UK STEEL – SUBMISSION TO THE UK ETS FREE ALLOCATION REVIEW

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About UK Steel

UK Steel, a division of Make UK, is the trade association for the UK steel industry. It represents all the country's steelmakers and a large number of downstream steel processors.

Submission to the consultation on UK ETS Free Allocation

1. Do you have any views on the interactions between other carbon leakage mitigation measures and a CBAM and/or the broad policy scenarios which the UK ETS Authority should explore in the future, in light of the UK Government's decision to introduce a CBAM? Please explain your answer.

UK Steel welcomes the opportunity to respond to the consultation on UK ETS Free Allocation. As steelmaking is a very carbon-intensive process, carbon pricing and free allocations significantly impact the industry's ability to operate in the UK and its overall competitiveness. Before dealing with the specific questions in the consultation, it is worth laying out some characteristics of the steel sector and exposure to carbon leakage that will be relevant considerations for DENZ in this consultation.

- Carbon leakage is occurring in the steel industry, directly and indirectly. Steel is a global commodity, intensively traded across borders. In 2022, while 22.2% of all steel produced is traded internationally, this climbs to 39% in markets outside of China, and the UK exports 40% of its steel production and imports 55% of its direct requirements. Whilst increasingly specialised and high-value steels are being produced, market requirements and economies of scale mean that the vast majority of steel made in even developed economies is commoditised and available from a broad range of sources. There is, therefore, intense competition, which keeps steel prices and margins low. Carbon price differentials are a key risk factor contributing to carbon leakage.
- Mechanisms, such as emissions trading and carbon pricing taxing domestic producers' emissions, create an uneven playing field when countries exporting to the UK have not faced comparable policies. For example, the UK Emission Trading Scheme (UK ETS) currently prices carbon at £40/tonne of CO_2e, which would add roughly £80 to the cost of producing one tonne of steel at integrated sites if they did not receive free allocations, increasing production costs by up to 15% (based on January 2024 prices). If free allocations are lower than overall emissions, this would add costs which non-EU imported steel has not faced. It is no coincidence that the loss of UK producer market share is typical to countries like China, India, and Turkey, which have large steel production capacities and face both lower energy costs and no carbon costs.
- The HM Treasury's Net Zero Review[1] analysed the risk of carbon leakage to different industries. It showed that the basic metal sector (dominated by the steel sector) had one of the highest trade openness at 72%, combined with the highest carbon intensity (CO2 tonne/$m) and the third-highest proportion of CO2 from domestic sources. The report showed that the steel sector's gross output was the most reactive to high carbon pricing among all industries.

[1] HM Treasury (2021), Policy paper, Net Zero Review Final Report, https://www.gov.uk/government/publications/net-zero-review-final-report

