



European Affairs Committee

Corrected oral evidence: The future UK-EU relationship

Tuesday 22 November 2022

4 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; The Viscount Trenchard; Lord Tugendhat; Lord Wood of Anfield.

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Questions 97 - 109

Witnesses

I: Adam Berman, Deputy Director, Energy UK; Mark Copley, CEO, European Federation of Energy Traders; Matt Hinde, Head of EU Affairs, National Grid.

Examination of witnesses

Adam Berman, Mark Copley and Matt Hinde.

Q97 **The Chair:** Good afternoon to everybody watching, and welcome to the hybrid House of Lords and the European Affairs Committee. We are in the middle of our inquiry into the future of UK-EU relations, and this is a public evidence session. This afternoon we are concentrating on energy, the environment and climate change, which is a key area of the future relationship and will form one of the chapters of our future report.

We are very lucky in having a strong panel to help us in our evidence session today. I ask all of you, when you speak for the first time, to give a little background about yourself. We know who you are, but those watching will not. A couple of sentences explaining exactly what you do in your organisations would be very helpful. We start with Matt Hinde, who is with the National Grid. In the centre we have Adam Berman, who works for Energy UK. On my right, we have Mark Copley, who is with the European Federation of Energy Traders.

Welcome to you all. As it is a public evidence session, a transcript will be prepared and sent to you. If you could make sure that it is correct, we would be very grateful. We will use the transcript to help us create the report and will quote from it, so it is important that it is correct. We have only one hour this afternoon, so I appeal to both questioners and answerers that your questions and answers are crisp and to the point.

I will ask the first high-level question. How would you characterise the current state of the UK-EU relationship in the areas of energy, environment and climate change? What are the primary factors affecting that relationship in those areas? Has the Northern Ireland protocol impasse adversely affected things?

Matt Hinde: Thank you, Lord Kinnoull. I am head of European affairs for National Grid, and the head of National Grid's Brussels office. I am also a board member of the British Chamber of Commerce in the EU.

It would be fair to call the overall state of the relationship on energy between the UK and the EU improved since 24 February. There have clearly been moves towards greater co-operation on both gas and electricity since the Russian invasion of Ukraine.

There are a couple of points to bring up. The use of the UK's gas transmission system and the three LNG terminals in the UK has been pretty key to refilling European gas storage. Up to the beginning of November, we flowed 17 billion cubic metres of gas into the European system. Equally, since February the electricity interconnectors have been flowing pretty consistently from GB to the EU. That demonstrates the importance of the UK to the European energy system.

In the medium term, there is a really strong driver, which I think has been recognised by both sides, over co-operation on renewable

deployment in the North Sea, which is potentially a really important part of reducing reliance on Russian gas.

Finally, the energy title of the trade and co-operation agreement provides a good basis for that relationship going forward. The TCA gives the basis to develop a strong relationship, and its implementation is key going forward.

The Chair: Thank you very much. We will go into greater detail in a number of those areas through the course of this hour. Adam Berman?

Adam Berman: Thank you. As a brief introduction, I am deputy director at Energy UK, which is the industry body for the energy sector in the UK.

In terms of both energy and climate change, the EU is incredibly aligned with the UK, and vice versa. There are very similar targets. On the energy side there are slight differences in the proportion of different technologies—things such as offshore wind versus onshore wind—but ultimately, the end goal is the same: a rapid increase in the provision of domestic, low-carbon energy as a way to ensure that we do not end up in this situation again—a crisis caused by high and volatile international gas prices.

In terms of climate change policy, again, both jurisdictions are in very similar places. They are legally committed to net zero by 2050, and they have very similar policy structures in place, particularly in relation to their respective emissions trading systems.

On one hand, we have this convergence around ambition and goals, and things such as energy flows between the UK and the EU, which Matt mentioned. Brexit has not stopped that happening; energy still flows. Indeed, the EU has reason to be grateful for the net flows of electricity and gas from GB to the EU. On the other hand, almost two years on from our formal departure from the EU, we have very little to show in terms of more enhanced co-operation, especially given the exceptionally high levels of alignment on ambition.

On the question on the protocol: yes, it is entirely clear that the EU is unwilling to move forward substantively on any major items that go beyond what is specifically a legal obligation within the TCA until there is some resolution on the question of the protocol.

I agree with Matt that the issue of Ukraine has brought both sides together and it is great to see progress, but there remain very significant questions about the ways in which the EU and the UK work together to address not only the short-term energy security issues that are our focus at the moment but the longer-term issues around the energy transition and net zero.

The Chair: We will come to precisely those points in a moment. Mark Copley?

Mark Copley: Thank you very much indeed. It is a pleasure to be here. I am the CEO of the European Federation of Energy Traders. That means that I represent 130 companies from across geographic Europe: the UK, Ukraine and the Balkans. My members trade electricity, gas and carbon across the continent, so our interest lies in simple, stable, aligned rules which allow gas and power to move in response to price signals.

The question is about the overall state of the relationship. I would say that it is slightly concerning, with one or two more recent causes for optimism.

The gentlemen to my right are correct that there are shared goals. Ukraine has brought us together but, fundamentally, the things that were agreed in the trade and co-operation agreement have not moved forward as quickly as any of us would have liked. We are trading gas more or less as we did before, which is extremely positive. Our electricity trading is less efficient, and we have not made progress in improving its efficiency. There are signs that co-operation is improving and conversations are starting to happen, but there needs to be more behind that to turn those conversations into tangible action.

