

Business, Energy and Industrial Strategy Committee

Oral evidence: Leaving the EU: Energy and Climate Negotiation Priorities, HC 909

Tuesday 7 February 2017

Ordered by the House of Commons to be published on 9 February 2017.

[Watch the meeting](#)

Members present: Mr Iain Wright (Chair); Richard Fuller; Amanda Milling; Albert Owen; Michelle Thomson.

Questions 43 - 111

Witnesses

I: Dr William Kyte OBE, International Emissions Trading Association Fellow, IETA; Sara Vaughan, Strategy & Corporate Affairs Director, E.ON UK; John Lanchbery, Principal Climate Advisor, The Royal Society for the Protection of Birds; Andrew McDermott, Technical Director, British Ceramic Confederation.

II: Isaac Occhipinti, Head of External Affairs, Energy and Utilities Alliance; Philip Sellwood, Chief Executive, Energy Saving Trust; Stew Horne, Energy Regulations Principal Policy Manager, Citizens Advice; Joanne Wade, Vice President, European Council for an Energy Efficient Economy.

Written evidence from witnesses:

- The IETA submitted [evidence](#) to the ECC Committee's inquiry on Brexit and climate change.
- E.ON submitted evidence to the ECC Committee's Brexit inquiries on [energy](#) and [climate change](#).
- The RSPB made written submissions to the BEIS Committee's [inquiry](#) and the ECC Committee's inquiries on [energy](#) and [climate change](#).
- The British Ceramic Confederation made submissions to the ECC Committee's inquiries on [energy](#) and [climate change](#), as well as the BEIS [inquiry](#).
- The Energy Saving Trust has made a [written submission](#) to the current inquiry.

- The Energy and Utilities Alliance submitted [written evidence](#) to the Energy and Climate Change Committee's inquiry on the implications of Brexit for energy.
- Citizens Advice submitted evidence to the Energy and Climate Change Committee's inquiries on the implications of Brexit for [energy](#) and [climate change](#).

Examination of Witnesses

Witnesses: Dr William Kyte OBE, Sara Vaughan, John Lanchbery and Andrew McDermott.

Q43 **Chair:** Good morning. Thank you for coming to give evidence to us. For the purposes of the record, do you mind telling us who you are and which organisation you represent?

Dr William Kyte: Dr Bill Kyte, representing IETA, the International Emissions Trading Association.

Sara Vaughan: Hello. I am Sara Vaughan and I am from E.ON.

John Lanchbery: I am John Lanchbery from the Royal Society for the Protection of Birds.

Andrew McDermott: Morning everyone. My name is Andrew McDermott, technical director at the British Ceramic Confederation. We have about 55 sites in the scheme in the UK, accounting for about 5,000 jobs.

Q44 **Chair:** May I start with the EU ETS and the UK's role within that? To what extent have we helped shape its design? To what extent have we helped create and then implement it?

Sara Vaughan: If you look at the fact the UK was the first country to have a traded emissions scheme, which was set up in 2002, and Bill might have been involved in it, the UK has played a very active role from the start in EU ETS. If one looks at the times when EU ETS has not worked as well as it might have done, following the financial recession when there was an oversupply of EUAs, the UK has been very strong and very persuasive in terms of looking at the options for back-loading or market stability reserve. We have played a very active role.

Chair: Would people generally agree with that?



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Dr William Kyte: Yes, the UK has made very significant steps, particularly in the early stages, because we learned from the formation of the UK ETS, which emissions trading groups set up with the UK Government; the City of London became involved, and we knew all the nuts and bolts. We really taught the EU how to do it. We were very influential, particularly in the first phase. Going through the different phases, the UK has been very, very strong. They have always been looked at as the people who know what they are doing.

John Lanchbery: I would support that. Before the EU ETS came along, Tony Blair set up a UK emissions trading scheme trial. Bill and I were on the panel of that. It started very early on, and I agree that the UK has generally taken a lead. When the EU ETS has strayed, we have tried to correct it, although not always successfully. We have generally tried to make it better.