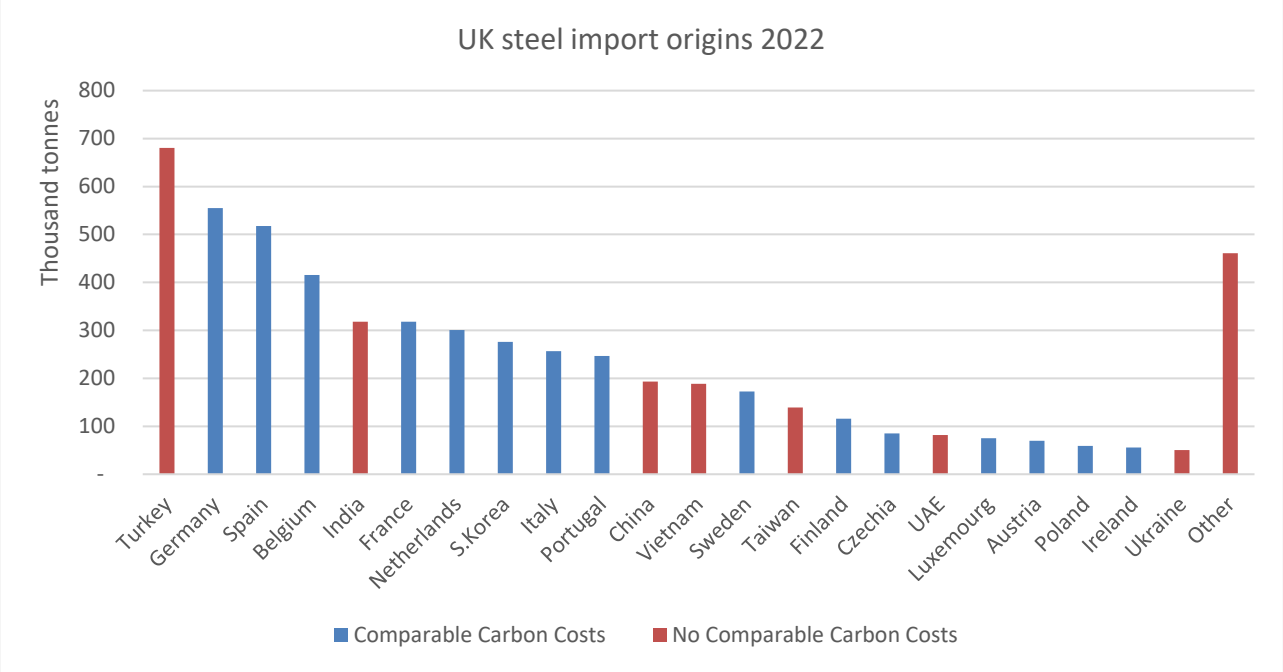
Table 2.B: Carbon intensity for UK manufacturing sectors, and the illustrative cost of carbon pricing

Sector	Overall trade openness[19]	UK-sourced carbon intensity[20] (CO_2 tonne/ $ million)	Proportion of CO_2 from domestic sources	Illustrative cost of UK carbon pricing (% of gross output)		
				$50/tonne	$75/tonne	$100/tonne
Computers & electronics	78%	71	41%	0.4%	0.5%	0.7%
Textiles and apparel	76%	125	63%	0.6%	0.9%	1.2%
Mining & energy extraction	75%	381	90%	1.9%	2.9%	3.8%
Basic metals	72%	790	80%	3.9%	5.9%	7.9%
Other transport equipment	72%	76	37%	0.4%	0.6%	0.8%
Chemicals & pharmaceuticals	70%	121	59%	0.6%	0.9%	1.2%
Motor vehicles	69%	96	43%	0.5%	0.7%	1.0%
Electrical equipment	69%	90	36%	0.4%	0.7%	0.9%
Machinery and equipment	67%	118	46%	0.6%	0.9%	1.2%
Other manufacturing	54%	170	69%	0.8%	1.3%	1.7%
Refineries	52%	681	83%	3.4%	5.1%	6.8%
Rubber and plastics	51%	300	76%	1.5%	2.3%	3.0%
Wood products	35%	122	55%	0.6%	0.9%	1.2%
Fabricated metals	34%	112	49%	0.6%	0.8%	1.1%
Mining of non-energy products	32%	176	73%	0.9%	1.3%	1.8%
Non-metallic minerals	30%	417	81%	2.1%	3.1%	4.2%
Paper	28%	157	66%	0.8%	1.2%	1.6%

Source: OECD, HM Treasury calculations

- Similarly, the steel sector was singled out as having a high proportion of demand covered by imports and a high proportion of production exported. Finally, the UK basic metals sector has significantly lower CO2 intensity embodied in exports than non-OECD countries and somewhat lower than OECD countries. The HMT Net Zero Review concludes:
    - *"In summary, this analysis suggests that some UK manufacturing sectors have substantially lower emissions intensities compared to some trading partners. Many of these sectors are also relatively open from a trade perspective. However, when different levels of carbon price are applied to sectoral emissions intensities, the impacts look relatively low for most sectors. The main exceptions are basic metals, refineries and non-metallic minerals."*
- The UK imports its steel from an increasingly wide range of countries. Whilst the majority come from the EU, primarily due to geographic proximity and integrated supply chains, countries such as Turkey, India, South Korea, China, Vietnam, and Taiwan are all major exporters to the UK now – each supplying over 100,000 tonnes a year and with Turkey providing as much as 680,000 tonnes in 2022 – 12% of imports and 6% of total demand.