I know that we will talk about things such as North Sea co-operation, which is a good start, but, frankly, we need to go further and faster in order to realise the benefits in energy that trading and alignment with our European partners can deliver.

The Chair: Thank you very much. That sets the scene very well.

Q98 **Lord Wood of Anfield:** Hello there. To pick up on some of the answers we just heard about co-operation, I will ask about the co-operation between the UK and the EU in the light of the Russian-Ukraine crisis. What has the co-operation on Russia and Ukraine—or the response to the crisis—revealed about the areas that work well in EU-UK co-operation? What does it reveal about areas that do not work well?

In the past few weeks, we have been particularly interested in technical-level co-operation. How much ongoing co-operation is working effectively, and is it worrying, in that context, that the Specialised Committee on Energy set up by the TCA has met only twice during 2022?

Mark Copley: Thank you. It is a really good question. To start at the end of your question, yes, it is worrying that the Specialised Committee on Energy has met only a couple of times. Given where we are, you would expect there to be a certain urgency to improving the way we are trading electricity with continental partners, and for it to be a bit more positive.

The co-operation at technical level between the transmission system operators has improved significantly. As I understand it, the electricity system operator and the gas system operator are talking much more closely with their continental partners about the security of supply and resilience, which on one hand is what you would expect with the shared challenge, but it is also more than was happening at the start of the post-TCA signing period.

My final point is that it was reported earlier this month that EU officials have been given a blanket ban on meeting UK officials on topics which are not related to the war in Ukraine or are not legally mandated. I would not want to pretend there is a very strong overall level of debate going on here, and that concerns me for the medium term.

Adam Berman: I am happy to jump in at this point. I absolutely agree. There is technical-level discussion, which is great. More should be happening within the TCA specialised committees but, ultimately, we have ended up with quite a lot of bilateral engagement with relevant member states, particularly in northern Europe—France, the Netherlands and Germany—which is one way to go about those discussions.

In terms of what has and has not worked well, if we look forward from here there are questions to be asked about how the UK and the EU will work together if we face a supply crunch, be it this year or, perhaps more likely, next winter, given that we are out of the EU solidarity mechanism—the solidarity rules which essentially oblige member states to help one another if there is a supply crunch. There is less clarity on exactly what happens in what order on both sides.

We want to avoid the politicisation of energy. We need to ensure that we have really clear dialogue and rules in place, particularly at the technical level, so that someone can pick up the phone for an issue that might be only hours in the making and have only hours until there is a crunch point and not have to have the meeting signed off on the EU side by a very senior official. These types of things may well be rare eventualities, but none the less we need to consider them.

To go beyond that, and back to the protocol, it has been frustrating to see that, short of a resolution to discussions around the protocol, there is relatively little chance for enhanced co-operation. While I understand the Commission's point here, it is a little frustrating, given that we are both in the midst of an energy crisis, we share a common physical energy infrastructure and, if ever there was a moment to work more closely together outside the confines of some of the nuts and bolts of the TCA, it is now. We know that whenever the UK tries to do that, the Commission comes back to the protocol and the TCA. Those are the two overriding issues, and everything else comes later.

Matt Hinde: I agree with what has been said. I will quickly make a couple of points. There is some technical discussion happening now and last week the electricity system operator was invited to the electricity co-ordination group for the first time since Brexit. It was quite a short intervention, but the fact that it was invited is quite a positive signal. The gas system operator is doing the same thing this week. Those co-ordination groups are the bodies to manage emergency situations, so it is positive that UK representatives will be in them.

I take the point that has been made that there is a lot of good work bilaterally. Of course, it is an internal energy market and at EU level, so bilateral co-operation can only go so far on this and we need the EU level

to work. One thing that have been blocked by the protocol, for example, is the development of new working arrangements between the ESO and the GSO and the ENTSO-E and ENTSG. That is explicitly being blocked by the protocol. Things such as that need to be freed up, too.

In terms of the number of Specialised Energy Committee meetings, there is a point here that, while those mechanisms are very useful to perhaps move things forward to the political level, I do not think that they were ever envisaged to be the primary driver of discussion; the technical conversations—the day-to-day and week-by-week discussions—between TSOs are probably the most important thing in this area.

Q99 Lord Hannay of Chiswick: To follow up on that, I imagine that none of you three would disagree that Europe in the widest sense is going through the most important moment in the development of energy policy and energy security since 1974. If the TCA's energy committee has managed to meet only twice in this period, either there is something wrong with it or it is not where the action is. Which is it?

Mark Copley: I would agree with that statement. My view is closer to your second point, in that the scale of this crisis has really put pressure on the EU, as an overall body, and each of the member states to react quickly. Their focus has been on working as a union and, in a lot of cases, reacting nationally through sanctions and, more recently, through co-ordinated energy policy decisions.

That has simply meant that the TCA has fallen down the priority list quite substantially. From my perspective, that is a missed opportunity for both of us, but certainly, I do not see a champion for moving this forward, perhaps because the benefits are medium term, and a lot of people are seeing the immediate crisis as short term.

Adam Berman: It is also worth saying that, when it comes to energy specifically, the EU and the Commission understand that there are things that the UK would like in terms of an enhanced relationship and more co-operation.