Andrew McDermott: The UK has played a strong role in that, but looking forward to the future, as has already been mentioned, it does not work for everybody. We need to take stock and look at the alternatives as well. There are opportunities to do something else and we should seize them.

Q45 **Chair:** That brings me on to my next question. You have all said we have been really crucial in helping to introduce an EU-wide emissions trading scheme, but the ETS is not very good, is it? It does not work very well, does it? If we come out of the EU and then, by implication, the ETS, are we losing anything here?

John Lanchbery: It is difficult, because it is built into a lot of the UK's mechanisms for reducing emissions. You are right: it does not work very well. In spite of the UK trying to make it better, it keeps being pushed back, so it is, yet again, being revised for the post-2020 period. We should probably remain in until the end of the so-called 2020 package in the EU, which ends at the end of 2020, because it would be silly to just pull out suddenly. What we do after 2020, when the new package including the EU ETS is concluded, is another matter. It is not working well, which is why the carbon price is very low. I can go into great detail about why it is not working, but it clearly is not; otherwise the carbon price would be much higher. That is why the UK put in a floor price.

Q46 **Chair:** Is this not the key point? Brexit provides a great opportunity on a whole range of things for Britain to chart its own path. Therefore, on something like carbon reduction, in terms of trying to deal with emissions, given that the ETS is not working, this is a great opportunity. Should we go it alone?

Dr William Kyte: I dispute that the ETS is not working. The ETS is working. It is a fact that a number of parallel policies, such as energy efficiency policy and renewables policy, which have a very much greater cost in reducing carbon, have eaten away. What is really wrong with the ETS is just one thing: it does not have a tight enough cap. That is the



thing. If the cap were tightened, the ETS problem would be solved overnight.

Sara Vaughan: As a company, we have always favoured having a Europe-wide scheme, rather than a purely UK scheme. If you look at the positions in terms of relative competitiveness between the UK and the rest of the EU, that has been a really important point. The Committee on Climate Change has said, "The ETS has the potential to be a least-cost approach without creating competitiveness challenges for industry".

You may recall that, when Government capped the carbon price floor, which was the mechanism they put in place to give a strong carbon signal, one of the reasons they gave at the time was to reduce cost to consumers and to limit the impact on competitiveness. We need to be really careful about thinking that we can do it alone and everything will be fine, because we need to keep that competitiveness and impact on consumers point always in mind.

Q47 **Chair:** Does the carbon price floor not put us at a competitive disadvantage relative to our European neighbours and run the risk of carbon leakage?

Sara Vaughan: That is exactly right. We would be in favour of continuing, as we said in our evidence, with a European-wide scheme. If we look at the trends, we would like to see broader trading schemes, rather than narrower trading schemes. I will make one point: from a UK perspective, as a company that operates in the UK and as an investor, we want to see continuing clear signals around decarbonisation. I would question whether the CPF is the right way of doing that.

Andrew McDermott: The ETS does not work from a manufacturing perspective. I would offer three observations. First, it provides perverse incentives. The way in which it is based on absolute emissions means there is a natural driver there to meet targets by reducing output and making fewer emissions. It also acts as a brake on growing: if you want to make more, you will emit more. That is pushing in the wrong direction. It gives you a perverse incentive to reduce output and not to grow. Of course, as we know, we need many more houses, bricks and roof tiles. We have the capacity there, so we should be growing, not reducing, those industries.

Secondly, there is a fundamental dichotomy within ETS in terms of carbon price signals. Power generators want a higher carbon price to incentivise investment in renewable technologies. From a manufacturing perspective, we want a low carbon price. It is all about international competitiveness for us. A high carbon price does not work for us. It is a disincentive. We have funds, and we would rather see them invested in technology than in paying for emission credit. There is this fundamental dichotomy: the industry wants a lower carbon price; power generators want a higher carbon price.



Thirdly, there is this perpetual discussion we have in terms of carbon leakage mitigation. It is a Damoclean sword hanging over industries all the time. We are only a few years away from the next review. You have the review and then you are sat looking at what comes next. There is a threat, in that we do not know what is happening in terms of free allocation. That undermines investment and can also impact existing investments. We see Brexit as an opportunity to look at alternatives.

