that over time, they get better and better.

One of the most important lessons for the EU has been to ensure a level of stringency across the system that can handle economic cycles and continue to supply pricing signals in the marketplace. The initial designs of the EU ETS were fairly laissez-faire and resulted in an oversupply of allowances in the market which led to excess allowances circulating in the market at a very low price. This was not achieving the aims of the EU ETS and it became clear that a sort of syndicated pricing signal linked to the supply of allowances was necessary. This is the role of the Market Stability Reserve – it modulates the full flow of allowances that can be auctioned.

Another lesson learned is that registry security is of paramount importance—especially in a system that links together a bunch of disparate systems. Originally, the EU had each member state running its own registry that were all linked together so you could move allowances around within the system; but hackers breached one of them in Eastern Europe and that infected the whole system. This showed that you are only as good as the weakest link in a registry system that has many registries! So they consolidated them into a single EU-wide registry that has been much more robust and protected against cybercrime.

With this in mind, the type of registry and whether it will be linked to the EU* will be a critical consideration. As part of this decision-making process, it's worth looking at Switzerland** which has recently linked to the EU, the first time via treaty. It's remarkable how much of the treaty deals with the nuts and bolts of registry security and what happens if one registry goes down, or if there is a breach, or divorce later, and how disputes are resolved. A lot of it is also about the mechanics of the registries talking to each other so that there can be smooth flow of units without fear of any kind of nefarious activity.

> The really important things for the UK will be the stringency of the system and how it mimics the Market Stability Reserve, registry security and what type of registry it wants.

* The response indicates that the UK remains open to the UK ETS operating as a stand-alone or linked scheme and notes that a large number of respondents thought that the UK ETS should link to the EU ETS.

** On 1 January 2020, Switzerland became the first country to successfully link its greenhouse gas emissions trading system with the EU ETS:

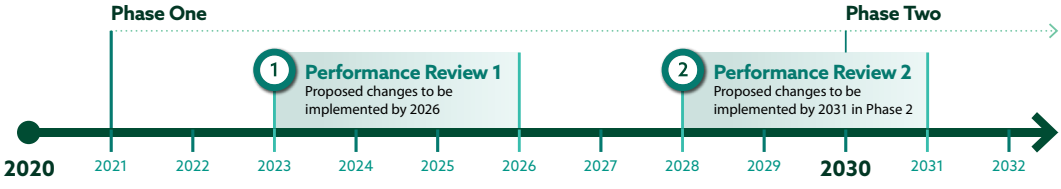
https://www.consilium.europa.eu/en/press/press-releases/2019/12/09/linking-of-switzerland-to-the-eu-emissions-trading-system-entry-into-force-on-1-january-2020/

KEY FEATURES OF THE PROPOSED NEW UK ETS

EH

We will come back to the EU Market Stability Reserve* because pricing and market stability are clearly fundamental.

Phase one of the proposed scheme will run for ten years from 2021 to 2030 and will be subject to two performance assessment reviews. The first starting in 2023 with proposed changes to be implemented by 2026 and the second starting in 2028 with changes to follow in the second phase in 2031.



EH

Generally, do you think that this is a good approach? Presumably the split-review approach is another lesson learned because in the past, mistakes have happened but not been resolved and thereby allowed the market to evolve and function in a sub-optimal manner.

* https://ec.europa.eu/clima/policies/ets/reform_en

> It's good to see the UK planning to align itself with the EU and other trading partners.

DF

Whilst the reviews feel a little close together, I suspect that this is to try and keep the scheme in sync with other international obligations – none of this happens in a vacuum. For example, if you have obligations under the Paris Agreement* to strengthen programmes and move towards "net zero", you are also interested in the trading system targets and how things that affect them, like carbon leakage**, are shaping up. It's a complicated process to ensure that everything works together, **so I think it's probably a good move to have split reviews and be able to calibrate along the way**.

* The Paris Agreement sets the ultimate goal of reaching net zero greenhouse gas emissions (otherwise described as being "climate-neutral") by 2050. This objective is also at the heart of the European Green Deal:

https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

** Carbon leakage is the risk of business being relocated as a result of carbon prices affecting it in the relevant jurisdiction.

> Wholesale change is something that shouldn't be undertaken routinely because it makes planning for the future difficult for companies.

EH

If the reviews do find that drastic changes are required, how willing do you think the government might be to implement change? There will be a lot of effort going in to developing this, so to change it after five years could be seen as a serious failing.

DF

Having the opportunity to review and make sure that you are satisfied with how things are going, is a good thing. But I am not sure you want or need to make a bold set of reforms every time. Wholesale change is something that shouldn't be undertaken routinely because it makes planning for the future difficult for companies.