There is a profound lack of trust between both sides, and it has been made very clear that the Commission is willing to look at energy as an extension of political roadblocks in other areas of the TCA and, indeed, the protocol. That is probably the principal reason why, despite the energy crisis we are in, we have not moved further and faster on that co-operation.

Matt Hinde: I might be slightly more optimistic than that. If you look at the scope of UK-EU relations, I am not sure there are many other areas that have made more progress than energy. That may be limited, but the North Sea energy co-operation MoU is quite an important move.

The Chair: Indeed, it is the specialised committee which has had the most meetings.

Q100 Lord Tugendhat: I will follow on from that. In your view, what are the

main short- and medium-term risks that the UK currently faces as a result of the energy situation in Europe? Do you think that appropriate arrangements are in place to ensure that energy supplies can continue in the face of a critical supply shortage?

Adam Berman: We very much look to the National Grid, the system operator and to BEIS for guidance on this and for their views on security of supply. The assessment generally seems to be that the rest of this winter is perhaps slightly less severe than we thought it would be a few months ago.

However, for the next winter there are questions to be asked about preparedness in the EU and in the UK. That is essentially because storages of gas have been filled by Russian gas in Europe over the last few months and that will not be the case for next winter unless there is some sort of profound geopolitical shift.

There will be more competition for shipments of liquid natural gas. Over the last few months, as Matt said earlier, we have been acting as a land bridge to the EU. Shipments of LNG have been coming into UK terminals. It has been regasified into the network then piped out to the EU. That is really positive, but there is a limited supply of LNG in the world. It is not like oil tankers where there are many of them floating around. There are very specific physical requirements for LNG tankers and the onshore facilities at either side to be able to ensure shipment. There is an open question as to how the UK and the EU are going to work together on LNG.

At the moment, the EU has put forward a kind of joint purchasing programme and is at the early stages of thinking about getting companies and countries together on a long-term gas purchasing programme. We have one in BEIS at the moment, which there has not been a great deal of transparency about. It is also looking at long-term gas contracts but very much separately. There is a question to be asked there.

However BEIS wants to look at this, there is a need to ensure that there is more communication between the UK and EU on this issue because we are interlinked. The worry in terms of the politics is that we are not simply any third country; we are the third country on which Ireland relies almost exclusively for its gas supplies. If supplies of gas were to become politicised for any reason, it would get very, very messy. That is why we need more transparency and dialogue between the two sides.

Lord Tugendhat: Do our other witnesses agree?

Mark Copley: I would broadly concur with that. I will try to be optimistic for a moment. The fact that Britain has invested in three large LNG terminals puts us in a relatively better place than some of our neighbours, but I think the short-term risk is cost to customers. Customers have obviously suffered a huge amount through the current crisis. Adam is right that we are fundamentally competing globally for liquified natural gas. That is likely to mean relatively higher prices than

have been seen historically, which will lead to some difficult decisions about which customers need support.

You also asked about the medium term. I hope I am wrong in this, but it is really important in the medium term that there is not a push-back against decarbonisation ambitions because that is the way out of this crisis in the long term—or, indeed, in the medium term. There is always the danger that you see people equating higher prices with renewables, which is incorrect. We need to make sure that we are continuing to remove planning barriers and deploy large amounts of renewable energy and—I know Matt will come on to this—make sure we are building things in the North Sea where the wind resource is abundant.

This is a crisis for both the UK and the EU. Co-operation would help both of us. I think Adam is correct that it is probably more about cost than security of supply, but you never want to be complacent about that. We need to accelerate renewable build in the medium term.

Matt Hinde: I do not have much to add. I agree with what has been said. Co-operation and flow of information is absolutely essential between the UK and the EU on this. Avoiding anything surprising is one of the key things.

The other point I would make on gas supplies is that Mark is entirely right; we are in a good position in having three LNG terminals. Historically, however, in cold winters we have needed to pull in from the European system and it is worth bearing that in mind as well.

Q101 **Lord Tugendhat:** Looking at the other side of the coin, if there really was a shortage, how do you see events unfolding? What would the course of events be?

Mark Copley: In a former life I was responsible for security of supply for the regulator so I should probably go first. The good news is that each of our interconnectors have emergency assistance contracts underpinning them. That means that there are agreements between the transmission system operators on how they would work in this situation. In the UK there is an emergency handbook which essentially gives you the steps policymakers will take to manage the system if you get to a point where the market no longer functions. That involves the electricity and gas system operator going through a series of very well prepared and planned steps to keep the integrity of the system.

Interestingly, my job is to work in all the EU countries and around one-third of them have made preparations like this. The fact that these things exist here is a relative plus. It is a system that has been tested, but one that I never want to see used in anger.

Matt Hinde: To add to that, one thing that has been worrying people in Brussels, for example, is an emergency situation that leads to a cessation of cross-border trading. That has been mentioned; the Norwegians, for example, a couple of months ago said there may be a need to curtail electricity exports over low levels in hydropower reservoirs. There was

quite an immediate reaction to that of “Please, don’t do this”, because cross-border trading is one of the best tools we have to deal with security of supply.

From a European perspective, I think there will be quite a lot of pressure to make sure that the market continues working and cross-border trading keeps functioning for as long as possible.

The Chair: Thank you very much.