Sources of UK Steel Imports 2022



Source: International Steel Statistics Bureau.

- With such high levels of international trade in steel and carbon intensity, the steel industry is at significant risk of carbon leakage. With the presence of high carbon prices without carbon leakage protections (e.g. free allowances, CBAM, product standards, etc.), UK steel producers will be outcompeted by producers that do not face carbon costs. The ETS compliance costs erode UK producers' thin margins and are so substantial that some companies consider them an existential threat to their ability to operate in the UK. Hence, a UK CBAM is welcome in creating a level playing field on carbon pricing.
- The steel industry cannot pass on carbon costs to their customers, as noted in the analytical annex, due to the trade intensity of the sector. Neither is it possible to mitigate the impact of carbon pricing through "product differentiation, marketing, or innovation". While it may be the case for other sectors, the suggestion that "carbon pricing could also increase the demand for some products, expanding or opening new consumer markets" is entirely false for the steel industry, as many steel grades are commodity-like products, where customers buy based on price, rather than potential carbon pricing the producer has faced.
- The steel industry has suffered indirect carbon and investment leakage via uncompetitive industrial electricity prices, which were caused by climate change-related levies (i.e. levies to fund the decarbonisation of the power sector, such as the RO, FiT, CfD, and Capacity Market levies). UK steel producers typically face an average electricity price of £113 per megawatt-hour (MWh) in 2023/24 compared to the estimated French and German prices of £61/MWh. The gap compared to steel producers further afield is even greater. Therefore, UK production sites pay 86% more than their main EU competitors. The price disparity directly impacts competitiveness and equates to a total additional cost to UK steel producers of around £117 million per year compared to if the same production was based in Germany or France.
- The European Union is currently introducing the EU CBAM, which will apply to steel, cement, aluminium, electricity, fertiliser, and hydrogen. Initial reporting requirement has already been introduced for imported CBAM products, and from 2026 to 2034, EU free allocations will be phased out, meaning that EU steelmakers will eventually face the full EU ETS carbon price, and the CBAM compliance obligation will be applied to imported, high-emission steel. When exporting steel to the EU, non-EU steelmakers will have to buy a CBAM certificate corresponding to the amount of emissions generated in the production of those goods, which is priced according to the average weekly price of ETS auctions. As the UK steel industry is so integrated with the broader European steel market, the EU CBAM will directly impact the UK sector in the following ways:

- Trade barriers: In 2026, EU and UK producers will face different effective carbon prices, and UK exporters will have to buy CBAM certificates, resulting in a trade barrier to our biggest export market. The divergence in ETS prices, free allowances, and benchmarks will lead to trade friction. In 2022, the UK exported 3.4m tonnes of steel, of which 2.6m tonnes went to EU member states, constituting 75% of exports. This means that the EU CBAM will have a big impact on UK steel exports, resulting in carbon leakage, and separately supports the case for linking the UK ETS to the EU ETS.
- Trade diversion: When facing EU CBAM costs, high-emission steel currently exported to the EU could be diverted to the UK, flood the market, and depress prices. In 2022, 28,849,708 tonnes of steel were exported to the EU, which could be diverted to open markets, like the UK. As CBAM compliance obligations will fall on steel, which has not faced carbon costs already, not all steel is at risk of diversion, nor will the compliance obligation be large if emissions are low. Canada and New Zealand both have carbon schemes which apply a carbon cost of around £30-40/tCO_2e, which would reduce their compliance costs and risk of trade diversion (22,033 tonnes). Similarly, scrap-EAF-based production would also face a reduced compliance burden, as its emissions would generally be lower, reducing the risk of trade diversion (6,342,089 tonnes). This still leaves 22,485,587 tonnes at risk of trade diversion, which has faced no or negligible carbon costs and is produced via BF-BOF or DRI-EAF production routes, which would induce a significant compliance cost. The 22.5MT steel is at risk of being diverted to other open markets, like the UK, which could damage UK domestic production and cause carbon leakage. This is a particular risk in 2026 when the EU CBAM has been introduced, and the UK CBAM will be introduced the following year. Of the 15 highest exporting countries to the EU, only South Korea and Japan apply a carbon price to their steel industries, although at significantly lower levels than the UK (£12/tCO2e and £10/tCO2e, respectively). Canada and New Zealand, the only two countries with somewhat comparable carbon pricing, only make up 0.08% of the tonnes of steel exported to the EU. The vast majority of the steel exported to the EU faces no significant carbon price and will likely face CBAM compliance costs when exporting to the EU.