As has already been mentioned, the carbon price floor results in carbon leakage and increased costs for the manufacturing industry versus our EU competitors, let alone our international competitors. We have had a long-standing position that, because of the impact on competitiveness, we would like to see that go or at least be permanently frozen.

Dr William Kyte: Andrew makes three fundamental errors. The ETS is not a cap on growth, because it just places a cap on emissions and you can either cut your emissions or buy from somebody else who can cut them more cheaply. There is no pressure on anybody to cut their growth at all; it is a cap on emissions, not on growth. Secondly, he has mixed up price and cost. At the moment, we have a very low price in the ETS because, across Europe, people are pursuing a high cost basis in the national interest in terms of very high subsidies for other systems. You have to look at the cost. The ETS delivers the least-cost mechanism. Whatever the price is, it is a least-cost one.

Q48 Chair: Sara, you mentioned the Committee on Climate Change and I want to push on that particular committee. It has suggested that, without the UK participation in EU ETS, we would need to implement more stringent carbon budgets at home in order to meet our carbon targets. I have two questions for you on this. Do you agree? If you agree, what does this mean in practice?

Sara Vaughan: If you look at the way the EU ETS operates at the moment, as we have talked about already, the price signal coming out of the EU ETS is not the strongest price signal. The price in the UK at the moment is really coming from the carbon price floor, which is giving rise to this problem of carbon leakage and divergence.

In terms of the carbon budgets that we have in place, we were very pleased that the Government adopted the fifth carbon budget, but we are waiting for the emissions reduction plan. We were, first of all, told we would see it before the end of 2016. Then we were told we would see it in the first quarter. We have heard rumours recently that it might be slipping again. That is what we are looking for in terms of seeing what the future looks like and, in particular, the impact that is going to have on things such as heat and transport. As to whether it leads to tighter carbon budgets, I must admit I am a bit puzzled by that, given that the carbon budgets are there to meet the Climate Change Act. I am very happy to take that away and look at exactly what they have said, if that will be helpful.



Andrew McDermott: The overall framework—the Climate Change Act and the carbon budgets that result from it—has been set unilaterally. There was no impact from EU institutions in that. We see no reasons why it should change. The overall, overarching targets should stay fixed. It is the mechanism by which we meet those targets: Brexit gives us the opportunity to look at how we achieve those targets and the mechanism that we use.

Sara Vaughan: Could I come back with another point on the impact on leaving? Clearly, the UK is the second largest emitter in the EU and has taken great steps to reduce its emissions over time. That means that, if the UK leaves EU ETS, it runs a real risk of EU ETS being weakened and weakened quite substantially. There are a couple of points that come out of that.

Chair: We will come on to that in a moment.

John Lanchbery: I was going to support what Bill said about the cost. The carbon price reflects the so-called marginal abatement cost: how much it costs when you have done everything else. It is an accurate reflection of what is going on. I would bring up the timing thing again. The current EU ETS will run until the end of 2020. In many ways, we should look at what comes out of the current set of negotiations on the 2030 package that, as you know, is going through the EU system at the moment. We have until the end of 2020 to come in with any new policies, measures, tweaks on the EU ETS or whatever it is. All I am trying to say is that it is not a mad rush.

Q49 **Chair:** My final question is on that. We have established, although there could be some debate on this, that the EU ETS is not working wholly satisfactorily and therefore some degree of reform will be needed, certainly post-2020, if not before. What role can we play, post-Brexit, in helping to reform any EU ETS?

Dr William Kyte: The most important thing in any emissions trading scheme is scarcity. You have to make sure you have a target that really reflects the wider targets, such as carbon budgets, the Paris agreement and anything else. The ETS was written and the first targets were set up at a time when growth was looking very, very strong and everybody was thinking this was a tremendously tough target. As the recession and other things bit into it, the target has become very, very weak. Renegotiating the target in line with the Paris agreement is an absolute priority, whether it is a UK system or an EU system. It is the same thing. You have to have a stringent target to make an ETS work properly.

