Integrating greenhouse gas removals in the UK Emissions Trading Scheme

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Consultation response from Shell[1] to ukets.consultationresponses@energysecurity.gov.uk

1. Introduction

Shell's target to become a net-zero emissions energy business by 2050 remains at the heart of its strategy to deliver more value with less emissions.[2] Shell is transforming its business, reducing emissions from its operations and energy products, while growing sales of low-carbon solutions. Shell supports a balanced energy transition, one that maintains secure and affordable energy supplies as the world moves to net zero. Shell believes it has an important role to play in providing the energy the world needs today, and in helping to build the low-carbon energy system of the future.

We advocate robust policies, legislation and regulations in areas where we can best support the decarbonisation of our customers and reduce our own emissions.

Shell believes that putting a direct price on carbon emissions – whether through cap-and-trade, a carbon tax, or a hybrid system – is a central pillar of any comprehensive net-zero emissions policy framework. A carbon price provides an economic signal to drive changes in the behaviour of consumers, businesses and investors, spurring technological innovation and generating revenues that can be allocated towards the energy transition.

Shell is one of the largest global participants in carbon markets. We have been active since 2003, when the first emissions trading scheme was set up in Europe. Since then, we have expanded significantly to become a global presence in both the regulated and voluntary carbon markets. Today, we participate in all major emissions trading schemes in the world.

We have answered the questions most relevant to our businesses.

Section one: Principles for policy design

Do you agree with the Authority's principles for policy design?

Shell believes that through careful policy design, GGRs should be integrated into the UK ETS. This can be achieved by the UK's GGR standard pre-approving specific existing methodologies – e.g., Verra or Puro – and, where required, providing additional criteria that must be met.

Shell is in broad agreement with the principles set out in the consultation document. However, one policy element currently missing is the cross-border trading of CO_2 through Article 6 of the Paris Agreement.

[1] The companies in which Shell plc directly and indirectly owns investments are separate legal entities. In this response "Shell", "Shell Group" and "Group" are sometimes used for convenience where references are made to Shell plc and its subsidiaries in general. Likewise, the words "we", "us" and "our" are also used to refer to Shell plc and its subsidiaries in general or to those who work for them. These terms are also used where no useful purpose is served by identifying the particular entity or entities.

[2] Shell's operating plan, outlook and budgets are forecasted for a ten-year period and are updated every year. They reflect the current economic environment and what we can reasonably expect to see over the next ten years. Accordingly, they reflect our Scope 1, Scope 2 and NCI targets over the next ten years. However, Shell's operating plans cannot reflect our 2050 net-zero emissions target, as this target is currently outside our planning period. In the future, as society moves towards net-zero emissions, we expect Shell's operating plans to reflect this movement. However, if society is not net zero in 2050, as of today, there would be significant risk that Shell may not meet this target.

In the near term, cooperative implementation of nationally determined contributions (NDCs) using Article 6 could substantially reduce the resources needed to achieve emissions reductions compared to achieving the same global outcome with all parties implementing their NDCs independently.[3] The UK government should therefore consider the extent to which Article 6 can be utilised in the UK. If the savings from cooperative implementation of NDCs using Article 6 were reinvested in greater ambition, emissions mitigation could be substantially increased. [4]

As we have commented in our response to previous UK government consultations, for example our response to the consultation on the introduction of a UK carbon border adjustment mechanism[5], Shell supports the UK and EU linking their ETS schemes, and notes that both parties agreed to continue working together on carbon pricing in the EU-UK Trade and Cooperation Agreement (December 2020).

In addition, if the UK is to capitalise on its potential as a leader in carbon storage, the UK government should work to ensure that cross-border movement across jurisdictions of captured CO_2 through CCS deployment is encouraged.

Section 2: Cap

Do you agree the Authority should maintain the gross cap for initial integration of GGRs in the UK ETS (Option 2)? Please explain your answer.

We broadly support maintaining the gross cap (i.e., applying the existing cap to GGRs), as set out in Option 2. In the longer term, transitioning to option 3 will support the scale-up of removals.

How can the UK ETS sustain demand for GGRs in the long-term, taking into account the consideration of setting a new cap (Option 3)?