For the above reasons, the Government must take a careful and considered approach to changes to free allocation in this review. Changes to free allocation will have huge implications for steelmakers and greatly affect their competitiveness. Considering the joint pledge between Government and Tata Steel UK to invest in new electric arc furnaces (EAF) to place the existing blast furnaces and British Steel published plans to switch to EAFs, this transition must be managed carefully. Sudden and rapid reductions in free allocations could jeopardise the new Net Zero steel investments by imposing unexpectedly high carbon costs.

UK Steel has welcomed the announcement that the Government will introduce a UK CBAM. This will be necessary to support the steel industry's decarbonisation, create a level playing field between imported and domestically produced steel, and introduce new, additional carbon leakage protections. Of course, a UK CBAM cannot stand alone but must be accompanied by other supportive policies, like competitive electricity prices, support for the decarbonisation of industrial heat, and fair trade policies, to name a few. Similarly, the design of the UK CBAM policy itself will be critical as to whether it will create adequate carbon leakage protection or create several unintended consequences. We have noted that the Government intends to introduce the UK CBAM by 2027, a year later than the EU (the UK steel industry's largest trading partner), which carries a number of additional risks, notably the threat of trade diversion, as detailed above. It is ill-advised to delay the CBAM implementation for little gain but at huge risks to the sectors affected by the EU CBAM, and we strongly encourage the Government to reconsider a 2026 implementation timeline. Should this not be possible, the Government must be ready to intervene with new and additional trade measures in case of increased imports as a result of the EU CBAM.

Therefore, it will be essential that there are no reductions to free allocations in 2026 for sectors affected by the UK and EU CBAM policies. The Government must not reduce its main and primary policy against carbon leakage a year before it will introduce its replacement. Carbon leakage measures must be developed in parallel and as part of a holistic approach. Free allocations can, therefore, not be assessed in a vacuum but only alongside the development of the UK CBAM and other carbon leakage policies.

Finally, it is worth noting a minor technical point on the claim in the consultation document that the UK ETS encourages decarbonisation by allowing operators to keep any surplus free allocations after decarbonising production. This is not the case for the steel industry if steelmakers switch from integrated BOF production to

scrap-based EAF. As a new EAF benchmark will be applied, they will automatically lose all their excess free allocations and will, therefore, not see any benefits from the UK ETS from decarbonising their steel plant.

2. Should the UK ETS maintain the current approach to activity level changes or switch to a dynamic approach (i.e., should free allocation be adjusted after the end of the scheme year, based on reported activity levels)?
We would support maintaining the current approach to activity level changes, as this provides a more predictable supply of free allocations. Large organisations like steel producers set their corporate budgets 6-9 months in advance of the beginning of the financial year and value predictability and stability. The current HAL/ALC approach would allow them to forecast their UK ETS compliance costs more effectively and ensure their carbon traders can work more economically.

We would also agree with the noted disadvantages in the analytical annex, which states that with the dynamic approach, "allowances outlined at the start of each 5-year allocation period would be highly provisional and liable to change, potentially decreasing certainty for operators", and "higher frequency of FA changes and fluctuations in annual level of FAs may make it challenging for operators to forecast which could require additional resource for planning and management of FAs". For these reasons, we support retaining the existing approach.