Andrew McDermott: It is a golden opportunity, Brexit, for us to do something different. It is an opportunity for the Government to boost their investment credentials and to offer an approach that is less stick and more carrot, with more positive incentives to invest in energy and carbon efficient manufacturing. It is the opportunity for us to do something else.



John Lanchbery: It is questionable, post-Brexit, whether the UK would be able to stay in the EU emissions trading scheme, especially if it is going to be a hard Brexit, which is what it looks like being at the moment. Although Norway is currently part of the EU ETS, it is a special case, so if we left completely it would be quite hard to continue to be part of that.

Chair: We might explore that in depth in a moment.

Q50 **Michelle Thomson:** I wanted to pick up on Andrew's point, in terms of alternative options to deliver emissions if we leave the EU ETS. On every side, there are opportunities, risks and unintended consequences. I would like to get a feel from the panel of what you see we might be able to do.

Andrew McDermott: There is a range of potential options for us to explore. The first one is the climate change agreements scheme that is already in operation. It covers manufacturing industry. It has been in operation for 15 years or so. The key issue with that particular scheme is that it allows relative targets. You are looking at energy use or tonnes of carbon emitted per tonne of product, so it maintains the focus on energy and carbon efficiency but does not act as a choke on growth. You are looking at energy or carbon per tonne of product, so it is a better metric in order to grow industry, so there is that.

There are alternatives based on the existing small emitter opt-out scheme, which is an option for some of the small emitters in the EU ETS to go into the UK opt-out. There are opportunities around that scheme and rolling it out UK-wide. We also have the environmental permitting regulations, which cover things like nitrous oxide, sulphurous oxide and particulates. They could be amended to include carbon as well. We have quite a range of potential options that we could explore, and we should seize the opportunity to explore these alternative avenues.

Dr William Kyte: The CCAs have been around for a long time. Most of them are relative targets. That gives Government a dilemma, because they have no guarantee that they will meet their carbon caps. That is one of the very big benefits you get from an ETS: absolute certainty that the cap is going to be met. If you are looking at another alternative, command and control, this is an extremely expensive way of doing it. It does not allow businesses to reduce their emissions in the most cost-effective way.

There are other schemes that could happen. The UK could have its own emissions trading scheme, which it could link with the EU ETS and the wider world. China is introducing an ETS. California and Quebec have an ETS. New Zealand has an ETS. Korea has an ETS. A number of countries are introducing them, so we could have the benefits of working on a worldwide scale and Britain working, in carbon terms, in a wider market than the EU alone.



Sara Vaughan: Starting at the umbrella level, if we look back over the last year to 18 months, quite a few policy changes have hit the industry: things like the early closure of the renewables obligation, the removal of the zero-carbon homes policy and obviously Brexit itself, which is big not just for our industry but across the country as a whole. In terms of that policy uncertainty, we really do not want to see policy uncertainty heaped upon policy uncertainty. This was one of the reasons why, in our response, we were quite keen that we should remain within the EU ETS, we should keep going in the direction of the Climate Change Act and the Government should be absolutely clear about that.

Q51 **Michelle Thomson:** Is that as a transitional arrangement, because it provides a level of stability, but allowing an evolution over time?

Sara Vaughan: It is at least transitional. The Chair said that we are coming on to how one might exit, so I do not want to stray too far into that on this question, which is around what the alternatives are. Bill mentioned a number of things that are alternatives—schemes in the UK and schemes you could have elsewhere. At the moment, the question I would ask is why you would rush to something else that will cause cost and disruption when you have something that is there already and in which we are playing a part.

It is true that Norway is outside the EU but within the scheme; so is Liechtenstein and so is Iceland. It is not strictly necessary to be a member of the EU. Then it comes on to the question of whether it is the short term or the medium term. Are you talking 2020 or are you actually talking 2030, in terms of the period for which it might be feasible to stay within the EU ETS?

