



European Affairs Committee

Corrected oral evidence: The future UK-EU relationship

Tuesday 22 November 2022

5.05 pm

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Members present: The Earl of Kinnoull (The Chair); Lord Hannay of Chiswick; Lord Jay of Ewelme; Lord Lamont of Lerwick; Lord Liddle; Viscount Trenchard; Lord Tugendhat; Lord Wood of Anfield.

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Questions 110 - 116

Witnesses

I: Jonny Peters, Senior Policy Adviser, E3G (Third Generation Environmentalism); Dustin Benton, Policy Director, Green Alliance; Silke Goldberg, Global Head of ESG, Herbert Smith Freehills.

Examination of witnesses

Jonny Peters, Dustin Benton and Silke Goldberg.

Q110 The Chair: Welcome back, everyone, to this hybrid House of Lords European Affairs Committee. This afternoon's public evidence session is to do with our forthcoming report on the future of UK-EU relations. One key part of that report is on the energy, environment and climate change sector. We are very pleased to have a strong panel here to go into various aspects of it.

I will briefly introduce the panel. Dustin Benton is from Green Alliance, Silke Goldberg is from Herbert Smith Freehills and Jonny Peters is from E3G. We know exactly who you are and that is why we have invited you, but those watching will not. When you speak for the first time, if you could give a very brief resume of who you are and why you are here that would be very helpful.

As this is a public evidence session there will be a transcript. We will send you that transcript, which will be the basis of our report and what we might say about this evidence session. Please check it and let us know if anything needs correcting within the transcript.

We have only an hour and there are quite a few questions to go through, so I would be grateful if questions and answers would be pretty crisp and to the point so that we can get through the whole question set we have organised.

I am going to begin with a very general question. How would you characterise the current state of the EU-UK relationship in the area of energy, environment and climate change? What factors are underlying that relationship at the moment? In particular, has the relationship been adversely affected by the impasse over the Northern Ireland protocol?

Dustin Benton: I am the policy director of Green Alliance, an environmental think tank based here in London.

To come straight to your question, it is fair to say that the UK-EU relationship overall is a bit rocky. Within that, energy is among the best of the relationships. There are pretty good technical conversations happening and a lot of excellent work at Civil Service level. It is fair to say that the politics have made that work more difficult. That is the energy answer.

Climate does not form a direct part of the trade and co-operation agreement between the UK and the EU. The fact that the UK has held the COP presidency up until a few days ago has been quite helpful in facilitating conversations between the EU and the UK that are not through that particular relationship. That has gone reasonably well, but we are somewhat lacking in mechanisms for further dialogue, particularly on climate. Did you want anything on the broader environmental questions or specifically on climate and energy?

The Chair: I think we will come to some of those issues later on. At this high-level moment, you can probably keep it nice and high.

Dustin Benton: I will leave it there.

Silke Goldberg: I am a partner with HFS—Herbert Smith Freehills—and I am also a visiting professor at Queen Mary University of London and at the University of Groningen. I am also an author of a book on energy and Brexit.

I shall take the question on the relationship in two parts. I distinguish between the formal level and the political level. The relationship is somewhat reluctant. The energy sector is immensely interconnected across the European Union and the United Kingdom. However, the TCA provides a reasonably fluffy basis for that relationship because it is very politicised.

In contrast to the EU directives, it does not provide a very direct and clear legal framework. In that respect the relationship is somewhat suffering from politicisation vis-à-vis the Northern Ireland protocol and its connection to fisheries.

At a more short-term and political level, I would say that the relationship is reasonably functional, which has been particularly the case since the Russian invasion of Ukraine. That is effectively an external factor that has had a positive impact on the relationship between the UK and the EU in relation to energy.

The Chair: We will come back to a number of the issues you have raised in greater detail later on.

Jonny Peters: I cover trade policy at the climate change think tank E3G. I am going to approach the question in quite a similar way. I would separate it out into three different levels: the diplomatic level, the technical level, and the political level.

At the diplomatic level, I agree with Dustin. That has been shifted on by events, particularly the UK hosting the COP 26 Glasgow climate summit at the end of last year. As he rightly said, the COP 26 presidency lasted from then up until the handover to COP 27 in Egypt, which happened a few weeks ago.

With those events, we saw really solid UK-EU co-operation, perhaps most personified in the relationship between the COP 26 president Alok Sharma and his opposite number the executive vice-president Frans Timmermans. From that level down through the diplomatic teams on both sides we saw really close co-operation.

That was really positive and definitely to be welcomed. A lot of the momentum around the UK and the EU raising their climate ambitions—both their net-zero and 2030 targets—before COP 26 had a lot to do with that political moment. At diplomatic level that was all very positive. However, with the handover from COP 26 to COP 27 that area for co-

operation has now gone, so we need to look for new areas for co-operation between the UK and the EU on climate change.

At the technical level, again, it has been driven forward by events. As my fellow panellists have said, the Russian invasion of Ukraine and the resulting energy crisis have driven forward the need for close co-operation.