EH

It seems to me that part of the review process is also going to be, or should be, to assess whether particular sectors should be in or out. Have you been struck by any notable absentees or inclusions under the proposals so far?*

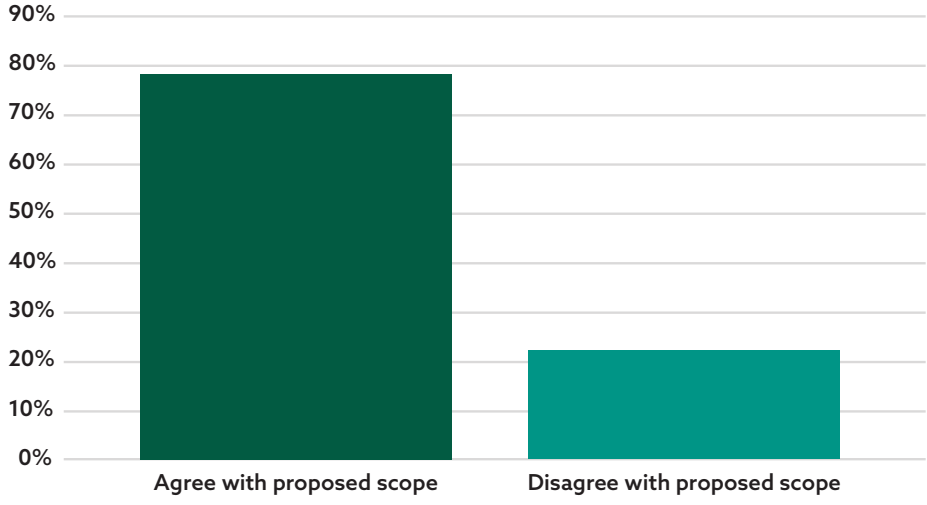
* The UK ETS will apply to energy intensive industries, the power generation sector and aviation (in the same manner as the EU ETS). Coverage may be expanded to additional sectors following the first review in Phase I. Some respondents to the UK Government consultation had suggested expanding the UK ETS to cover municipal waste incinerators but these operators will not be included in Phase I.

DF

Broadly speaking, **I think the most noticeable absentee is the maritime sector**. We've seen aviation do their fair share for a number of years (as they see it) to reduce emissions and now maritime will be in the spotlight. It's not going to be a quick and easy one to tackle because COVID-19 has hit this sector hard and there is a gaping hole in terms of emissions reduction coverage globally. Whether that ties into a UK ETS, I don't know. I think that it could be one that is addressed by way of a scheme that's similar to CORSIA* but equally, the UK may decide to take a leadership role with respect to this sector and include it in the UK ETS.

> Countries need to be as innovative as possible to meet targets and create new products on top of existing mechanisms like the EU ETS.

Position of respondents to UK Gov't consultation on the proposed scope of the UK ETS



Source: 'The future of UK carbon pricing: UK Government and Devolved Administrations' response', June 2020

The transport sector is another rising source of emissions. So far, only California seems to have successfully addressed this by implementing measures such as requiring parties to acquire permits for emissions from transport fuels. Germany is now looking at its own parallel scheme for transport because it couldn't see the EU ETS expanding to include this and felt that something needed to happen on a community basis. This is a responsible move, backed up by an open mind about how the EU ETS and their parallel transport scheme can come together down the line. So, **transport emissions control is a hot topic and an opportunity for the UK to show leadership and potentially put them a step ahead of the EU**. It can choose to innovate in a way that could be an example not only to its European neighbours but also to others around the world who are building and expanding their own schemes such as South Korea, Canada and Australia.

* Carbon Offsetting and Reduction Scheme for International Aviation.

THE UK ETS CAP AND NET ZERO

> By being more stringent, the UK is actually saying that it will strengthen the EU ETS if linked.

EH

Moving on, one of the notable proposals is that the UK ETS' cap will be set 5% below the UK's notional share of the EU ETS cap for Phase IV of the EU ETS.* Why do you think the cap is so aggressive?

* The initial cap will be reduced annually by 4.2 million allowances so that it remains 5% below what the UK's notional share of the Phase IV EU ETS cap could have been expected to be year on year had the UK remained a participant in the EU ETS.

DF

The easy answer is that, as mentioned before, **none of this exists in a vacuum** and there are other agendas to satisfy like the Paris Agreement. But in addition, it is definitely a leadership move to show that stringency in the system is something the UK believes it can achieve with excellence. By being more stringent, the UK is actually saying that it will strengthen the EU ETS if linked.