3. If a dynamic approach were to be implemented, should provisional allocation be calculated based on a rolling period of recently reported activity?
If a dynamic approach is implemented, the full advantage should be taken, and provisional allocation should be calculated based on a rolling period rather than a historical baseline. However, as free allocation would then be adjusted after the end of each scheme year to reflect actual activity as reported in the ALR, it matters less whether based on a rolling period or historical baseline.

4. If provisional allocation were to be calculated via a rolling period, should this be based on the most recent two full calendar years of verified activity (e.g., 2023-2024 for 2026 allocation)?
Yes.

5. Under the dynamic approach, should the energy efficiency calculation for fall-back benchmark sub-installations continue to refer to a fixed historical baseline?
Yes.

6. If the UK ETS does not switch to a dynamic approach, should the UK ETS Authority consider reducing the 15% ALC threshold, and, if so, what would be an appropriate threshold?
Should the current HAL/ALC approach be maintained, we would support keeping the existing 15% threshold, as this is a reasonable trigger level for making changes. Lower thresholds would make free allocations less predictable and erode their benefits.

7. Do you agree that benchmarking is the appropriate methodology to ensure free allowances reward top performing installations and incentivise decarbonisation? (Y/N Please explain your answer)
Yes. We agree that benchmarks incentivise installations to improve overall efficiency. However, they do not incentivise decarbonisation but merely gradual improvement. Furthermore, benchmarks are also victim to outliers, where site circumstances and locational issues allow installations to achieve lower emissions than would otherwise be possible elsewhere.

8. What are your views on the proposed options for updating UK ETS benchmarks?
Considering the implementation of a UK CBAM in 2027, a year after the EU CBAM starts, the steel industry will be exposed to additional carbon leakage risks in 2026 due to the risk of trade diversion from the EU. Our preference is, therefore, to retain existing benchmarks to avoid any reductions in free allocation in 2026, when risks of carbon leakage increase.

While the benchmarks for free allocation should incentivise efficiency and emission reductions, the primary purpose is carbon leakage protection. The benchmarks should, thus, not be reduced any further than absolutely necessary to ensure adequate protection for exposed, vulnerable industries. When the UK CBAM is introduced, free allocations will likely be reduced for the affected sectors beyond the benchmarks regardless, nullifying the concern that option 1 would not lead to a reduction in free allocations and the incentive to reduce emissions.

The second preferred option is option 3, where future benchmarks are based on UK data, although this is suboptimal for several reasons:

- Benchmarks are, in general, victim to outliers, which can greatly impact the average for the whole industry. For example, if a plant has access to biomass because it is co-located alongside a papermill or wood furniture manufacturer, leading to lower emissions, other similar plants cannot replicate this, as they do not have access to biomass. Similarly, with access to CCUS pipelines, industrial clusters, and low-emission hydrogen supply. Basing benchmarks on just *one* installation exacerbates this problem to a point where a whole industry can be substantially disadvantaged because of just one of their competitors. This becomes further problematic if unconnected Government policy on industrial clusters dictates which plant can decarbonise or further reduce emissions.
- The steel industry is dominated by six steel producers, comprising two integrated BOF, ore-based producers and four scrap-based electric arc furnace producers. For example, basing a benchmark on just one of two plants for BOF production will be suboptimal. Moreover, as Tata Steel has announced plans to switch to EAF production, it could leave just one BOF producer in the UK in 2026, making benchmarking impracticable. On the other hand, if Tata Steel's transition is delayed, it could leave just four EAFs for the EAF benchmark, which produce different steel grades and products. Basing the benchmark on just one of these plants, which produces a product range that is less energy and carbon-intensive than others, would leave the other EAF unnecessarily exposed. Basing benchmarks on just *one* installation would not be appropriate in this situation either. The UK steel industry is simply too small for effective benchmarks using the approach suggested in option 3.