Ultimately, the energy interdependence between the UK and the EU, as we have heard from so many panellists before, is stark. That has only risen in profile. The need for more solutions is reinforced by the final area that I want to point to, which is of course the political level.

It is undeniable that the Northern Ireland Protocol Bill has got in the way here. Ultimately, while we have seen events driving forward progress at the diplomatic and technical levels, we have not seen that happening yet at the political level. Ultimately, diplomatic and technical talk get you only so far. We need a fresh political mandate from both the UK and the EU to drive forward the diplomatic and technical talks any further.

The Chair: Thank you. I think we should move straight on to Lord Faulkner.

Q111 Lord Faulkner of Worcester: My question follows that almost exactly. Looking at the energy security challenges in Europe following the Russian invasion of Ukraine, how effective do you think the co-operation between the UK and EU has been? Which areas of co-operation have worked well, and which have worked less well?

Jonny Peters: Building on where I finished, on the technical level we have seen officials and the grid system operators—the National Grid and its counterparts in the EU—picking up and running with this situation very effectively. Co-operation has been strong, and we owe a lot to the officials and those technical operators for that kind of work. We need to build more trust at the political level to avoid any issues blowing up in future. If there is one example of this, it is in an area I think we will come on to later: the finalising of the new electricity trading arrangements between the UK and the EU.

Ultimately, this is a classic example of where technical discussions have stalled and we need fresh political impetus from Ministers on the UK side if we are going to see those technical-level discussions progressing any further. We have seen issue linkages time and again. Again, the Northern Ireland Protocol Bill means that the EU, understandably in some respects, is not progressing talks any further at the technical level until the political issues are resolved.

Silke Goldberg: At the pragmatic level, almost the operational level, there are a lot of contacts. They work reasonably well to the extent that they do not need political approval or extra political mandates. Where it is not formalised, it does not need to be formalised; this is fine.

Where there is a need for a greater legal basis and a more formalised interaction, it does not work so well. This is chiefly, again, because of the political backdrop of the Northern Ireland protocol. I would exemplify that in relation to the multi-region loose volume coupling arrangements, which the TCA mandates. Those have not been brought about and the deadline was missed.

I would also point to unclarities in the TCA. There was a lot of talk in the previous panel about the interconnectedness of the UK and the EU. For instance, the TCA grants the possibility for future cross-border infrastructure to have exemptions from certain legal provisions such as unbundling. It gets a bit technical at that point.

It is entirely unclear on the EU side who would grant such exemptions. No one seems to have the desire to pick that up and carry it further, so more clarity is required. As has already been touched on in the last panel, perhaps the Specialised Committee on Energy has not met as often as might be desirable.

Looking forward to where improvements could be made, we talk a lot about energy security, particularly in the wake of the Russian invasion of Ukraine. Energy security has two aspects to it. First, there is availability. Do we have enough of the stuff to go round? The next question is: how do we get the energy that we have to consumers?

Lord Faulkner of Worcester: Would you like to answer those questions?

Silke Goldberg: Do we have enough of it? For right now, yes. That is chiefly because of energy saving mechanisms, LNG imports and energy storage. In both the UK and the European Union, however, these are short-term measures. Should the situation in Russia and Ukraine persist until next winter, that is an entirely separate question. Overall dependency on Russian gas imports to the European Union has dropped significantly. However, the gas markets are simply no longer the same compared to prior to 24 February.

The next question is on deliverability, which is the other aspect of energy security. The answer right now is yes. However, Ofgem has given out a target. Currently we have just under 8 gigawatts of interconnector capacity. Ofgem would like to see 18 gigawatts of interconnector capacity installed in Great Britain. That means a significant number of interconnectors will need to be built to meet that, and that deliverability of energy security will need to have a stable and clear regulatory framework. At the moment, the TCA simply has a number of uncertainties in that regard, and the co-operation agreement could be improved.

Lord Faulkner of Worcester: The TCA has only met twice during 2022.

Silke Goldberg: Indeed, the specialised committee has only met twice. If you look at the meetings and the agendas, it was fairly high-level

discussion and did not go into very detailed technical discussions.

Lord Faulkner of Worcester: Dustin, do you think the current volume of engagement between the UK and the EU on these issues is sufficient? Is it good enough?

Dustin Benton: On a technical level, officials are doing a great job. It is worth stepping back for a second and thinking about the nature of the relationship, which was formalised through the TCA. That was put in place before we realised there would be a massive Europe-wide security crisis and a substantial imbalance between our demand, particularly for gas, and the available supply because Russia is basically now shut off. If you had written the TCA in the context of the invasion of Ukraine, you would expect much more robust interrelationships. That is worth saying at the start; that TCA process was not designed for this kind of crisis, and officials are working around it.