Dr William Kyte: Australia came very close to linking with the EU ETS, until there was a change of Government and it decided that climate issues were not top of its agenda. You can link with the ETS. If Australia can do it, then the UK could do it quite easily.

Q52 **Michelle Thomson:** What is the impact, going forward, on consumers? I appreciate that that is a very wide question; it depends on a whole variety of things.

Sara Vaughan: At the moment, the thing that has the biggest impact on consumers is the carbon price floor. If you look at the impact within the wholesale price of EU ETS as opposed to the carbon price floor, the carbon price floor has about three times the impact of EU ETS. That is where the issue is, rather than around EU ETS as such.

John Lanchbery: A well operating cap and trade scheme, as Dr Kyte as said, is probably the most efficient way of doing it, certainly as regards consumers. That should give the lowest possible price, because that is what it is designed to do. The more you tinker with it, the more likely you are to raise the price.



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Andrew McDermott: In terms of the consumer point, we are consumers of the power that is generated, so we feel the effects of the carbon price floor. Also, unlike power generators, we cannot pass our ETS costs on to our customers without impacting our international competitiveness. We are competing in a global marketplace, so if we raise our cost to counteract those increased ETS costs that makes us uncompetitive. People can then undercut us. We have to look at it from a global perspective. We are competing in global markets, so it is very difficult for us to pass on the costs. It is not the same for the power generators, which can pass on costs to all of us as consumers.

Dr William Kyte: Again, if it is on a worldwide basis, the best thing to do is to link and draw as many people into an ETS across the world as possible. This means that other countries are thereby bearing carbon cost, we no longer have that competitive issue and global emissions come down, because, at the end of the day, it is global emissions that matter.

Q53 **Michelle Thomson:** To what extent, if we are in or out of it, will it affect our relative influence in terms of these global issues?

Dr William Kyte: The UK's voice, even when we have been negotiating on the international stage as part of the EU, has always been very strong in those negotiations. I would expect the UK to still have that very strong voice, even if it was outside the EU. I have attended many conferences of the parties to the Convention on Climate Change. EU voices and EU Ministers have always been very strong in there. If it becomes more global, and if the UK is seeking to become more global in its global market, these two things can march hand in hand.

John Lanchbery: It is an international question, though. I agree: the UK has led on climate change since Mrs Thatcher's time, frankly, and we have pushed for good mechanisms internationally. Then there is the question of what we do when we leave the European Union. Within the European Union, we are part of a large and powerful bloc. When we leave, we will not be, so we need to consider whether we want to continue operating with the EU in international negotiations, where we traditionally have led the EU, or whether we can set up another arrangement, form our own bloc or whatever. It is quite a big question for the international negotiations: how we continue to be a major player in the climate talks.

Q54 **Amanda Milling:** Can I pick up on this? One of the things that I wanted to really understand, picking up on the point that Sara made earlier, was about our role in the EU ETS to date and what that means for the ETS going forwards. You say we are quite a powerful voice and we are quite influential, so what do you think that means going forwards?

Sara Vaughan: I am part of a larger organisation, and our parent company is German. One concern that has been expressed to us within the company is around losing the strong voice of the UK, in terms of trying to reinforce the importance of the EU ETS, and the signal that it



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gives both through the cap and through the pricing mechanism. There are different views within the EU, and the UK was always seen on the side of supporting the EU ETS, as opposed to some other countries that are less supportive. There is a concern around that.

John Lanchbery: The UK has liked market mechanisms, and it is a market mechanism. We have pushed on climate change, and in many ways our leaving the EU will adversely affect EU climate change policy generally. We have been a major voice. It is not clear whether the French would continue to have that role; Germany probably would; but Poland certainly would not. Out of the big countries, it has been us and the Germans, with some French support recently, but it is not clear that that will continue. I would not bank on the other big countries, the Poles, Italians and Spanish, to be good on climate change, so it is a problem.

Sara Vaughan: There is also the natural impact. Unless an exit is managed well, it could have an enormous destabilising impact on the ETS, because of the current position of the UK as the second largest emitter, and, indeed, on all of us who participate in the EU ETS as well. The timing is vitally important. The forward planning, the signalling and the warning around that and the arrangements that are made for whatever replacement may be in place are fundamentally important.