This cap is suggested to achieve the 2030 targets which could yet be strengthened further. It's unclear how the pathway to net zero will change and how that will impact the UK ETS targets. They could even change the 2050 net zero date so there are a number of moving pieces which will impact the UK ETS cap on a continuing basis. It definitely appears that whatever the net zero trajectory, the cap will be aligned.

The context of net zero targets will be critical in all discussions the UK has with the EU and other trading partners, and in particular, the "net" in net zero. This is partly about the ability to cooperate and get an average (as in net) result between the UK and its partners and how each party is going to play its part by achieving gains on a cost-effective basis. **For the UK, there is great potential in carbon removal strategies—it's a really fruitful area of innovation. Forest and land availability together with existing storage facilities means that the UK is an enviable position to develop a robust removal strategy and work closely with companies specialising in removal technology.**

So, thinking about targets and other features of any new trading scheme cannot be in isolation to cooperation and opportunities in relation to net zero targets—they go hand in hand.

> Targets and other features of any new trading scheme cannot be in isolation to cooperation and opportunities in relation to net zero targets—they go hand in hand.

TRADE EXPOSURE AND CARBON LEAKAGE

EH

The aggressive cap certainly demonstrates both goodwill and strength on the part of the UK, but do you think that it will lead to carbon leakage, or will free allocation of allowances mitigate this risk?

DF

The availability of free allocation has been a real benefit in schemes to mitigate leakage concerns. The challenge will be what happens as you move closer to net zero since the targets will get tighter and tighter resulting in much less free allocation to spread around.

It will become increasingly difficult to protect every trade-exposed industry and that's partly why the border adjustment* conversation —led by the WTO and others—is starting to gain some momentum in Europe;** the WTO is rightly worried about carbon leakage. Maybe the worlds of free allocation and border adjustment have to collide at some point, but how this can happen will be a real challenge, not helped by concerns that border adjustment could lead to a real morass or worse still, trade wars.

We're a lot better off if countries actually take the issue seriously and start reducing emissions in line with each other with a consistency of scheme stringency. But it's never going to be perfect, so having some tools in the arsenal will be important. I expect we're going to see a lot more of that border adjustment conversation alongside consideration of free allocation.***

* Border adjustments are import fees levied by carbon-taxing countries on goods manufactured in non-carbon-taxing (or lower carbon-taxing) countries. So that if a business relocates to avoid carbon pricing obligations but wishes to sell in its former jurisdiction of residence, border adjustments will apply and reflect the difference in the stringency of climate policies between the jurisdictions.

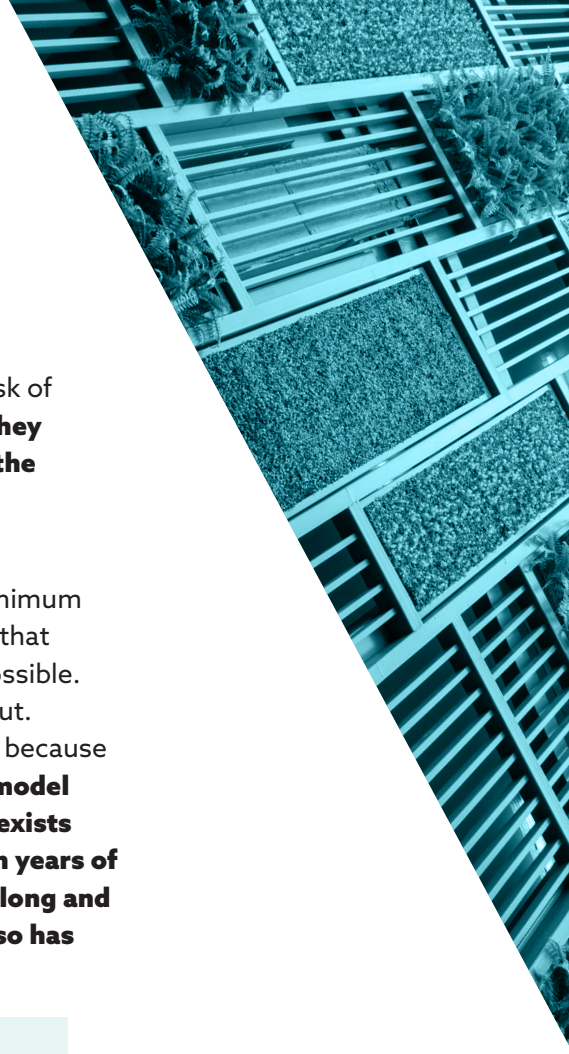
The EU has recently launched a consultation on the feasibility of an EU border adjustment programme:

https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-Carbon-Border-Adjustment-Mechanism

** WTO is the World Trade Organisation.

*** Most UK allowances will be auctioned. To mitigate the risk of carbon leakage, a proportion of allowances will be allocated for free. Some of these free allowances will also be made available to new entrants to the UK ETS as well as to existing operators increasing their activity.