Secondly, I want to comment on the pragmatic interactions that have happened, which are broadly pretty good. The UK is actually quite important in terms of Europe's energy security. I am an environmentalist so I do not particularly like this, but we have been supplying gas to Europe in quite large volumes because we have a large fraction of LNG import capacity and can push that gas into Europe through the interconnector. The interconnector has been running at 570% of its normal flows, which is a very intelligent thing for the UK to do from a national security perspective because we do not want the EU not to have energy in winter. That would rebound on us as well.

We have been burning gas in British power stations and pushing electricity to the continent to cover for the unexpected loss of quite a large fraction of France's nuclear fleet. So pragmatically, as what happened in the context of a relatively easy summer—I say that because demand was comparatively low this summer—it has worked reasonably well. European gas stores are pretty high, and this winter seems like it will be all right.

Next winter is what we should be concerned about. If I were in charge, I would be saying, "Let's make the TCA operate such that we can help to mitigate the risks of next winter". There is some stuff to do with technical co-operation and some stuff to do to continue to build trust on both sides about how both electricity and gas systems will operate in a system stress event.

Now that the UK is outside the internal energy market there is a theoretical risk. I think this does not crystallise in most scenarios, but it is a very low-risk high-impact scenario. If you have a system stress event across the continent and an operator decides they need to shut down somebody in order to balance the system, the UK is not in the internal energy market, so we get switched off and then there is a kind of recriminations risk that occurs. If it happens on electricity then we are talking about seconds; if it happens with gas, it is probably hours. You

can imagine an accidental mess up that would lead to a substantial systems security crisis.

You mitigate that by building technical relationships and political relationships such that, should that situation occur, people can pick up the phone and say, "Hey, we all know what's going on. This is a risky point. Let's work out how we do this in a sensible manner". Those are the kinds of relationships I would be seeking to build to secure Europe's energy security next winter.

Silke Goldberg: Can I just build on that? There is also the point that, following Brexit, the UK has fallen out of the EU solidarity mechanisms. What Dustin has described is an external factor where somebody decides to effectively switch the UK off from the EU system. It could also be that, due to an accident or an outage of some kind, a big UK generator or energy facility drops off.

At that point, were this to happen within the European Union, the UK could then call on its European neighbours to continue to supply it with electricity. That, post Brexit, within the framework of the TCA, is no longer the case. So improving this would be essential.

Dustin Benton: I might just add that there is slight good news here. The UK and the Netherlands signed an agreement last week that helped to address this. Signing more of those would be a useful way of moving forward pragmatically.

Q112 **Lord Lamont of Lerwick:** The UK has recently secured an MoU on North Sea energy co-operation. Would you give a view on the significance and importance of this? In what specific ways would it be beneficial for the UK and other North Sea countries to co-operate on the development of renewable energy? To what extent are the policy objectives of the UK and the North Sea countries on renewable energy aligned or not aligned?

Dustin Benton: It is really good news that the UK is now participating in the North Sea co-operation group. That flows directly from the political signal that was given through the European Political Community. That gives some political impetus to what is very obviously in the UK's national interest.

I will paint you a bit of a picture about what the future is likely to hold in terms of the UK's energy system, particularly the electricity system. We have done some work to quantify close to 30 different scenarios about how you get to zero-carbon power by 2035 in line with the Government's goals. All of them roughly triple the level of renewables, with a pretty heavy emphasis on offshore wind.

The 50-gigawatt target the Government have is in the right ball park but you might get 100 gigawatts of offshore wind or perhaps more. Europe as a whole has a view that it would like roughly 300 gigawatts of offshore wind. I give you these numbers just so you have a sense of how important a player the UK is in that potential future offshore wind market compared to Europe as a whole.

If you are going to do that, you really want to robustly interconnect through load centres, without necessarily thinking about what the political friction might be, with a view to understanding what efficient markets ideally want. An efficient market would like lots of interconnection points. It would like multiple markets to be able to sell into. It would like interconnectors arranged so that, if you are running a wind power plant and there is a constraint in the UK, you can sell to Norway, the Netherlands or other European countries in a rational manner.

In practice, that probably means 20 to 25 gigawatts of interconnection. Ideally you would want to design that in either hybrid interconnectors or multipurpose interconnectors. That is where they go into a wind farm, they go off to a nodal point and they blend the connection to the wind farm with the connection to another country. There are a couple of advantages; one is cost. I think it is the National Grid's modelling—they may have said this to you in the last session, so forgive me if I am repeating it—that the kind of design that blends interconnectors and offshore wind connection points would save roughly £3 billion for 10 gigawatts of wind. You can do the sums for the kind of levels of wind power that we are likely to build.

Another major benefit is that there are fewer coastal landing points. I have been speaking to MPs. For years I used to work for the Campaign to Protect Rural England, so I had lots of conversations about landscapes. There are few things that are less liked by people in rural England than massive new electricity transmission infrastructure in their backyard. The hybrid interconnector points usually roughly halve the number of connection points, so that is a real advantage.

You are also probably likely to get cheaper renewables because, as an investor, you are thinking you could sell to multiple markets. Continuing to engage in that is almost certainly a good thing for the UK and it happens to be a good thing for Europe too.