Q102 **Lord Liddle:** We have heard quite a bit about our re-engagement with North Sea energy co-operation. Can the witnesses tell us what the practical significance of this memorandum of understanding is likely to be? What specific ways is it going to be beneficial to the UK and other North Sea countries? We need to understand why co-operation is so beneficial and important. If there is co-operation, to what extent are the objectives on both sides of the North Sea aligned? I would have thought Mark would like to start with that.

Mark Copley: If you do not mind, I will give it to Matthew, who I know gets a bit passionate about this topic.

Matt Hinde: Thank you, Lord Liddle. North Sea energy co-operation is very important because you need to take a step back and look at the overall targets for the North Sea from the UK and the EU. In the UK, for 2030 we have a 50-gigawatt offshore wind target. The equivalent target for the EU sectors of the North Sea is 76 gigawatts for 2030. I think that goes up to 189 gigawatts in 2040 and 260 gigawatts in 2050. The equivalent numbers for the UK are around 100 gigawatts. We are talking about an enormous amount of infrastructure in a relatively small area.

To do that in a way that uses the space effectively, that builds infrastructure in the right places and that reduces the amount of onshore infrastructure, we need to work with our partners. NSEC gives us a platform for those political and regulatory discussions that has not existed post Brexit.

We have a very close relationship with our transmission system operator colleagues. For example, the interconnectors we have with Denmark, Norway, the Netherlands, Belgium and France have all been built on the basis of commercial projects. All those countries are now looking at the development of multipurpose or hybrid interconnectors, energy islands and, in the long term, a meshed offshore grid. If you were to develop that kind of system in the North Sea without UK involvement, you would effectively have a large map of infrastructure with a big hole in the middle and, within that whole, there is 50 gigawatts of offshore wind. It needs to be connected.

As I say, in terms of maritime spatial planning—considering where to put the infrastructure—you are thinking of where you minimise the amount of onshore infrastructure needed for it to go back into the onshore energy grids. It is also about developing compatible regulation. If we are building cross-border infrastructure, we need to be able to work with our partners

in a mutually recognisable way on things such as revenue sharing. Without the mechanism of NSEC, we do not really have a way into those policy and regulatory discussions. To give a hard example of this, NSEC has mandated ENTSO-E to develop a strategic offshore network development plan in 2023. Clearly, the UK needs to be part of that planning exercise.

Lord Liddle: I did not understand the point about revenue sharing. Can you explain that to us?

Matt Hinde: Sure. This is relevant as we build more complex infrastructure in the North Sea, depending on how you build it. For example, at the moment, we are focused on multipurpose interconnectors—one or more wind farms in the middle of the sea with two interconnectors coming off the sides. The EU is developing a regulatory process called offshore bidding zones to effectively set the regulatory terms for that and how revenue will be shared between generators and by the transmission companies. We need to understand how we will plug into offshore bidding zones, for example. As an aside, those are one of the reasons we need to find a route towards implicit electricity trading as well, due to the complexity of this infrastructure.

Lord Liddle: Do others have anything to add to that?

Mark Copley: I will be very brief. I cannot see a way for the EU and UK to reach their net-zero decarbonisation targets at a reasonable cost without developing the North Sea. If you want to develop the North Sea, you need co-ordinated planning, operation and trading, and you need to work together. It is the only way you can make that happen. All the alternatives appear to me less likely and more costly. I said Matt was passionate about it; I am kind of passionate about it too. I think it is a no-brainer for getting us to our decarbonisation targets.

Q103 **Lord Liddle:** What are the points of potential argument and disagreement in this? Is it all hunky-dory co-operation? Where would the tensions be?

Mark Copley: The way I would characterise it, perhaps slightly bluntly, is that if you have a wind farm in the middle of the sea connected to two countries, at the moment you have two different sets of rules governing how that electricity will be sold. Effectively, you are driving on two sides of the road, depending on which direction you are sending your energy.

That is an extremely complicated business case. It is quite hard to go to a bank and say, "I would like to finance this wind farm. If I sell the power to Germany, it is going to get me this amount of revenue and if I sell it to Britain, I will get this amount, but I am not sure how much of each I am going to be able to do." We have two sets of rules which do not dovetail together. Unless we sort those out, the cost of the projects will go up, the trading opportunities will become less efficient and overall, frankly, customers will pay more. Is that fair, Matt?

Matt Hinde: It is. I will add one other thing on this. We made a calculation on the security of supply aspect of the North Sea, which was fairly rough, but we think it stands up. We think that for every 1 gigawatt of offshore wind you put into the North Sea, it offsets 0.6 billion cubic metres of natural gas. That works as a calculation only if you are applying it to power generation, but it is indicative that if you put 100-odd gigawatts of offshore wind in the North Sea, you offset the need for an enormous amount of external gas.

Lord Liddle: That is very helpful. Does anyone else want to add anything?

Adam Berman: I would just say briefly that you can achieve net zero in a costly and disruptive way. That primarily involves treating net zero as exclusively a national-level issue. If you want to achieve net zero in a co-operative and low-cost way, you have to work with others. The potential of the North Sea is really substantial. It is not just about generation; it is about green hydrogen and carbon capture and storage—a whole set of things. It is about not just producing the energy but what you do with it when no one wants it. You have to store it somewhere. It is about what you do with the carbon dioxide which is then piped out to the North Sea and stored underground there. We need co-operation to be able to do that and to build compelling investment cases which provide the lowest cost to consumers.