The least preferable option is option 2, which would leave the UK without any influence over benchmark values for its emissions trade scheme, basing UK benchmarks on EU data, which does not include or take account of UK installation data. As outlined in the analytical annex, EU benchmark values do not include any UK data, so they could "reflect efficiencies and technologies different to those attainable in the UK". Furthermore, "if UK and EU installations diverge in technology or attainable efficiencies, this method cannot account for such changes over time[, …] the UK ETS Authority has limited visibility on what the updated benchmarks for 2026–2030 will be until they are published, which limits certainty for operators". We would therefore urge the Government to avoid option 2.

9. Do you agree with the proposed minded to position for updating benchmarks using UK data only to set the ARR? (Y/N Please explain your answer)
No. We do not agree with the minded to position for updating benchmarks using UK data only to set the ARR, as this would likely lead to a reduction in free allocations in 2026 despite the UK CBAM not being implemented. For the reasons outlined above, this option is also exposed to several risks for small sectors, like the steel industry, which is dominated by 1-4 installations for each benchmark.

If option 3 is to be implemented, it should be delayed until after the UK CBAM has been fully implemented and proven effective at providing sufficient carbon leakage protection.

10. If you do not agree with the suggested methodology, please provide accompanying evidence as to why it should not be pursued and suggestions for an alternative methodology for updating benchmarks.

As per our answer to question 8, our preferred approach is option 1, which would at least retain the existing benchmarks for 2026 when the UK has not implemented its CBAM policy and provides similar carbon leakage protection as now.

11. Do you have any views as to alternative methodologies that can be applied for updating benchmarks with zero UK sub-installations?

All proposed options are suboptimal for different reasons. However, we do not believe it is feasible in the long-term approach to base the UK's benchmark methodology on data that does not include any UK installations, ruling option 2 out completely. Option 1 could be a temporary option until 2030, when a UK CBAM is implemented, after which option 3 could be introduced, ensuring UK benchmarks are based on UK industries. At this point, all UK steel producers will also have switched to EAFs, reducing the disadvantages of option 3.

12. Do you agree that the carbon leakage list should be updated to reflect UK industrial sector's risk of carbon leakage? If you disagree, please explain how you think the carbon leakage list should be calculated in the future
Yes. It is only right that UK data is being used to assess carbon leakage of UK industries.

13. Do you agree that carbon leakage risk should continue to be calculated on the basis of emissions intensity and trade intensity, or are there other factors which you think the Authority should consider?
We agree in principle but wish to add that the UK ETS Authority needs to consider a methodology for when industries have decarbonised. Once the UK steel industry has completed its transition to electric arc furnaces, its emission intensity will be significantly less, and this will only continue to drop as the electricity grid further decarbonises and hydrogen becomes available. However, it will still have to compete with high-emission steel imported from integrated BOF/BOS plants and is still exposed to the risk of carbon leakage despite its lower emission intensity. The Authority must, therefore, develop an approach for decarbonised industry to ensure these are not kicked off the Carbon Leakage List once they have transitioned to green manufacturing.

14. Based on the data sets we have explored, do you agree with our approach to explore using UK data based on ONS, ABS and HMRC trade data? And, if this data set is found to be representative, do you agree that the Authority should use this to calculate the carbon leakage indicator?
We agreed with the proposed approach, given that it is fully transparent, and industry has access to data sources to provide feedback or corrections in case of data errors.

15. Do you agree with the risks we have set out with the alternative data sets? If not, please provide evidence.
Yes.

16. Do you agree with our minded to position to bring forward the phase out date of the CLEF for those not on the 2026 carbon leakage list to 2026?
Yes, we agree.

17. Do you agree that the Authority should tier the carbon leakage list to better target those most at risk of carbon leakage?
While we agree in principle that a tiered carbon leakage list may better target the industries at most risk of carbon leakage, we would be concerned that it could lead to industries at the edge of different tier categories not receiving sufficient carbon leakage. The primary aim of the free allocation review should be to ensure sufficient carbon leakage protection for exposed industries rather than reduce free allocations as much as possible. While we appreciate and understand that the UK ETS Authority wishes to incentivise decarbonisation through the UK ETS, it must recognise that industrial decarbonisation requires numerous policies in place and a supportive package of support to transition to new production methods. Industries could close down rather than decarbonise if the Authority reduces free allocations too much.