Lord Lamont of Lerwick: It is about scale, really.

Silke Goldberg: It is about scale, and it takes in a number of points. It goes to supply security, climate change, the amount of renewable energy that is in our energy mix collectively. It also goes towards affordability. If you talk about the famous energy trilemma, which is supply security, renewable energy, affordability and competitive markets—it is perhaps a quadrilemma—it makes a lot of sense to co-operate within the North Sea energy context because this will also allow for holistic grid design in the North Sea. This again talks to the deliverability of supply security and makes it a lot more certain and robust.

That would also require, speaking from a purely legal perspective, a robust regulatory framework and a degree of alignment with European Union network codes, for instance, in relation to MPI—multi-purpose interconnectors. What developers talk a lot about is the difference in availability rules on the European Union side. There is the famous 70% rule compared to the non-application of that rule in the UK.

Jonny Peters: We have heard about the technical side and the legal side, but I will focus on the politics to complete the picture. One crucial issue to focus on is that—while it is definitely very welcome that the UK now has access to the North Seas Energy Cooperation forum—it is important to note that it has observer status, not full participation, even though it is not an EU body. There is still more political work to be done in terms of sorting out the UK's full access to that.

The reason why that is important is that we know the European Commission has always been incredibly wary about the UK's participation in the North Seas Energy Cooperation forum. Ultimately, it can see where the forum starts to blur into EU rules and laws, and it has quite a defensive position on the UK's access to the forum. There is more political work to be done in terms of driving forward fuller participation of the UK in the forum.

I will conclude by saying that it is absolutely about scale. The volumes of offshore wind that are planned to be deployed in the North Sea are absolutely vast. There is no way that you can deploy offshore wind at scale—260 gigawatts are being talked about by the North Seas Energy Cooperation forum countries and a further nearly 100 gigawatts by the UK by 2050—without the planning capabilities of the North Seas Cooperation forum. To be super clear, the UK does not have access to the planning aspects of the forum at this moment.

Q113 **Lord Liddle:** You have probably answered quite a lot of the questions that I was going to ask. Are all problems you are talking about a result of the decoupling of the British energy market from the EU energy market in both gas and electricity as a result of Brexit? Is that what has caused the problem? Without Brexit, would this all have sorted itself out? That is not quite clear to me.

What has been the main implication of delays in concluding the supplementary agreement in the cross-border trading of electricity envisaged in the TCA? What has been the cause of that delay? What can we do now to break the deadlock? What progress has been made on building the new interconnectors that I think you have all mentioned the need for?

Silke Goldberg: I am happy to take this question from a legal perspective. To a very large degree these problems are solidly a result of Brexit, because the sort of regulatory problems that we are talking about did not exist prior to Brexit. This is because the UK was part of the internal energy market, and therefore there was complete legal and political alignment—with the UK very often taking the lead in Europe in order to bring about competitive market design and other regulatory initiatives.

The TCA only solves the issues that were created in part. That is partially the case because, for instance, on electricity trading the TCA functions on a no-deal basis. Had there not been a TCA, we would have the same

problems in regard to electricity trading and the efficiency issues, which are all due to the way that the TCA is drafted and has been implemented.

You asked about why there is delay in the multi-region loose volume coupling arrangement. My understanding is that there has been a fair amount of technical progress, but ultimately implementation is contingent on political questions. I said at the beginning that the energy questions have been politicised in the wake of Brexit and as a result of the way the TCA was set up. It is clear that there is a link between the Northern Ireland protocol issue and technical progress or further political progress in terms of the electricity trading arrangements.

Dustin Benton: I would add that one way in which Brexit has made things more difficult is that it means that if the UK has a temporary cooling of feet, it is more difficult to come back. About a decade ago, the UK decided not to participate in one of the precursors to the North Sea co-operation group, for its own domestic political reasons. I believe Charles Hendry was the Energy Minister at the time. Were we still in the internal energy market, we would not have had to negotiate access to the group that was talking about this; we could have just said, "Okay, domestic policy has changed. We'll get back into the group that is discussing this and we'll go ahead and do it." The fact that we have had to deploy a reasonable amount of diplomatic and Civil Service effort to get to a situation where we are having the technical conversations as an observer is an indication of the challenge we have created for ourselves in the way we have negotiated the post-Brexit arrangements.

Jonny Peters: I do not have loads to add. I think Silke's assessment was really good. Ultimately, we know what the flexible trading arrangements looked like before, because we were part of them, as part of the EU. Now it is about finding out how we can have those degrees of flexibility while being outside the EU. That is the purpose of these technical discussions. It is right to say that those discussions are currently blocked because of the impasse around the Northern Ireland Protocol Bill.

To register why this stuff is important, ultimately, we know that the default electricity arrangements under which the UK is currently trading with the EU are costing UK consumers in the realm of hundreds of millions of pounds per year on top of their energy bills. At a time of an energy-price crisis, when consumers are paying through the nose for their energy bills, this is an area of low-hanging fruit that we should address quickly, moving beyond the petty politics.