The limit on the total number of allowances available for free allocation (the industry cap) will initially be set at the UK's notional share of the EU ETS industry cap for Phase IV: highly exposed sectors and subsectors on the carbon leakage list will receive 100% of allowances for free; less exposed sectors will receive a maximum of 30% free allocation up to 2026, which will then be phased out to zero by 2030.



EH

Aside from free allocation, do you think auction processes and the imposition of minimum prices will also need to be considered in the context of carbon leakage?

DF

Absolutely, but a separate important question about trade exposure and risk of leakage is how auction revenues will be allocated. **In particular, whether they will be used to fund technological advancements to help solve some of the problems faced by trade-exposed industries and ultimately, to stop them from looking to relocate**.

It's interesting to look at the California / Québec models* which apply a minimum price at auction, like the UK is proposing**, but also have a maximum price that governs volatility on the other side – we have never reached that but it's possible. Throughout the COVID-19 pandemic, the California auctions haven't sold out. And all the market commentary was about how much of it will not be sold, because it does have that minimum price. **This then raises the question of which model is better, is it the pricing-based one or is it the quantity-based one that exists under the EU ETS?*** That's something I'd love to look back on after ten years of them both operating. But right now, the EU one seems to be chugging along and continuing to produce a price, and the California one sort of is, but it also has that weird wrinkle of not all of the units selling at auction**.

* California's cap-and-trade programme is currently linked with the cap-and-trade programme of Québec.

** If the UK ETS is standalone, there will be a transitional auction reserve price of £15 / tCO2e to ensure a minimum price, especially during the "initial" years of the UK ETS, which will be kept under review. As in the EU ETS, price spikes will be dealt with by a Cost Containment Mechanism which will mirror the EU ETS model (by addressing significant price spikes by auctioning additional allowances from within the cap), except that the UK trigger thresholds will be lower for the first two years of the scheme.

*** There are a number of proposed changes to the EU auctioning process in the UK ETS (*e.g.* unsold allowances at auctions should be "rolled forward" to the following four auctions, and each auction should offer for sale allowances up to a maximum of 125% of those originally intended for sale at that auction).

MARKET STABILITY AND PRICING

EH

This topic leads us on to the next question. We were talking earlier about the Market Stability Reserve. From what you've seen, do you think that pricing and market stability have been considered to the appropriate level?

DF

The Market Stability Reserve for Europe is a really terrific innovation and reflects the view of the industry – we always urged them to set up the system and then leave it alone. And now it decides whether allowances go into or are released from the reserve in accordance with agreed parameters. I think the real test in light of COVID-19 is whether the reserve is capable of handling the massive changes resulting from the pandemic because the parameters are quite rigid.

EH

On that point, do you think that the pandemic has significantly impacted carbon price?

DF

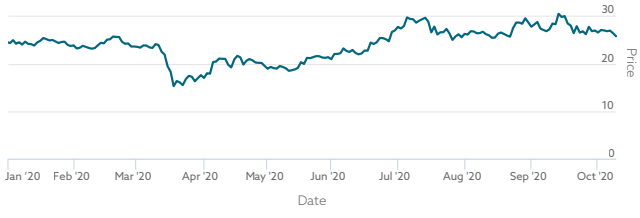
That's a tough one to answer at this point in time. The market doesn't seem to be too badly hit. **The price has been pretty stable throughout —it went down but has been steadily climbing for the past couple of months.** This could well be due to the expectation of caps tightening because there's a lot of noise about a green recovery, and how an aggressive EU ETS can be part of it. But at the same time, there are a lot of other factors that go into pricing carbon. I think the important thing is that it's still working.

There are so many lessons to be learned from this crisis, but in the end, the long-term trend will be what matters. We will need to look back on the various tools and instruments to see what has worked well to ensure stringency and a consistent pricing signal. The UK can really benefit from this exercise and take the best bits resulting in what will likely be a hybrid of different schemes.

And just coming back to a market reserve tool for the UK, it will be really interesting to see how the system has coped. I think they will want as long as possible to get their sea legs to really understand what design parameters will work.*

* A Supply Adjustment Mechanism (the equivalent of the EU ETS's Market Stability Reserve) is under consideration but cannot be introduced straight-away as it requires at least one year of verified UK emissions data.