As free allocations are provided to prevent carbon leakage, it would not be appropriate to provide lower free allocations to sectors at risk of carbon leakage if the UK CBAM has not been introduced yet.

If the Authority proceeds with a tiered carbon leakage list, it should be the "Tier Design Example 2: Large high-risk tier", as this would prioritise having more sectors covered in the high-risk tier, with smaller tiers for medium and low risk. This ensures that more exposed sectors receive adequate carbon leakage protection.

18. Do you have views on the principles that the Authority should use to guide decision making on tier design if we opt to tier the carbon leakage list?
19. Above, we have outlined three illustrative examples of ways we could tier the carbon leakage list. Do you have any views on these? Do you have views on alternative ways that this could be done?
We would be concerned that some industries may fall on the wrong side of the tiers, providing inadequate carbon leakage protection. We would therefore favour the "Tier Design Example 2: Large high-risk tier", as this would prioritise having more sectors covered in the high-risk tier, with smaller tiers for medium and low risk. This ensures that more exposed sectors receive adequate carbon leakage protection and minimises the risks that industries at the edge of tiers do not receive adequate protection.

20. Do you have views on whether we should tier the Cross-Sectoral Correction Factor in the instance of its application?
We would support this approach, which seems more proportionate and appropriate, considering the main aim is to protect against carbon leakage.

21. Do you have views on the principles we have outlined for consideration of decarbonisation technology?
We welcome this discussion and think it is important to consider access to decarbonisation technology when providing free allocations. This will be a crucial issue for the steel industry when the entire industry is producing steel via scrap-based EAFs, where the remaining scope 1 emissions will originate from using natural gas, making access to low-emission hydrogen vital. Some steel companies are today located in Track-1 and Track-2 industrial clusters, where hydrogen supply will likely be available with Government support. However, several steelmakers are not situated in track 1 or 2 industrial clusters and are unlikely to have access to hydrogen within this decade, greatly affecting their ability to reduce their emissions further.

It is worth reiterating again that the steel industry already has different benchmarks for the same product, which means that the incentive to decarbonise via electrification is greatly minimised, as companies cannot retain the surplus allowances.

22. Do you have views on how the UK ETS Authority should define decarbonisation technologies to be included in this work?
For the steel industry, access to hydrogen supply will become a key differentiator for companies' ability to reduce their emissions further. Other factors, such as access to grid infrastructure and government co-financing, will also play a key role.

23. Above we have outlined two possible methodologies for how we could consider access to decarbonisation technology in FA calculation. Do you have any views on the approaches outlined above?
Of the two options presented, option 1 is the least objectionable proposal, as option 2 would penalise companies for not having access to decarbonisation technologies. This seems to be completely counter to this section of questions and the considerations extended to companies simply not having access to Net Zero technologies.

Option 1 does offer the potential to consider these factors, but as they will be numerous, it will also be very complicated. For example, if only two sub-benchmarks are created (e.g. Product Benchmark with access to project and Product Benchmark without access to a project), how will these be applied to a company with access to hydrogen supply but not Government financing? Or does have access to CCUS, but not hydrogen? Furthermore, the steel industry will likely only comprise six steelmaking sites, which could be complicated by creating sub-benchmarks.

Regardless of these complications, the availability of decarbonisation technologies must be considered in reforming the free allocations.

24. Are there alternate ways that you think we should examine to alter the free allocation methodology to consider access to decarbonisation technology?
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25. Are there alternative ways, outside of free allocation, that the ETS could consider access to decarbonisation technology?
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26. Do you have views on whether the Authority should introduce conditions, related to decarbonisation efforts, on receiving free allocations?
We do not believe that the Authority should introduce such conditions, as this would be counterproductive to the aim of free allocation, which is to provide carbon leakage protection. If the Government wishes to incentivise decarbonisation further, it should do so with other policies rather than reduce carbon leakage protections.