Lord Liddle: On the interconnectors, what are the barriers? Are discussions taking place on future interconnectors? What barriers stand in the way of agreement being reached?

Silke Goldberg: From a legal perspective, the European Union has a system called projects of common interest, which is for cross-border infrastructure. Once an interconnector between, say, two European Union member states has this status, that project gets administrative help and can apply for grants and so on. UK interconnectors can, under certain

circumstances, still be a PCI, but it is much harder to achieve that status. There are additional hurdles in the way. That is the first issue for interconnector developers.

It is much harder in the post-Brexit world for interconnector developers to operate on the basis of an exemption from certain rules, such as bundling, for instance, because it is unclear who in the European Union would grant the relevant exemption, pursuant to the TCA. This is particularly the case for interconnectors between the UK and France, because France allows only interconnectors that are operated by incumbent TSOs—in France, by RTE—to operate on the basis of such an exemption.

Ultimately, network co-development will affect interconnectors once they are operational, so by the time they have been developed and operated. The UK has less access to the sort of political and policy discussions pertaining to interconnectors. At the same time, the UK has, as I mentioned earlier, a political and operational interest in increased interconnection. Ofgem is aiming for 18 gigawatts of installed interconnector capacity. It is currently running the third application window for the cap and floor interconnector regulatory regime. It is vital that interconnector developers have certainty that, when they participate in that, they will also have support from the countries to which they are connecting. Being part of the internal energy market arrangements makes that much easier.

Lord Liddle: That is helpful.

Dustin Benton: I have been surprised that point-to-point interconnectors have not been particularly disrupted. That is a good thing. What is likely to be at greater risk is multipurpose interconnectors, which have more project risks and potentially more points of connectivity. If we want a highly economically efficient system that reduces the cost of capital, those other things are at risk. We can brute-force a zero-carbon system by designing interconnectors that are sub-optimal. That is always going to be possible.

Q114 Lord Hannay of Chiswick: Could we look now at policies for combating climate change, known usually as climate change mitigation? How closely aligned are the UK and EU policies in those fields currently? How likely is it that UK and EU policies will diverge in future? What would be the implications if greater divergence in the policy objectives was to emerge? How do you assess the current levels of co-operation on these issues between the EU and the UK?

As we heard in our previous evidence session, do you think a gap is opening up now that, following the beginning of COP 27, the UK is no longer the chair of COP 26, which brought about a lot of close co-operation between Alok Sharma and Frans Timmermans? How would that best be remedied, if indeed it needs to be?

Jonny Peters: To work through the different questions in order, at the highest level, both the UK and the EU are committed in law to achieving

net zero by 2050. Both sides agreed this independently around the time of the TCA being agreed. In fact, we have a shared agreement to achieve net zero by 2050 in the TCA, up top in the level playing field, or non-regression, chapter. In a sense, that is locked-in law in a few different areas, both in national systems and under the TCA.

Since then, ahead of COP 26, both the UK and the EU upgraded their 2030 emissions reduction targets. The UK upgraded its target to at least 68% and the EU upgraded its target to at least 55%. The interesting thing here is that the UK's figure of at least 68% would have been roughly the UK's effort share if it was still an EU member state. So we have seen this broad equivalence progressing, even in the Brexit context. There is still a sharing of notes between the two sides and a lot of mutual understanding on climate targets, coming from a mitigation standpoint.

Of course, targets are one thing and policies are another. We will see some differences between the UK and the EU when it comes to specific climate policies in different sectors. We know that the UK is historically much more favourable towards CCS than the EU, for instance. Since Brexit, we have also seen other European countries double down on hydrogen and put a lot more money behind that than the UK has. There are different levels of support for different technologies, but ultimately the goals are still the same. In other areas, we have actually had exactly the same goals and commitments, such as on the phase-out of petrol and diesel vehicles. Both the UK and the EU are aiming for 2030 in that area.

Lastly, on your question about COP 26, to be candid, COP 26 was incredibly useful for the UK from an EU co-operation standpoint, because we had a reason for the EU to talk to us. Now that the COP 26 presidency is over, there is less of a reason for the EU to talk to the UK, if I am being honest. The UK is a smaller country when you look at the global mitigation efforts. The UK is not the US, China or the EU, so the reasons to talk to us are fewer. So, as I said earlier, the UK will have to step up its political offer and make clear why the UK should still be a partner of choice for the EU in future on climate mitigation policy.

Silke Goldberg: You asked how far the policy aims were aligned. I would say that they are very much aligned. The TCA is one of the first global trade agreements to have climate change locked into the level playing field provisions, meaning both parties have committed to not go back on the commitments they have already given. Climate change has effectively been elevated to one of the core level playing field elements, which has not been done in any of the previous trade agreements.

Both parties are committed to this, which is not surprising. Even prior to Brexit, the UK was very much engaged in EU policy and was often one of the driving forces in terms of commitment and market solutions. Not least, it was the UK that first ran the EU ETS and the UK ETS from 2005 to 2007, so from that perspective there is a very large degree of overlap.