YTD EUA Price Change



Source: Sandbag / Quandl / ICE

Long-term EUA Price Change

Source: Sandbag / Quandl / ICE

EH

"Finding their sea legs" is a good way to describe it! Just one final question on the system itself: In a standalone UK ETS, whilst it will be possible to bank* allowances across phases (mirroring the EU ETS), it doesn't seem as though EU ETS allowances will be bankable coming into the UK ETS. Doesn't this seem contrary to the macro objectives of flexible mechanisms like trading schemes?

* Banking is the carrying forward of allowances across phases of a trading scheme that have not been retired for compliance purposes.

DF

In the long-term, you want banking because you want to encourage early reductions and give those value. And by losing banking, you are making it more difficult for companies to manage their carbon positions.

However, I think that part of this has to do with a shared concern by the UK and EU around old Kyoto credits. If you recall, there were issues around recycled Eastern European assigned amount units and we have also had CERs* generated under the Clean Development Mechanism that has itself been consistently seen as needing reform and improvement. So, there's a lot out there that hasn't been cleaned up and maybe there is a feeling that we should be tightening things up moving forward. It's an inflection point, moving from the old system to a new one.

But I think we can be a little bit contradictory because on the one hand, **we like the concept of instilling value in things and being consistent but at the same time, we are always looking to create tension in the system to ensure that the pricing signal is robust and make improvements.**

* Certified Emissions Reductions.

> The UK has played a really healthy and important role—because of its early experience in emissions markets—as a market facilitator.

BREXIT AND CONSIDERATIONS FOR LINKING THE UK ETS TO THE EU ETS

EH

One of the design considerations is clearly whether the scheme will be linked to the EU ETS or be standalone. The government has said that the UK and EU ETS systems will only be linked if this suits both sides' interests. What do you think they mean by "both sides' interests?"

DF

I think it's just recognising that there has to be a linking agreement, and that it probably occurs in the broader policy context of other Brexit matters that have to be worked out.

Hopefully, it will develop on a linked basis. It's a programme that has been run centrally at the European level—which is admittedly unusual for an environmental programme—and we'd like to see market continuity. After all, we're in a joint endeavour under the Paris Agreement.

The UK has played a really healthy and important role—because of its early experience in emissions markets—as a market facilitator. It's the trading community in the UK that helped to provide a lot of the legal, accounting, exchanges and frequent jurisprudence around the carbon market from which all of Europe has benefited—and we would like to see everything stay together as much as possible.

But maybe this is an olive branch of sorts from the UK, to show that together with the tough targets being set, the UK is making a good faith effort to cooperate with the EU.

Either way, it's important to make a decision as a matter of priority to provide clarity to the market participants.

EH

I suppose the next question is that if we do adopt the linked design, are we underestimating how hard the process will be? Although it may be a slightly misleading figure in some respects, for Switzerland, it took almost ten years!

DF

Well, maybe, but I actually think that the fact that the Swiss example is out there is extremely helpful. There's a lot to draw on in terms of the overall framework and the experience of people who were heavily involved in the process.

I think it took California and Québec something like seven years to accomplish a linkage. And then Ontario came in, and it was unleashed in around 18 months to two years.

And the ten-year figure is a little misleading. The Swiss process got caught up in a completely unrelated issue of public referendum against immigration that suspended a whole bunch of EU programmes they were progressing. Once this was resolved, and the clouds had lifted, I got the sense that it then came together pretty quickly.

So taking the Swiss example and what has been learned, you add in that the implementing regulation already exists and is understood and the similarities in system design, it's actually a perfect time to do it.

> A UK-EU linkage could turn out a little different than the Swiss example, just due to the size and scale of the cooperation needed. But it has the potential to provide a real break-through in showing the world how international linkages can work in the future.

Switzerland and the European Commission finalised the agreement to link their emissions trading systems at COP25 (Madrid, 2019)
Source: European Council

POTENTIAL CHALLENGES AND POLITICAL BARRIERS

EH

We will of course have our own battle in the form of Brexit which could easily cause a similar delay! Can you see any other major hurdles to overcome?

DF

You're right. There will be other reasons to delay, there always are and this could definitely get swept into the broader Brexit discussion. But right now, apart from politics, I don't think that any of the hurdles are major.

There will be mechanical issues relating to the development of a UK registry. But the UK had the first registry of anyone – they developed the model for everyone else to follow. So this won't be an obstacle; it's an informed IT challenge. As mentioned, an existing alignment of regulations and market infrastructure will aid this process. **The big missing thing at this stage will be what kind of agreement is needed between the EU and UK and hopefully they can draw on the Swiss model.**

EH

On the subject of politics, do you think that the noise around a new UK ETS could be used for internal political warring or have a negative impact on relationships with countries who don't necessarily support carbon reduction?