Regulatory certainty will be the most important factor in defining whether and how the UK ETS can sustain demand for GGRs in the long-term. With Option 3, while the cap would be maintained and there would be a route to market via the UK ETS, it could be argued that the demand signal may be insufficient unless it were complemented by a demand obligation to surrender a share of GGR-based allowances. However, an efficient support scheme such as a Negative Emissions Payment or a Negative Emissions Guarantee, as proposed under the GGR Business Models consultation, will provide a long-term signal to invest and therefore shape the future carbon market. Early clarity on the UK GGR standard is also crucial, so that it can be aligned with relevant methodologies.

As set out above, Article 6 will also be an important factor. If the source of GGRs is limited to the UK, significant additional incentives will be needed. Expanding the scope of eligible GGRs via high integrity Article 6 credits may grant access to lower cost engineered GGRs and, as a result, lower subsidy costs for the UK government and support for capital investment in the global south. Article 6 has the potential to channel carbon finance and raise NDC ambition over the next decade.[6]

Section 3: Allowance Design

Do you agree that GGR allowances in the UK ETS should be issued ex-post (i.e. after the removal has taken place and been verified)? Please explain your answer

[3] IETA, Modelling the Economics of Article 6, A Capstone Report, 2023

[4] IETA, Modelling the Economics of Article 6, A Capstone Report, 2023

[5] Gov.uk, Consultation on the introduction of a UK carbon border adjustment mechanism, March 2024

[6] IETA, Making Net Zero Possible, July 2024

Shell agrees that GGR allowances in the UK ETS should be issued ex-post, assuming there is a pre-approval process to ensure the issuance of credits upon certification. This may help mitigate the risk of the developer being unable to access finance. Our current understanding is that the UK GGR standard will be a form of "pre-approval" for methodologies that align; however, it would be helpful for the UK government to confirm this.

Does the Authority need to consider any additional measures for the UK ETS to ensure GGR operators are able to arrange offtake agreements? If yes, please provide specific details of which measures should be considered.

Shell's understanding is that the owner of the carbon removal will be either the GGR project or an entity that has entered into a commercial arrangement with the GGR project. We do not believe regulation is needed to address this.

Who should receive the GGR allowance? Please consider whether this would also apply for GGRs that involve multiple actors in the value chain and provide examples.

For engineered GGRs, the developer should receive certification of storage from the operator.

Should allowances from GGRs be differentiated from UKAs and, if so, how?

Yes. UKAs have a domestic use, whereas GGRs could be either domestic or international, through Article 6.

Do you think that differentiated GGR allowances would attract a higher price than existing emissions allowances and why? To what extend does this depend on the degree of differentiation (e.g., a generic GGR allowance versus a technology specific GGR allowance)?

Differentiated GGRs will vary in price based on capital costs, durability, operational cost and permanence (to name a few). Where there are removals with lower operational costs (such as nature-based removals), the introduction of a cap could be used to incentivise the appropriate level of investment in engineered removals; however, as demonstrated in the consultation analytic index, deployment of nature-based removals, such as via the Woodland Carbon Code, is likely to be a small share of the UK ETS. Once the credits are in the system, they should be fully fungible and without preference to origin.

What should the Authority's role be in facilitating a route to market for allowances from GGRs?

We believe the Authority should have a minimal role in this and it should be left to developers and the secondary market. However, there should be a registry for transparency purposes and to avoid double counting.

Do you agree that allowances should only be awarded to UK-based GGRs? We welcome views from all stakeholders including sector-specific considerations. Please explain your answer.

Yes, in the case of nature-based GGRs. The UK has an effective uniform methodology via its Woodland Carbon Code to drive investment in high-quality NBS projects, and this should be rewarded and incentivised. The UK ETS should therefore include allowances up to a reasonable cap for UK-originated credits.

In line with the principle of international fungibility, but with respect to differentiated national capabilities, there should also be a reasonable but limited level of NBS-based allowances for internationally generated high-quality NBS credits, in addition to the UK-based allowances permitted. Any determination on the cap for internationally generated high-quality NBS credits should also be

designed around an acknowledgement of the relatively limited potential for UK-based production volumes.

However, this should not be the case for engineered GGRs, where high costs mean the UK would benefit from sourcing these wherever available, at lowest cost.

Section 4: Permanence

Do you agree with the proposed permanence framework of both a minimum storage period, a liability measure and a fungibility measure? Please explain your answer.