You also asked to what extent there might be future divergence. Divergence is possible, pursuant of course to the TCA and provided it

does not go against the level playing field provisions. That divergence might be seen in different legal instruments. For instance, the European Union is in the process of amending the gas directive to specifically provide for market order for hydrogen. That may not be reflected in the same way in the UK. The UK is currently choosing a hydrogen and CCUS cluster model, but that looks slightly different in the EU. However, there is no reason why that would not be compatible when it comes to trading arrangements or overall regulatory compatibility.

Dustin Benton: I cannot really disagree on the headlines. The UK and the EU are very closely aligned. I will say two things. First, on governance, we have the same goals, but we do not necessarily have the mechanisms to operationalise progress towards those goals in a collaborative or co-ordinated way, or such that where we decide to do different things, we are at least talking to each other. We could improve that by having information-sharing mechanisms or joint initiatives on, for example, academic programmes or R&D—issues where it is in both the UK and the EU's interests to co-operate. We could even have a joint ministerial group on climate and the environment so that there is regular political interaction that enables politicians to decide, or not, to push things forward. That regularity of interaction would be valuable at a governance level.

Substantively, there are two areas where I have seen the beginnings of divergence. The first is steel, where the UK has not gone down such a hydrogen-heavy route as we might have expected. In particular, one thing that worries me is that when the EU and the United States concluded their steel deal in advance of COP 26, they put climate as one of the shared goals, but when the UK managed to replicate that deal about a year later, that shared climate objective was missing. That opens up the opportunity for higher-carbon steel trading between the United States and the UK versus the United States and the EU.

The other area is agriculture. The UK has a pretty good set of goals for agriculture on both climate and nature. There are questions about operationalising them of course, but the goals are actually very good. The EU has not moved forward in any meaningful way on supporting farmers to decarbonise through the use of the common agricultural policy. It really is a pretty bad policy area and the UK is substantially ahead, at least on paper. That is one to watch for potential divergence.

Lord Hannay of Chiswick: Is the rather remarkable discrepancy between the level of gas storage in the UK and that of most continental European countries a factor of divergence too?

Dustin Benton: I would not say it was a factor of divergence. The UK has traditionally dealt with storage by increasing or decreasing its own North Sea production. Now we have chosen to make a kind of virtual storage, through liquified natural gas contracts. It is a different approach to the market. You are taking more price risk, because you are having to compete in real time with countries even as far away as Asia on your LNG imports. The UK has an awful lot of LNG import capacity, so as long as we

are willing to pay the price, we will certainly be able to supply ourselves with sufficient gas. It is a different story in Europe, just based on the physical infrastructure.

Silke Goldberg: I would add that that difference is driven not by regulatory patterns but by market attitudes and trading patterns, which are largely unaffected by Brexit in this context.

Q115 **Lord Tugendhat:** I too have a double-barrelled question, as it were. First, should the UK and the EU seek to link their emissions trading schemes? In your view, what would be the advantages or potential disadvantages of that? Secondly, what is the current volume of trading in the respective emissions trading schemes? How might that be expected to change in future? Thirdly, in your assessment, how easy—perhaps I should not say how easy, but how difficult—would it be to negotiate that with the EU?

Jonny Peters: It will be hard to follow the performance of Adam Berman from Energy UK in the previous session. He is a strong proponent of this, as am I. To be honest, I can name only upsides to linking the UK ETS with the EU ETS; I cannot name any downsides.

For the purposes of your inquiry, before we get to the benefits, let us be really clear that we are talking here about market linking. We are not talking about market integration. These are different things. When talking about a linked system, we are essentially talking about being able to exchange credits between the two systems. That is broadly it. It will come to the point where I think we will have a shared carbon price between the two. That is not a prerequisite, but it is probably where it will end up.

Again, that is probably broadly fine for the UK, because our carbon price is broadly equivalent to the EU's. I think the UK's is slightly higher in some respects, but in general, our levels of ambition are the same, because we are both transitioning to net zero by 2050, so we can expect our carbon prices to climb in line with each other towards that destination.

The other key point that might come up again here is the sovereignty argument. Again, if we are talking about ultimately sharing a carbon price, the UK is not losing any sovereignty here, because this is a market. Ultimately, the carbon price is dictated by the market, so the UK is not losing any sovereignty in terms of its policy decisions. As I will come on to, linked systems remain independent of each other, so you can still have a degree of policy difference between the two systems. Common monitoring and enforcement practices are highly desirable and will likely be subject to negotiation as a point of high alignment, but areas such as the use of revenues and the decline of the market cap, or even sectoral coverage, can be different between the systems. So again, the sovereignty argument does not really apply here.

The last thing to be super clear on here is that we have the precedent of the Swiss EU ETS link. The Swiss Government are also quite worried about this stuff, but their documents are explicitly clear that the Swiss Government did not have to adopt any EU law when completing their linking agreement with the EU, so this will likely be the same for the UK. I am happy to share the Swiss documents with the committee if that is useful. Essentially, that is what we are talking about here; that is what linking is, or is not, if there are preconceptions about what it might be.