Lord Liddle: Thanks very much. That was very clear.

Q104 **Lord Wood of Anfield:** I would like to turn to the electricity and gas markets. We are interested in the impact of the decoupling of the British energy market from the EU energy market on the state of electricity and gas interconnection between the UK and the EU. What is your assessment of the state of that interconnection? In particular, as we all know, the TCA envisaged a supplementary agreement on the cross-border trading of electricity, which seems to have been delayed, to put it mildly. What is going on? Can you explain why there is such a delay? What are the consequences of the continuing delays in securing that agreement for the electricity and gas markets?

Matt Hinde: On interconnection, it is still working, which is a good thing. At the end of next year, when the new interconnector with Denmark opens, there will be 7.8 gigawatts of electricity interconnection. There are two gas interconnectors with the EU, plus one to the Republic of Ireland, all of which are functioning.

What has happened is that, in the short term, the efficiency of the electricity trading system has declined, as was inevitable in leaving the market coupling process. What does that mean? It means greater costs for UK and EU consumers. We do not have a particularly accurate assessment of what those costs are. They are probably in the hundreds of millions. That is the immediate impact.

The problem with the lack of the supplementary agreement is in some ways more about the medium term, with the development of new infrastructure such as multipurpose interconnectors. It is quite difficult to find anyone who thinks you can run that level of complexity without an algorithm-driven trading system which balances generation and capacity. We think that needs to happen for the next stage of interconnection and that move towards a mesh grid. So yes, it is functioning, but at a lower level of efficiency.

Adam Berman: From the industry perspective, we want both parties to make some real progress on developing the new trading arrangements, given the need for implicit trading. We obviously reverted to explicit trading when we left the EU, but implicit trading is vital for an integrated electricity grid.

My main point here is not particularly a technical one. Electricity trading arrangements are one of countless areas that in the post-Brexit trading relationship have resulted in incremental barriers to the way that businesses can trade between the EU and the UK. They may be small regulatory barriers, but over time they add up. At a time of a cost of living crisis—from April, consumers are going to face another increase of probably 40% in energy bills from an already staggeringly high base—it seems astonishing that we are not moving faster on trading arrangements that will lower energy bills by hundreds of millions of pounds, if we are able to essentially take those savings through to consumers.

To take it away from the technicality for a minute, there is just a key question when you add all these different regulatory barriers together about the amount of money, particularly on energy bills at the moment, that we are effectively spending to be able to finance a regulatory divergence that at the moment is fundamentally not happening, at least in this area.

Mark Copley: I will be very brief. I apologise, as this is a slightly geeky point. I just want to make it very clear that there are things the UK could do to improve these arrangements. When we left the EU, we reverted to a situation where—this is the geeky bit—we have two prices for day ahead power being calculated by two different exchanges. They used to be merged into one. That creates an unnecessary level of complexity which we could fix relatively easily if we wanted to. Similarly, we have some trading arrangements on some of our interconnectors which do not, for example, allow trading in intraday and forward timeframes.

What these guys have said about the need to develop these more quickly and the efficiency lost to customers is right, but we should also make sure that the low-hanging fruit we can fix ourselves is fixed as soon as possible.

Lord Wood of Anfield: To briefly follow up on that—maybe I missed it—did any of you cover the question of why this supplementary agreement is not happening? Is there a single reason, is it just caught up in the

protocol or is it the complexity of it? What is going on?

Matt Hinde: It is caught up in the protocol. There was some work done immediately after the signature of the TCA under a timeframe for the supplementary agreement. Unfortunately, it has been blocked since then.

Lord Wood of Anfield: Thank you very much.

Q105 **Viscount Trenchard:** I would like to talk about emissions trading schemes. As you know, at the end of the transition period, the UK set up its own independent emissions trading scheme, which started operation in May 2021. I think that since it started the carbon price has been identical on both exchanges, but that will not necessarily be the case going forward.

Should the UK and the EU seek to link their emissions trading schemes? What would be the main advantages or disadvantages of doing that? Could you also comment on the current volumes of trading in each of these two trading schemes and how you expect those volumes might change going forward? Lastly, could you say how easy you think it would be to negotiate such a linkage with the EU?

Adam Berman: I will kick this off. This has been a pet advocacy project of mine, certainly for the last two years if not longer. The simple answer is "Yes." It is remarkable that I could not name more than half a dozen people from industry across all major industrial sectors in the UK who believe any different. There is a remarkable unanimity on both the UK and EU side behind the need for linkage.

Ultimately, it comes down to net zero for me. If you are committed to achieving net zero, as we are, the ability to link emissions trading systems to connect renewables opportunities and carbon storage is going to be strategically important. Linkage is one of those remarkable international trading mechanisms which benefits both parties. It allows the UK to reach net zero faster and more cost effectively.

The advantages of linkage are clear in terms of liquidity. On your point about volumes traded, at the moment, the UK has a very illiquid market. That essentially means that there are not very many people interested in trading in it. You would be able to prop up that market by linking with the EU. I think there would also be advantages in price stability and in making sure we do not have any volatility, for example, market shocks, price discovery and the ability to attract abatement from across Europe rather than just the UK.

When it comes to linkage between the UK and the EU, frankly, there are no two jurisdictions that should be easier to link than these. They are already almost identical. The reason that the UK ETS was created to be almost identical was precisely because officials privately felt that they wanted to keep linkage on the table and that it was probably the right way forward for the UK.