DF

I'm not sure it will on either point. The UK has had an open and bipartisan spirit behind their climate programme for a long time and it seems like this is being sustained. **Occasionally you will hear a voice that seems out of sync but on the whole, it's an area where political parties have come together.** So I can't see this being used internally or changing the existing status of relationships abroad.

I actually think that the intense spotlight on the UK will be welcomed. The UK is proud of the story it has to tell and would, I think, like to create an important legacy on climate change on the international stage. So, this is a huge opportunity for the UK.

And the other thing to remember with international relations – and we are talking mainly about the US – is that you have the administration and you have the market. I don't think that the administration stance on climate is going to hamper the UK, particularly when the investor community, purchasing public and US companies are in a much different place – requiring and taking net zero pledges even though it's not imposed by the federal government. **Long-term, it's better for the UK to be aligned with these larger macro movements in the US rather than the present-day administration policy.**

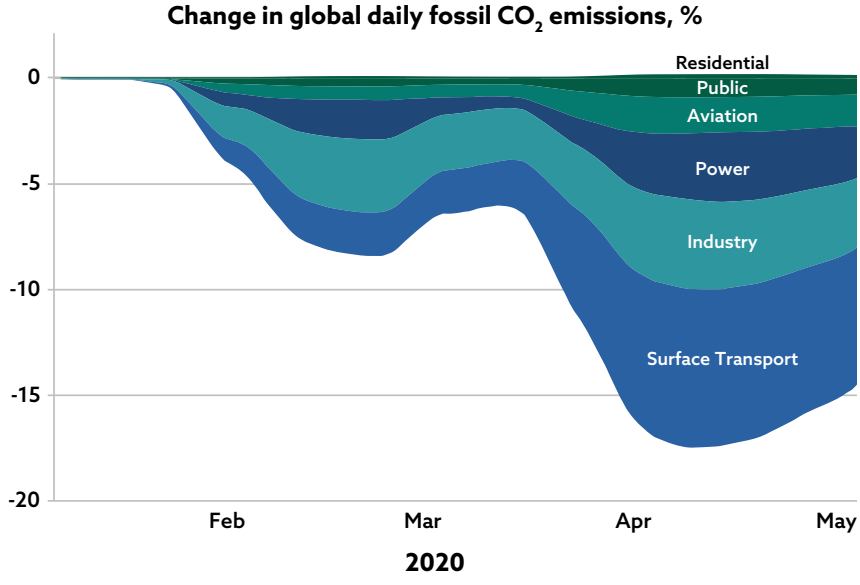
> The UK is proud of the story it has to tell and would, I think, like to create an important legacy on climate change on the international stage.

CLIMATE CHANGE AND THE GLOBAL CARBON CONVERSATION

> An economic collapse or a pandemic is not how we want to control emissions nor is it the message we really want to send. If that is what it takes, it will never happen.

EH

Moving even more into the macro discussion, we have seen the smog lift from the **Forbidden City in Beijing** and fish swimming happily in the usually murky waters of the **Venice canals**. Do you think that this "evidence" could be positive and motivational for schemes like the UK ETS and the net zero targets more broadly?



Source: LeQuéré *et al*. Nature Climate Change (2020); Global Carbon Project

DF

Well, it's really difficult to say without knowing the shape of the recovery. But I do think that it has shown that we can do things differently – people and companies have learned that they can be effective with less travel so I do think the transport sector's emissions could be lower. But who knows, there is also a chance that people will make up for lost time and do more travel to stimulate a booming economy. **We don't really know the response just yet but whilst we are humans and life has to go on, I do think that travel in the future will be different – the majority of us can work remotely.**

I remember when I first started working on climate change on Capitol Hill, we were advising on a legislative proposal and referring to various economic reports and models. Someone came to me and said "have you seen these models? This is so stupid, the only way that the models show that you can reduce emissions is with an economic collapse." Because the only one that was winning in the models was the Soviet Union that had had an economic collapse. But **an economic collapse or a pandemic is not how we want to control emissions nor is it the message we really want to send. If that is what it takes, it will never happen.**

EH

No, but it does demonstrate to a wider audience that this is a real issue and that there are real, identifiable causes.

DF

That, absolutely. I do think coming out of this, the respect for science and an understanding of how much of an emergency the climate issue really is could help galvanize people to support an agenda. Collective action is always good.

CARBON TAX: A VIABLE ALTERNATIVE?

EH

Before letting you go, I have two more questions. Carbon tax has been presented as a fallback to a UK ETS but seems to be more of a parallel discussion. Do you have any views on carbon tax being a better alternative?

DF

I think the important question is whether you can calibrate a tax to ensure the reductions. It is not about raising money; that's not the purpose of the exercise. It's about calibrating it to get to net zero, and I don't think that is as simple an undertaking as some would suggest.