On benefits, it is good for business, it is good for net zero and it is good for the UK Government. It is good for business because it offers greater market liquidity. To address your point about market sizes, we know that the EU ETS is more than 10 times as large as the UK ETS. It is significantly larger. UK business will have access to a much greater market, much greater market liquidity and the ability to hedge on a larger market, which is also quite important for business. Ultimately, those business benefits are also good for net zero, because they allow businesses to decarbonise in a cost-effective way.

On why it is good for the UK Government, linking the UK ETS to the EU ETS would be the only way for the UK to get an exemption from the EU carbon border adjustment mechanism, which we will probably come on to in a bit. There are huge regulatory issues around that mechanism that the UK will want to navigate. The only way to address this is by having a linked ETS, in the same way that Switzerland has an exemption from the EU CBAM because of its linking arrangement with the EU.

Lord Tugendhat: That is very clear. Thank you. Do others agree with that very clear exposition?

Silke Goldberg: I do. Linking emissions trading systems is always down to the design parameters. The UK ETS, which ran from 2005 to 2007, was the godfather or godmother to the EU ETS, if you like. The design parameters were exactly the same, down to the software used at the time. The software that is currently used for the EU ETS is the same as that of the UK ETS. It is not the same as in 2005, but it is a development of that. The design parameters are the same. I understand that there might be software divergence, but no design divergence otherwise. Design divergence usually goes to what type of allowance you have. It covers one metric tonne of CO₂. That is the case in both. The tradability and parameters are exactly the same. At a regulatory level, it would be really easy. There could be divergence on sector coverage.

There is an additional benefit. Post Brexit, UK businesses cannot participate in all EU ETS functions. In certain circumstances, it is possible for a UK business to participate as a third country via registering through a subsidiary, perhaps in Luxembourg or some other jurisdictions, but by and large, UK companies have had regulatory hurdles to participating in the EU ETS. Linkage would take those hurdles away and, again, give UK companies greater access to a more liquid certificates market.

Dustin Benton: The great advantage of emissions trading schemes is that they prevent backsliding on climate. Most of the decarbonisation that the UK, EU and other jurisdictions have experienced have not been driven by ETSs, so I would not expect a linking to be something that radically improved the pace of decarbonisation. Presumably it would be less bureaucratic and would have the advantage of liquidity. The major benefit as far as I can see is that it avoids a potentially rancorous conversation about our carbon border adjustment mechanism. It just makes it easier—which, for me, is the principal advantage.

Lord Tugendhat: That is all very clear.

The Chair: It is a good segue to Lord Trenchard.

Q116 **Viscount Trenchard:** I will go a bit further on carbon border adjustment mechanisms—can I call them CBAMs? Are they not very bureaucratic? Would you not consider to be a regulatory barrier? I do not think the United States is following them; maybe some states are on state basis. I would like to know what implications the proposal to introduce CBAMs has for the UK. How could the impacts of the EU CBAM on UK exporters to the EU be minimised? Should the UK seek to introduce its own CBAM? If so, should the UK co-operate with the EU on that? What would be the main advantages or disadvantages for either party? You will have heard in the previous session the implications of the EU CBAM being applied to some parts of the Northern Ireland sector but not to others, because there are two ETSs applied in Northern Ireland. Can you also comment on that?

Silke Goldberg: I shall take the last bit of the question first. Yes, there are effectively two carbon prices in Northern Ireland. One is the EU ETS, which applies to the electricity generating sector because, for the purposes of electricity, Ireland is part of a single Irish market—the SEM. Therefore because Northern Ireland is part of the all-Ireland electricity market, the EU ETS applies to Northern Irish electricity generation stations. The UK ETS applies to those Northern Irish sectors that are also part of the UK ETS, just as in Great Britain, except of course for the electricity generation stations.

To that extent, there is a divergence between those two prices. We have two carbon prices that apply in Northern Ireland by virtue of regulatory operation. The way to improve that might be through linkage, as we have discussed, because linkage will most likely result in a near-identical carbon price across the linked jurisdictions.

It will also help to keep CBAM out of the door, effectively, because the best guarantee for the UK not being affected by the EU CBAM is to align the policies in that regard, either indirectly by shadowing it or by agreeing with the European Union that, because the EU and UK ETS systems are linked, therefore, by definition, the CBAM would not apply. The bureaucracy that might otherwise be caused—of whether the UK price is above or below it and what sort of papers and tax arrangements would need to be made on UK imports into the EU, should the UK ETS

price be lower—would effectively fall away. Aligning the two ETSs and the CBAM by operation of an arrangement would therefore contribute to easier market relations.