In terms of how long linkage might take and how it might work, there is already a bit of best practice. The EU is linked to Switzerland's emission trading system. That agreement took a long time; it took the best part of a decade. However, it took that long because it was the first linkage agreement between the EU and another jurisdiction. There is now a framework for it. There were a lot of non-market reasons, like how we are talking about the TCA. There were other items on the broader EU-Swiss trading agenda which were used to slightly slow down that process.

To be frank, I am confident that we could have this done in relatively short order. There will be a negotiation and there will be give and take on both sides; there are things to be settled. However, it would work well for both parties. For the Commission it would represent the definition of a level playing field, which the EU loves. For the UK it would represent an international trade mechanism which retains a full set of revenues and the vast majority of the rules of the system, which would be beneficial to both the UK's economy and sovereignty as well.

At the moment, to make a small correction, the UK and EU ETS prices are not the same. The UK is trading at a premium. British companies exporting to the EU have a competitive disadvantage and are facing a higher carbon price. Stabilising that and levelling it would mean that UK companies can compete evenly and openly.

Viscount Trenchard: That is very interesting. Has the UK been trading at a higher carbon price since inception of the market?

Adam Berman: Yes, from day one.

Viscount Trenchard: Matt, would you like to go next?

Matt Hinde: Sure. I do not have much to add to that apart from that, as the National Grid, we support the linkage of these system for the same reasons: price discovery, liquidity and the opportunities for abatement. We think it makes sense.

There is another specific reason we think linkage is important, which is the impact of carbon border adjustment mechanism—particularly when it is applied to electricity trading which could have a negative impact on GB to EU trading.

Viscount Trenchard: Thank you. Mark, do you have anything to add?

Mark Copley: Adam did an admirable job. Linking makes an awful lot of sense. I represent traders of energy and carbon. We like broad, liquid markets. Earlier this year we raised concerns with BEIS about some of the illiquidity in that market and the premiums that Adam mentioned.

In terms of your point on achieving this, there are four reasons for optimism. First, we have very similar schemes at present. That will change over time, so we have to be conscious that if we do not link now the option may disappear. Secondly, the Swiss agreement is a precedent

that can be followed. Thirdly, there was an awful lot of preparation for linking done in the run-up to Brexit.

Adam Berman: By both sides.

Mark Copley: By both sides. Fourthly, the people in BEIS who would be negotiating this are extremely good and know what they are talking about. This is one of those things in which there will be give and take, but it is achievable and genuinely beneficial for both parties.

Adam Berman: It is probably the single most attractive piece of low-hanging fruit in this whole discussion today. If you are looking for one item which, upon resolution of the protocol, you could move most quickly on, it would probably be ETS linkage.

The Chair: We hope it might be Horizon. Lord Hannay wants to come in here.

Lord Hannay of Chiswick: Could you perhaps define the concept of sovereignty in the context of the answers you have just given? Does it have any meaning at all?

Adam Berman: Yes, absolutely. You are not signing up to an EU institution; you are not at the table making decisions on EU structures and they are not making decisions on our structures. I would compare it most closely to a free trade deal.

The reason it is such an interesting mechanism in terms of sovereignty, is that you are allowing the vast majority of the rules to be set by both sides and the revenues to be used by both sides. An ETS is, frankly, a British concept; the Brits came up with the first ETS in 2002 as a mechanism to try to get the EU to put one in place. The EU dutifully did in 2005 and it has been running ever since. The fact that we now want to move away from what is fundamentally a British idea seems slightly bizarre.

I think there is a way of achieving this and guaranteeing sovereignty on both sides. There will be a negotiation and certain practical things would be on the table. The question of the cap—the level of environmental ambition—should be fine because we both have aligned net-zero trajectories. The coverage of the different sectors under it, again, should broadly be fine, but there are some emerging differences now.

There are also things like the attitude to negative emissions. Carbon removals, for example, through carbon capture and storage are not included under the ETS system. It is essentially only a carbon tax; it is a price to pollute. You cannot offset that by using CCS or any other negative emissions technologies.

The EU would probably ask, in some hypothetical negotiation, for the UK to include more sectors under its ETS as they are moving towards that. The UK would probably ask the EU to include negative emissions under their ETS because it would be at a strategic advantage, with a huge

nascent CCS industry and a lot of North Sea to be able to incentivise that. So I do not see it as a sovereignty issue. I think you would get UK asks and move faster to a more UK-compliant EU emissions trading system, and the EU would move faster to net zero. I think it is a win-win for both side. I do not think there has to be any loss of sovereignty.

Q106 The Chair: Can I just ask about the ETS? We have been talking about linking the UK and the EU, and we talked a little about Switzerland. There are quite a lot of other countries around. Would it make sense to link the US, for instance, into something like this? In the end, carbon is carbon is carbon.

Adam Berman: That is true, but not every system is the same and not every country has a system. Some places might just have a carbon tax, rather than an emissions trading system. As an example, the US has neither a federal carbon tax nor a federal emissions trading system. Some states, on both the east and west coasts, do have an emissions trading system, but the design is quite different.

Ultimately, given that in linkage you would end up with carbon price alignment on both sides, what you do not want to do is link to a system which might theoretically have a carbon price of £20 per tonne, when you have a carbon price of £90 per tonne. When you even that out, you end up with a much lower carbon price for your jurisdiction. We need to be pragmatic.