Furthermore, as explored in the sections above and acknowledged by the Authority, there will be limitations that prevent companies from decarbonising, such as access to grid connections, hydrogen supply, or Government co-financing. The steel industry has committed to decarbonising its production by 2035 by switching to electric arc furnaces, and companies are in bilateral negotiations with the Government to secure co-financing for these investments, similar to what is provided in other countries aiming to reduce industrial emissions. The suggestion to reduce carbon leakage protections if an installation has not made any emissions reductions or resource efficiencies over a certain period of time is very concerning to us, as there may be valid reasons why an EAF cannot reduce emissions any further, such as lack of access to hydrogen. The Authority does not seem to have considered how such conditionalities will be applied to industries which have already decarbonised and transitioned to new production methods.

27. Above we have outlined three illustrative designs for conditions for free allocations. Do you have views on whether we should introduce any of these options, how they are designed, and do you have a preference out of the stated options?
As outlined above, we do not believe that additional conditionalities should be brought in, as the primary aim of free allocations is to provide carbon leakage. As well recognised and outlined in response to question 1, over 90% of the steel produced globally has not faced any carbon pricing, leaving the UK steel industry exposed to carbon leakage. Reducing free allocations because an installation has not further reduced emissions for a period of time but plateaued due to the lack of hydrogen supply would significantly increase the risk of carbon leakage, where production declines and imports increase.

If the Authority is determined to introduce conditionality and reduce the carbon leakage protection it offers, the least objectionable option is “Condition Design Example 3: Require installations to have a decarbonisation plan in place”.

28. Do you have views on alternate conditions that the Authority should consider for receiving free allocations?
No, we do not believe that conditions are appropriate for free allocations.

29. Do you have views on whether there are alternative decarbonisation incentives that could be implemented through free allocations?
For the steel industry to decarbonise, many different policies needed to be implemented: Competitive electricity prices, UK CBAM, improved scrap utilisation and quality, energy efficiency funding, R&D funding, green public procurement, co-financing for CAPEX investment, support for decarbonising heat, and hydrogen supply. It is highly unlikely that steelmakers would have announced plans to decarbonise with incentives that could be implemented through free allocations if some of the listed policies were not available. Free allocation alone would not be a sufficient incentive to decarbonise. The primary aim of free allocations is to protect against the risk of carbon leakage, and the Authority should not start introducing additional aims, which cannot be achieved alone through free allocations.

30. Do you have views on whether there would be barriers to an equitable application of conditionality in principle, if the Authority was to pursue this option?
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31. Do you agree with the Authority's approach on Technical Change One for treating free allowances in the final year of operation in cases of permanent cessations of activity? (Y/N Please explain your answer)
Yes.

32. With the Authority's proposed approach on Technical Change One, what risks should the Authority consider regarding the return of overallocated allowances?
There is always the risk that with the aim to reduce overallocation of free allowances, the Authority instead underallocates and does not provide sufficient protection against carbon leakage.

Overall, we do not think the potential overallocation is a huge issue, which warrants concern. However, if the Authority wishes to reform it, we support the efforts.

33. Do you agree with the Authority's approach on Technical Change Two for updating the definition of permanent cessations of activity? (Y/N Please explain your answer)
Yes. This is a reasonable suggestion.

34. Do you agree with the Authority's approach on Technical Change Three to update the minimum content of the monitoring methodology plan? (Y/N Please explain your answer)
Yes.

35. Do you agree with the Authority's approach on Technical Change Four to change the heat metering measurement hierarchies? (Y/N Please explain your answer)
Yes.

36. Do you agree with the Authority's approach on Technical Change Five to adjust Monitoring Principles with relation to hierarchies? (Y/N Please explain your answer)
Yes.

37. Do you agree with the Authority's approach on Technical Change Six to update the unreasonable cost calculation reference price? (Y/N Please explain your answer)
We agree that the Authority should use an updated price; however, it should ensure that it is linked to the UKA price of the previous year to provide an adequate assessment.

38. Do you agree with the Authority's approach on Technical Change Seven to require control systems checks be made at yearly intervals? (Y/N Please explain your answer)
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