Yes. A permanence framework is necessary to ensure effectiveness of the ETS in achieving its emissions reduction goals. Appropriate governance and support mechanisms must be implemented to address the risk of reversal (e.g., appropriately sized buffer pools per methodology, and contractual obligations to ensure permanence activities are supported, or otherwise mitigate against reversal risk), and fungibility to address differences in time and security of removals.

The implementation of these measures should be appropriately differentiated between technology-based projects and nature-based projects, with respect to the higher risk of reversals for NBS (owing to potential human actions, e.g. deforestation, and natural causes, e.g. fire) relative to technology-based projects with permanent geological storage.

It should be noted that private sector vehicles are not designed to give indefinite liability coverage; key is that the liability exists for the lifetime of the special purpose vehicle or regulated asset-based company, and appropriate guarantees are in place to support permanence across the length of the project, with crediting mechanisms to meet the defined permanence requirements (such as they are). In this way, guaranteeing reversals is addressed if needed.

Nature-based solutions are a significant and critically important carbon sink requiring continued investment from an ecological and climate perspective – we would not want to discourage investment in such projects. With sufficient permanence minimums accompanied by legal assurances, such projects at scale will be impactful and necessary to support the purpose and aim of the UK ETS.

Liability measures are essential to ensure any reversal is addressed. Therefore, any liability measures will be an important component of the framework and should include appropriate safeguards. For engineered removals, liability measures should reflect those included in the UK government's cluster sequencing process for CCUS.

Before differentiated credits enter the UK ETS, credits and allowances should be fully fungible with appropriate balancing and discounting mechanisms.

How should the Authority manage potential reversal events from GGRs? Please consider the liability options outlined above, whether any options exist that have not been considered, and how the potential liability options could be used together or in sequence.

Potential reversal events should be buffer account funded, based on individual project risk profiles. For reversals during active project life, the developer should remit corresponding allowances and rely on drawdowns from the buffer account as a last resort. The buffer account should primarily deal with post-closure reversals.

Should the liability measure differ if the GGR is also subject to a fungibility measure? For example, if the reversal event was avoidable (i.e. within the control of the GGR operator) or unavoidable (i.e. due to factors outside of control of GGR operator).

Yes, in line with the governance of the Woodland Carbon Code, given the higher risk of leakage for NBS solutions, relative to engineered GGRs.

How could the Authority set the contribution rate for a buffer pool? Should this be a flat rate contribution across all applicable projects, or should this vary per project?

This should vary by project but should generally be consistent across project type

Which factors should be considered when determining the appropriate contribution rate for a buffer pool?

Factors considered should include historical evidence, analogous data, and some consideration of climate exacerbated risks.

Should new ex-post woodland units generated in line with UK Woodland Carbon Code standards be considered for inclusion in the UK ETS? Please base your response on the evidence outlined around permanence, costs and wider land management impacts, and on the policy options outlined in the rest of this consultation.

Shell supports the inclusion of NBS-based carbon credits, including UK generated and internationally generated credits, within limits guided by differentiated project characteristics. Please see our responses to previous questions for further details.

If the Authority does include new ex-post woodland units generated under the UK Woodland Carbon Code in the UK ETS, should any changes be made to the Woodland Carbon Code? For example, this could include changing the 20% flat-rate buffer contribution, or changes to the MRV and measures to mitigate wider land management impacts. Details of the woodland carbon code can be found here: https://woodlandcarboncode.org.uk/standardand-guidance.

Buffer pools and associated contributions are a key component of permanence risk mitigation. The establishment and design of MRV and buffer pools should be as robust as possible, with regular evaluation to ensure they remain commensurate to the associated climate exacerbated risks.

Should the Authority consider the use of demand controls to target any impacts other than mitigation deterrence?

This should depend on project type. Nature-based GGRs should be subject to an overall cap and should also have a cap for individual company use (% of UKAs).

Section 5: Pathway to integration

What would be the optimal timing for GGRs to be integrated into the UK ETS, taking into account the considerations set out above? Please explain your answer with reference to impacts on both the UK ETS and GGR deployment.

Integration should take place after 2027, assuming an earliest project start date of 2025 and allowing adequate time for the market to adjust to the changes. To facilitate this, the UK GGR standard needs to be finalised swiftly to allow projects under development to ensure they're aligned with methodologies that will be compatible with the standard. There should also be an ability for a

project to re-register with a different methodology if it’s already live, if this means it can be compatible with the UK GGR standard.