There are important voices out there that have gone with "just slap a big fat tax on it; that will solve it." The argument is that people don't like taxes and this will stop emissions. This is politically very difficult, because it's not that straight forward—it's complicated to create a perfect tax that is tailored to ensure a specific level of reduction.

On the other hand, the trading model assures that the environmental goal is met. Also, it gets you there on a net basis, across covered sectors and jurisdictions – so it is fit for purpose with "net zero" policies. **I think that the environmental assurance you have with the trading model gives it the advantage.**

That said, there are some jurisdictions who are currently probably not capable of administering a full-blown cap-and-trade programme or who may not have a sufficient mix of sources and market players to support a dynamic trading market.

"It's complicated to create a perfect tax that is tailored to ensure a specific level of reduction.

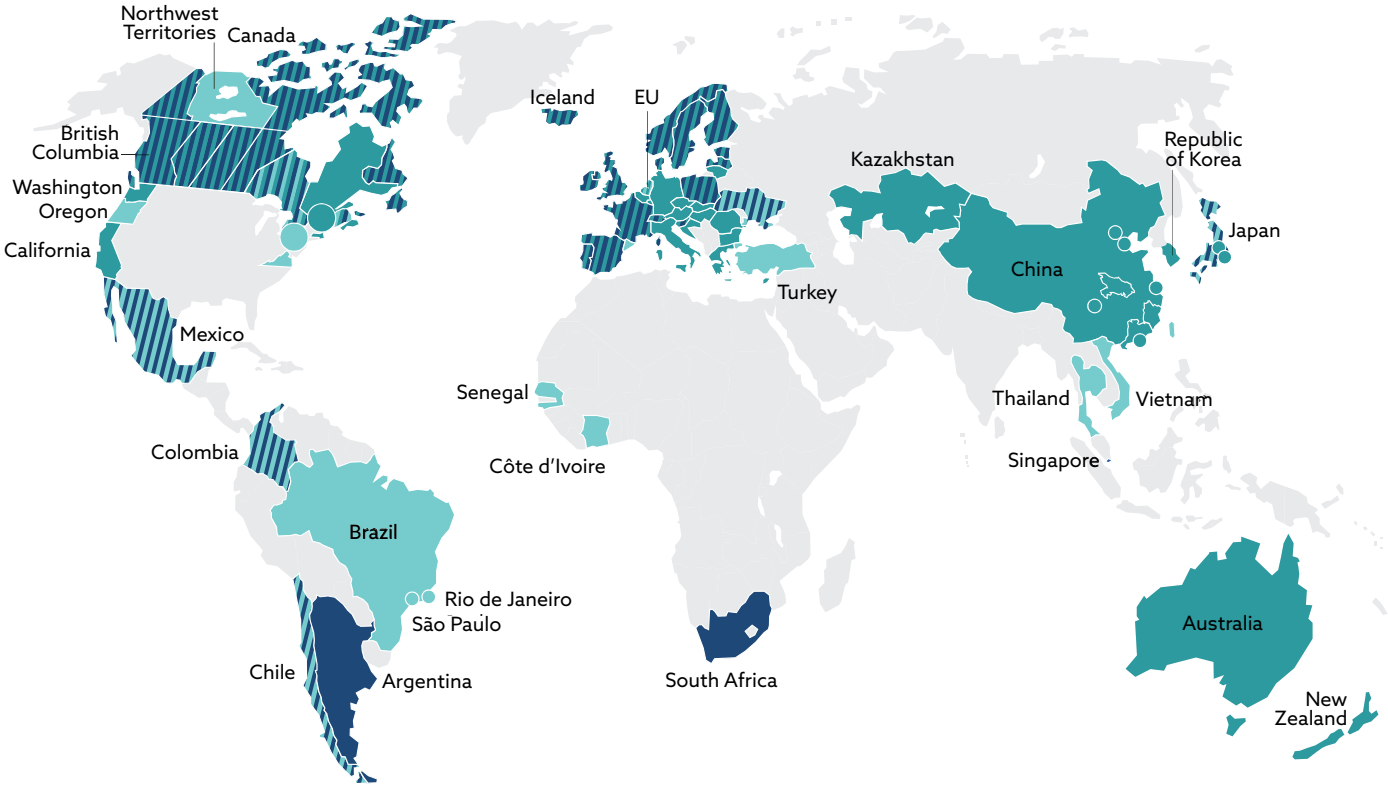
> All things considered, the UK is much better suited to a trading model than a tax model.