The Government have said that they are interested in linking with any jurisdiction, and there certainly are some out there that are theoretically possible, but I think we all know that that is a byword for saying that we will link to the EU if we believe that it is in our interests. It is the only practical linkage arrangement that could be sought by the UK. There are other international mechanisms that could be used to bring things such as offsets into the UK system through Article 6 of the Paris Agreement but, beyond that, the scope for international linkages beyond the EU is probably minimal.

The Chair: Thank you.

Q107 Lord Hannay of Chiswick: Could we talk a little about carbon border adjustment mechanisms, or CBAMs, as they affect the interests which you are concerned with? The EU is planning to introduce a CBAM, though it has not yet taken the legal decisions, of course. What are the implications of that for the matters we have been discussing, from the emissions trading system to the pooling and transmission of energy? How would the potential impacts of the EU CBAM on the UK's exports to the EU be minimised? For example, if the EU had quite substantial CBAMs on, say, Chinese steel or cement and the UK did not, how would that affect all these issues?

Mark Copley: To be perfectly honest, CBAMs make my head spin. Let us just try to take a step back. The UK currently has a higher carbon price than the EU, because of our carbon price support mechanism. On what a CBAM would do, we would probably be eligible for a full 100% discount

on the CBAM, because we would have a higher price on imports—Adam disagrees; he is very good on carbon pricing.

Adam Berman: I think Matt will talk about electricity. Unfortunately, there is a complication.

Mark Copley: Fine. The area where I get really concerned is Northern Ireland, because Northern Ireland has two carbon prices. A small number of the electricity generators in Northern Ireland are in the EU ETS and the rest of the industry is in the UK ETS. I then have to try to work out how a flow of electricity from Scotland into Northern Ireland would work with a carbon border adjustment mechanism. The answer, I think, is extremely badly.

To try to answer your question, this is about complexity and an additional impediment to trade. Even if you get large discounts because you have similar carbon prices, the people operating those interconnectors are filling in more declarations and more pieces of paper. It is more difficult to evidence where your energy came from, and the consequence of that is fewer flows across interconnectors, less responsiveness and therefore less security of supply and competition when you need it.

Hopefully, Adam will give you a better answer, but I think it is just an additional barrier on top of those that already exist.

Adam Berman: I think you are absolutely right. There are several ways in which the CBAM would affect the UK. The first is this regulatory barrier. UK companies exporting into the EU, their largest market, would be obliged to submit detailed assessments of the carbon footprint of their products and prove that they had paid a carbon price in the UK. That is the first thing, notwithstanding the point Matt is about to make about electricity.

The second is that, if the UK carbon price is lower than that of the EU, British companies exporting into the EU will be obliged to pay the difference. That money will not be collected by the UK Government; it will be collected by EU Governments. If the UK carbon price is higher, as it currently is, then British companies will be at a competitive disadvantage, because yet again, they pay more.

On Northern Ireland, the reason this is such a tricky area is that the CBAM falls under the scope of the Northern Ireland protocol. The UK would be obliged to discuss with the EU how the CBAM might be applied in Northern Ireland. Because we have this issue where power in Northern Ireland is covered by the EU emissions trading system, but everything else—so most of the stuff affected by the CBAM—is covered by the UK emissions trading system, the CBAM would apply to Northern Ireland, which would constitute a significant regulatory barrier for companies in Northern Ireland wishing to trade with the Republic of Ireland. We could get into complex negotiations about removing that, but in the end, the EU would come back to the same thing they use for Ireland all the time,

which is that it constitutes a backdoor into the single market if the CBAM is not applied. So it would have to be applied in some shape or form.

It is worth saying that, while we may have a UK CBAM on the way—we have a consultation coming out shortly—that will not solve any of those issues. It will help with carbon leakage, but all the regulatory stuff will remain. The EU has made clear that there is only one way for the UK to ensure that the CBAM does not apply to it and that is linking emissions trading systems. That is the only realistic way—I suppose rejoining the EU would be the other way.

You end up with linkage being the only way out of the very tricky political impasse in Northern Ireland. It is the only way to ensure that you do not end up with yet another slightly meaningless regulatory barrier which will achieve absolutely nothing. It will not reduce carbon at all. So, in this context alone, linkage makes a great deal of sense.

Matt Hinde: Adam and Mark have covered most of the issues here. On the general point about Chinese steel and if there was no UK CBAM—this would be the same for any energy-intensive sector—I imagine it would be quite uncomfortable for any UK sectors if there was an EU CBAM in place.

On electricity, the major problem is that it is very difficult to prove the carbon intensity of the generation in the UK or anywhere, because you tend to trade electricity anonymously on exchanges. The way the regulation is written is that every exporter needs to prove that they have paid an equivalent carbon tax. That is not very easy in the way the regulation is written.

In general, it is rather counterintuitive, since the carbon intensity of the UK system is slightly lower than the average in the EU at the moment, I think. In general, you tend to trade zero-carbon electricity across interconnectors, whereas firm capacity tends not to be traded. So, as the others have said, this is completely counterproductive, frankly.

Certainly, linkage of the systems would be a way around this issue. There is a list of countries that are not covered by the CBAM, which includes Norway, Switzerland, Iceland and, I think, the Energy Community Treaty countries. Finding a way for the UK to join that list would be the other way of doing this, if we are not going to link.