Dr William Kyte: It would have another impact as well. 90% of the carbon trades are made in the UK, and the City is the leading carbon trader in the world. It would have a very strong impact on that.

Q55 **Chair:** Is that at risk from other financial centres?

Dr William Kyte: That would be at risk, yes, very much so.

Andrew McDermott: It is widely recognised that coming out of the ETS within the third and current phase would be a disorderly exit, with all sorts of messy and disruptive outcomes. Given those complications and given the resources needed to try to unpick all that, it would make sense to continue as a transitional arrangement within ETS until the end of the current third phase. That would mean monitoring emissions until the end of 2020, and the reporting cycle ends in April 2021. That then gives us the opportunity to look at something else and to do something else. Yes, we should stay in the very short term as a transitional arrangement, but that does not mean that we support ETS in the longer term.

Q56 **Amanda Milling:** Can I pick up on something that is quite interesting? It is providing a degree of certainty in an environment where we have quite a lot of uncertainty in terms of policy. If we come out, what does that mean going forwards? Do we just have additional uncertainty? Is that a concern?

Sara Vaughan: We have semi-visibility out to 2030 within the EU ETS. Proposals were put forward in June 2015. We should still be within the EU and able to influence how those proposals play forward into phase 4.



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I come back to the CPF. The CPF is a tax. It can be removed tomorrow by a change in a Budget, in a Finance Bill.

This is one of the reasons why, when we were going through the EMR process, a number of companies came to this Committee or its predecessor and questioned the bankability of the CPF. It is that point around uncertainty, keeping the commitment to decarbonisation and giving future signals around direction. The membership of EU ETS is not decisive in that, but it is another important facet.

Andrew McDermott: On the ETS, we do not have visibility through to 2030. The fourth phase of the scheme is being discussed now. I talked about the Damoclean sword of carbon leakage mitigation and free allocation hanging over the sector. We do not know where we are going to be from 2021 onwards. There are a number of proposals on the table that would see free allocation for our sector completely lost. That would mean even world-class, energy-efficient brick and roof tile plants having to buy all their carbon. We simply do not know what the outcome of those discussions is going to be. We do not have certainty through to 2030. We have uncertainty now.

There is a short-term period, in that we do not know what is happening next with free allocation, and while you have that uncertainty it makes it extremely difficult to invest. We need more houses; it does not matter whom you talk to. We need many more houses and we should be investing in building plants to provide the building materials. We cannot because we do not know if we have a viable business. The cost in terms of buying all the carbon would eclipse profitability for many of our members, so against that backdrop manufacturers cannot invest.

Dr William Kyte: The ETS has a predictable future, because it has a target going out to 2075. That is there in the EU legislation: a reduction year on year on year. That goes right the way through. Until that is repealed, there is a target there. In term of the uncertainty about free allocation, there are ways round that. If an industry has to buy, the auctioning of proceeds could be used to compensate them, so there are mechanisms whereby that happens, provided the Treasury is not too greedy in seeing this as another useful tax. There are mechanisms that could be used to recycle the money back to industry.

Andrew McDermott: We do not have any guarantees of that. Those costs eclipse profits and that is why we cannot invest.

Q57 **Chair:** I want to be clear. This is very messy and disruptive. People are saying that we do not have clarity post-2021 and certainly post-2030, although, Dr Kyte, you were saying there are targets down to 2075. Of course, we are looking at this in the context of Britain leaving the European Union, and the Prime Minister has pledged that we will not be a member of the European Union by 2019. If you overlay those two factors, and you have that messiness and disruption, what does a clean withdrawal look like? What is the preferred timescale for that, given the



Prime Minister's pledge for the 2019 target?