DF

Colombia is a good example in many ways - it is based on a carbon tax model. I don't think they have been able to measure any emissions reduction from the tax. However, they also brought in carbon offsets as a credit against the tax and this has resulted in verified emissions reductions. So, whilst I would probably favour a pure trading scheme over a pure tax programme, there are also a lot of hybrid schemes out there which can work.

For the UK, I would be surprised if they ultimately went with a carbon tax. The UK is a big market, it's sophisticated and it can administer a cap. It has a lot of history and experience, and industry is more likely to accept a trading scheme. I think that all things considered, the UK is much better suited to a trading model than a tax model.

Summary map of regional, national and subnational carbon pricing initiatives implemented, scheduled for implementation and under consideration (ETS and carbon tax)



The large circles represent cooperation initiatives on carbon pricing between subnational jurisdictions.
The small circles represent carbon pricing initiatives in cities.

Source: World Bank

> When I was in the Clinton administration, we had a tax that was simple at the beginning but by the time it got through Congress it was neither simple nor effective.

EH

The only issue I suppose is time. To design, build and implement a trading scheme and get it passed by four governments, against the background of a pandemic and Brexit, could be a challenge. Maybe the tax option is insurance in light of the short timeframe?

DF

As an interim measure, that may make sense. For a longer-term strategy that is actually tailored to reducing emissions in line with what the UK wants and needs, the cap is a simpler mechanism to put in place. You will be tinkering with that tax forever trying to get to net zero!

I say this with some humility because I've worked on both. When I was in the Clinton administration, we had a tax that was simple at the beginning but by the time it got through Congress it was neither simple nor effective. It had gained so many exemptions and credits for this and that, that it became really complicated. But that was an experience from a long time ago, you know, a different century, so maybe it works differently now!

EH

That's a fairly compelling argument for the trading system! Final question: **in a world of limitless resource and capability**, is there one particular thing you would want from a new UK ETS?

DF

> Proving the concept of how the "net" of net zero can work on the removal side, involving nature and involving technology, I would say that that is the potential breakthrough the UK could help to foster.

These days I'm quite intrigued about making the nature-based solution side of the equation actually work in practice. When I started working on carbon markets back in the early nineties, the nature side was extremely popular and it had a connection with people.

I remember companies like AES who would build a new power plant and then protect a forest to sequester the carbon; they had support from NGOs to help quantify the benefits. I think that somewhere along the way, we've lost that connection. So when I hear people talking about "net zero" for me it has to involve nature and it has to involve technology and removals in a way that is much more substantial than the way we currently operate.

Proving the concept of how the "net" of net zero can work on the removal side, involving nature and involving technology, I would say that that is the potential breakthrough the UK could help to foster.

EH

A fitting way to end—thanks for your time, Dirk.

Key Takeaways
FROM OUR INSIDE ACCESS CONVERSATION WITH DIRK FORRISTER, CEO OF IETA

- The design of a new UK ETS can and should borrow heavily from the experience of previous schemes, models and processes including the EU ETS, the California / Québec models and the recent linking of the Swiss scheme; in this regard, some of the most important factors are going to be the stringency of the scheme, registry security and the type of registry, and whether or not it will be linked (and if linked, how this will be achieved).
- Intermediate performance reviews of the UK ETS are a good idea as they allow the UK to keep itself aligned with other international emissions reduction obligations. The UK ETS will not exist in a vacuum and requires ongoing calibration alongside the Paris Agreement and the evolving objectives of the EU and other trading partners.
- The maritime sector is the most notable omission from the proposed UK ETS, closely followed by transport emissions. The UK may decide to take a leadership role and include both sectors in the final design. In relation to transport, it can draw upon the success of parallel models in California and Germany.
- The aggressive allowance cap for the UK ETS is intended to demonstrate leadership and real stringency in advance of discussions with the EU about potential linking (and as a show of strength, diplomacy and co-operation as part of broader EU/Brexit discussions).
- The use of border adjustments is not considered by many as an ideal tool to control carbon leakage but is likely to be in the conversation alongside or instead of free allocation.
- How auction revenues are deployed is an important question and in particular, will they be used to fund technological advancements to help prevent carbon leakage.
- Being potentially unable to bank old EU ETS credits into a new UK ETS could be intended to form a clean break and allow the UK ETS to develop an entirely new and improved design.
- That said, the EU will not want to lose the UK altogether given its history and experience in developing the carbon markets—suggesting that a linked design is likely.
- Notwithstanding the current climate, there do not appear to be any major political or other challenges facing the successful implementation of a new UK ETS.
- The UK is better suited to a trading model (per the new UK ETS) as opposed to one based on a carbon tax.
- The UK has the opportunity to show leadership to the global market in developing the new UK ETS, not least by somehow reconnecting the dual concepts of emission reductions and nature-based solutions.

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