Lord Hannay of Chiswick: Thank you. I understand why your head spins when you talk about this. Does this lead you to the conclusion that while the British Government are apparently just starting consultations on CBAMs and the EU is some way down the track towards defining a CBAM system, it would be rather desirable for the two to talk to each other about what they are doing? If the answer to that is in the affirmative, is there any sign of that happening?

Matt Hinde: Maybe I can take that. It is not happening in terms of the Specialised Committee on Energy, for example, because I think this is covered by the trade committee under the TCA. I understand that there

have been some discussions but, as you say, we are at different stages of policy development.

Mark Copley: It is hard to avoid the conclusion that this is almost like two people who, maybe to use a silly analogy, fancy each other in the playground. Both sides would like to link, but neither would like to ask. So you have people dancing around and never really getting on with sorting the link out, which is slightly frustrating. To take my silly analogy, it almost takes someone to say, "Well, if they ask, you'll say yes, won't you?" It needs someone to broker that conversation to resolve this.

Your point is absolutely spot on. There needs to be a conversation either about the design of the CBAM or about the obvious alternative to both of us spending a lot of time and effort creating it.

Adam Berman: To be realistic, we are nearly at the finalisation of the CBAM negotiation. We expect the co-decision within a matter of weeks, so we are very close to a finalised legal text now. That will be signed off, essentially. We need to be realistic; the UK will remain a country which the CBAM covers, and we will have that regulatory barrier.

So I absolutely agree. A cynic might say that the UK Government were waiting until the EU had published theirs to try to base a new UK CBAM broadly on that idea, but without it necessarily being called an EU CBAM. So we end up in this rather frustrating situation where we all know that the UK will put forward something that bears remarkable similarity to what the EU is putting forward, yet it needs to be seen to be doing something different. That is a waste of everyone's time.

The Chair: This is a good time to bring in Lord Jay, who wanted to come in here.

Q108 **Lord Jay of Ewelme:** This is a question for Adam Berman. You talked earlier in this extremely interesting session—thank you very much, all three of you—about the trade of gas from Great Britain to Ireland. Were you talking about trade to the Republic of Ireland or to Northern Ireland? What route would the gas take to get to Ireland?

Adam Berman: Both rely almost exclusively on GB gas. The Republic of Ireland has about 80% reliability on GB gas, because its Corrib gas field has declined a lot in production, so about 20% is domestic. It has no pipelines to anywhere else, so it is wholly reliant on it. There are a number of treaties between both sides, and there are formal working arrangements that include the emergency protocols of the transmission operators on both sides. So there are structures in place to ensure security of supply. Northern Ireland's gas flows are, I believe, provided wholesale by GB.

Lord Jay of Ewelme: And what route does the gas take to get from Great Britain to Northern Ireland?

Adam Berman: I believe there is one major gas pipeline that splits. Is that correct?

Matt Hinde: Yes.

Mark Copley: Yes, Moffat.

Adam Berman: Moffat, yes. That is the one.

Lord Jay of Ewelme: Where does it split?

Adam Berman: In the Irish Sea.

Mark Copley: Somewhere just off the Isle of Man, from memory. You have a pipeline coming from—I want to say up by Blackpool—going across and then forking, with one bit going north and one bit going across. There is also a pipeline, which I think is called SNIP, from Scotland across to Northern Ireland. Oh God, that is old knowledge. I can confirm that afterwards, if necessary.

Lord Jay of Ewelme: If one of you could just send a little note explaining that, it would be extremely helpful. Thank you.

Q109 **The Chair:** Thank you very much. It looks as though we are going to get three notes. Much earlier, we had a discussion about risk. One risk that has been in the papers recently is the sabotage risk, of course; I am thinking about Nord Stream.

Should we be concerned about risk to all the various energy interconnectors of different types, and, if we were, what sort of approach should and could be taken to manage that risk? Very short answers please.

Matt Hinde: All I can say on that is that we take a very robust approach to the security of our assets. This is probably more of a question for the Government, to be perfectly honest.

The Chair: Does anyone disagree with that?

Mark Copley: I do not. All I would point to is the fact that being connected to a number of different countries for a number of separate pipelines at different locations gives you some sort of diversity effect here, but we cannot underestimate the importance of making sure that this infrastructure is as robust as possible.

Adam Berman: The Government analyse and map out scenarios—for example, for this winter and, indeed, for any given winter. These are theoretical scenarios—they do not necessarily attach any likelihood to them—such as incidents of sabotage or interconnector fires. We have had interconnector fires before; these are not eventualities that never occur. We do not need 100% of infrastructure to be functional at all times in order to have a functional energy system; we have margin built in to be able to ensure that we can maintain security of supply, even under difficult circumstances.

So, yes, we have a variety of pieces of infrastructure that stretch out from the UK but, equally, I think the Government have quite robust

scenarios in place to understand what a loss might mean in the energy system and how to counterbalance that.

Matt Hinde: It is also worth commenting that the interconnectors themselves are extremely reliable pieces of infrastructure. I do not want to give the impression that there is a problem here. These things work.

The Chair: We are well aware of that. Thank you very much indeed for a thoroughly interesting hour. It is exactly an hour since we began, so thank you for co-operating by keeping your answers very crisp. With that, I end this part of our evidence session.