John Lanchbery: First of all, to the end of 2021, it would make a lot of sense to write into the great repeal Bill all the existing European 2020 legislation on climate change. We are in it already; we might as well continue to do it. The question is whether we would try to stay in after 2020 and how we would do that. We can do the near-term stuff, but the post-2020 stuff is much more difficult. On the continuity bit, we do have a long-term target. The Committee on Climate Change has recommended that we revise the target at some time in the future to be more in line with the Paris agreement goals, which will probably mean going to net zero by 2050. That is the big target and everyone knows we will have to do that.

Andrew McDermott: Coming out in phase 3, everyone agrees, will be messy and disorderly, so it would make sense pragmatically to have the cleanest break and, in terms of the EU ETS, to continue until the end of the current phase. Unpicking it all would be problematic, not just for the UK but for all other member states. It would take a huge amount of resources to unpick it for those few years, so the cleanest and most pragmatic approach is to take us out at the end of the current phase.

Sara Vaughan: I certainly agree that we should not come out before the end of the current phase, absolutely. We should not discount the possibility of staying into the fourth phase. We should explore that. We have made inputs into the governance in relation to the fourth phase. We have made some high-level political commitments around the 2030 process in the EU. We have been involved in that. It is not reliant on remaining in the single market or even the internal energy market. As we have said, there are examples of countries that are outside but still participate. We should not discount that as a possibility at all.

Dr William Kyte: We all agree that 2020 is the key year. Up until 2020, everybody is agreed. I think you will find complete agreement across all of industry that 2020 is the critical phase. Wearing another hat, I am honorary president of the UK Emissions Trading Group. We are in discussion with officials there, and they are very well aware of the difficulty that this causes: not only technical difficulty but legal difficulty. Companies may find themselves in a position where they are legally unable to meet their commitments because various things become tangled up. If it happens after 2020, that also gives us the time for the discussions to go forward as to how the UK interacts with the EU ETS going forward.

Andrew McDermott: Post-Brexit, as a non-EU member, the UK will have lost its seat at the table. It will not be involved in the European Council, the European Parliament or any of the discussions on the design phase and the future targets of EU ETS. We will have lost our voice in that. At best we might have a consultative role. I doubt whether that would be politically acceptable, given the prominence of self-determination within the referendum outcome.



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- Q58 Richard Fuller:** A lot of the time when we talk about the EU, we talk about the word “uncertainty”. As far as I know, uncertainty is where there is a change, you are presented with choices, you are discussing them and you have not made a choice. Then people who are waiting for that decision to be made do not know what they are doing. The role of policymakers ought to be to identify the choices and then make a decision. We have just stumbled on one in the Chair’s last question.

Everyone can nod and agree up until 2020, but then it looks and sounds as if there is a choice for the UK to continue post-2020 in phase 4 of the ETS. There seem to be, as Andrew was saying, some positives and negatives about that, and Sara also mentioned that we should consider it and keep it as an option. Can we just debate that point? As I see it, we will be starting negotiations on the ETS while we are still in our phase of withdrawal between now and 2019. Can the UK play a legitimate role in those discussions, in shaping that, if it has not signed up to being a member of it?

Dr William Kyte: The discussions for phase 4 will finish by 2019. Until 2019 we will be a full member of the EU so we will be playing a full part in those discussions. Taking up your point about uncertainty, I do not like the word, because uncertainty is what distinguishes your business from another, in terms of how well you are at dealing with it. What we are looking for is predictability, in other words how the Government would react if this choice is taken, and how the Government would react if that choice is taken. If you can predict the way things are going forward, then you can deal with uncertainty. We are looking for the more predictability. You can predict the way decisions are discussed and taken forward, even though there is uncertainty. There is great uncertainty for the Government at the moment. We are all in this uncertain position.

- Q59 Richard Fuller:** Maybe, but you did not quite answer my question. You said the discussions are going on until 2019, so we can influence that. There are other members of the ETS, other people in that negotiation. If we have not signed up to be part of it and they know we are leaving, why would they take the slightest bit of notice of what the UK has to say?

Dr William Kyte: It depends on whether we have said we are leaving the ETS at that point.