Jonny Peters: To explain at a high level what a CBAM is—to use that acronym that we all love—it essentially externalises elements of the EU ETS. It basically asks for competitors who are exporting into the EU market to pay an equivalent carbon price to what those industries in the EU have had to pay. That becomes increasingly important over time because the carbon price is due to go up in the UK as well as in the EU, so that kind of competitive disadvantage becomes even more of a thing over time. In some respects, there are quite clear reasons why the EU is embarking on a CBAM. Those same reasons would apply to the UK, and I think it is incredibly likely that the UK will come to the same conclusions as the EU because, ultimately, our domestic carbon pricing regime is pretty much the same as the EU's.

The UK and the EU are in many respects a lot further ahead than other countries internationally in this area, so we can expect certainly the EU and possibly the UK to come first in terms of carbon border adjustments. We might see something from Canada, but its ETS systems are devolved to the state level, so it is quite hard for it to have a federal CBAM equivalent. That is the kind of headache it is going through at the moment. Ultimately, this is important because, as I said before, the EU CBAM essentially externalises elements of the ETS. The UK already has its own ETS, so the carbon prices are broadly the same and the UK therefore will not have to pay the direct tariff.

However, there are really serious non-tariff barrier issues when it comes to the UK's exposure to the EU CBAM. There are huge compliance costs for business: monitoring, reporting, verifying emissions, communicating with the new CBAM authority—this all takes time and reduces flexibility. As we heard on electricity trading arrangements, flexibility is key to keeping costs down so, again, this has an impact on consumers for the very same reasons as why this has a massive impact on Northern Ireland as well. We have already talked about the intricacies of the all-Ireland single electricity market and the differences there between the UK ETS for that and the UK ETS for the rest of industry in Northern Ireland. Ultimately, the way to simplify all this is to link the UK ETS with the EU ETS, which we have discussed before, because that gets the exemption from the EU CBAM.

Viscount Trenchard: Dustin, could you answer from the point of view of whether there is a threat, if the UK and EU align completely in this regard, that we could jointly become global outliers because it is most unlikely, in the short term, that the United States, China and even Japan are going to follow with this type of intervention in markets.

Dustin Benton: The United States has some domestic problems which mean that it is unlikely to create a federal CBAM; it would have to create state-based arrangements. The US is a complex political beast and I therefore think that your assessment is right, but that does not

necessarily mean that a CBAM would create problems. The reason why the EU and United States steel deal focused on climate change and co-operation was precisely to avoid the US steel industry being caught by a future EU CBAM.

Given the fact that the EU, which is still a relatively big beast, is doing that, were the UK to be able to pursue a parallel negotiating track, you might find that US-UK relationships were better as a result. In a way, you have to think about the regulatory barriers, of which a big one is that the UK still trades a lot with the EU. If you look at the countries that are most exposed to an EU CBAM—this is from 2021 data; I am quoting it from memory but I can send you details if you want—Russia was the most exposed, the UK was the second most exposed and Turkey the third most exposed. The reality is that a CBAM will affect the United Kingdom in a very significant way, so we have a practical question: do we want the regulatory red tape associated with that for most of our exporters, or do we not?

I should say that the UK is very unlikely to pay CBAM fees. Because our carbon price is higher, we are not going to be transferring money to the EU; we will just be filling out lots of declaration forms and red tape, basically. That is a bit of a nonsense, really; why create red tape for the sake of red tape? That is my take.

You made a point about reducing the UK's freedom to trade with other countries and whether it would be an impediment. The answer is now very different post Ukraine. If we look at the way that global trade is now moving, it is now moving much more towards a quasi Cold War-style trading bloc scenario. You can see that Russia is right out, the United States and the EU are sticking quite closely together, and there is a third pole in the form of China. So the question for the UK is whether we mind aligning with what will turn into a US-UK-EU kind of bloc through carbon border adjustment mechanisms, and therefore for trade, or whether we want to stay out of that bloc such that we can trade more with a country like Russia or China.

For me, the fairly obvious answer is that we want to stick with the club that has helped us for the last century—the US, the other countries in Europe and us. But there is a geopolitical consequence to making that choice.

Finally, there are real-world consequences of this. The companies that would be doing most of the legwork on a CBAM, were we not to link our ETS and therefore be subject to it, would be steel companies, and I will tell you right now that the British steel industry needs to decarbonise quite quickly. It basically has this decade before it faces a choice of very large investments in blast furnace relining, which bluntly I do not think the industry will make, or it switches to a much lower carbon form of production. Throwing an additional regulatory red-tape question at this industry does not feel like the most strategic thing to do. What you want is a robust zero-carbon British steel industry.

The Chair: Thank you very much. You have promised two things, I am afraid. Jonny Peters, you promised the Swiss ETS documents, and I would be very grateful if you sent those to our committee staff. Dustin Benton, you just kindly promised the 2021 CBAM data, and I would be grateful if you sent that. Silke Goldberg somehow did not promise anything.

Silke Goldberg: I can send you the book.

The Chair: Thank you. The three of you have been wonderful witnesses, and thank you very much. You have spoken with great clarity and a lot of authority on some very difficult areas, which is hugely helpful for us. I thank you on behalf of all my colleagues and declare the session over.