- Q60 Richard Fuller:** Exactly. What is your decision? What is your choice? This is a choice. You talk about the fact that you do not like uncertainty. Now there is an issue. You are in a negotiation. We have until 2019. Is your recommendation that we should stay in phase 4 or not?

Dr William Kyte: If you put it as a series of pros and cons, my first recommendation would be to stay in the ETS. The second one would be to make a mirror UK ETS that links with the EU ETS, in the way Australia was going to do. You can go down the list, and you can ask each person what their priorities are, in terms of a list of the best ways forward. Personally, I think the top one is to stay there in the ETS. I recognise all



the political constraints that there might be around that. The second one is the mirror ETS and the link, where the mechanism is there already in the EU laws.

Richard Fuller: That is very clear. I appreciate it.

Q61 **Richard Fuller:** Sara, you said we should keep it on the agenda.

Sara Vaughan: Yes, absolutely.

Richard Fuller: Dr Kyte has mentioned very clearly that he thinks we should be in. What is your choice?

Q62 **Sara Vaughan:** My choice would be to seek to stay in until 2030 as well. The risk is always: "What is the alternative?" Earlier, Bill listed a whole range of different alternatives. You can have mirrors; you can have links, etc. A lot of the industry's time is being spent thinking about what those alternatives are at the moment. Currently, we think the best answer would be to stay within.

Q63 **Richard Fuller:** Can I probe you on that? Are you saying that, at the moment, it is the best choice because we have not worked out any alternatives since it is too soon, or are you saying, "You know what? We can talk about those other choices, but actually they are going nowhere".

Sara Vaughan: I am not a trading scheme expert. I am surrounded by trading scheme experts here, but I am not a trading scheme expert. What I do know, I am afraid, comes back to this point about certainty and uncertainty. We know the devil we know. We know how that operates and we understand the rules around that. When you start throwing open all the other possibilities, you have to look at the design elements of those possibilities: how small is the scheme; can you get sufficient liquidity in the market, which is important for any market to operate properly; what sectors does it cover; the whole thing around registries, auctioning and all that stuff; is it fungible with EU ETS? There are so many questions of design that get raised.

John Lanchbery: We should certainly, in the near future, continue to argue for a better EU ETS. We are respected on this topic and, like I said, on climate change policy generally in Europe, so people will listen to us.

Q64 **Richard Fuller:** Are you saying we should be in phase 4?

John Lanchbery: We should be negotiating for a better outcome than currently looks likely in the EU, frankly, while we are still in the EU.

Q65 **Richard Fuller:** Are we in or out? If I am the counterparty—I am the rest of the EU ETS members—and you say, "Hey guys, you need to do this but I am leaving", I am not going to take the slightest bit of notice of what you have to say because you are not in the club. If we want to influence it, do we not have to say we are going to be in it?



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John Lanchbery: You have to raise that. You say, "If the scheme is modified to work well, then we will stay in it. If we do not like the scheme, we will consider leaving it". That seems a reasonable answer.

Q66 **Richard Fuller:** You are playing a power game. You are saying, "Look, we are the progressive voice. We would like to stay here but you have to sign up to this, this, this and this".

John Lanchbery: Yes, to some extent.

Q67 **Richard Fuller:** What is your priority? We do not like to influence the Prime Minister's list, in terms of her negotiating strategy. Mr Lanchbery, what is your negotiating strategy? What is not done that we ought to be negotiating for to be in phase 4, and do you think the EU would give a damn, one way or the other?

John Lanchbery: The Government would definitely like a tighter cap, as Bill said earlier. They would want a better reduction factor, so the cap decreases and tightens up over time.

Q68 **Richard Fuller:** That is to increase the price of carbon.

John Lanchbery: Yes, generally speaking.

Q69 **Richard Fuller:** That is the sole implication. You put a tighter cap on because the price of carbon is too low.

John Lanchbery: Yes. The UK would want the tighter cap and it would want fewer unused allowances slopping about the system, which need to be taken out. That is what we would want anyway, so I do not see why we should not argue for that.

Q70 **Richard Fuller:** You have gone further than that. You said, "I have negotiating leverage. I want to change it; otherwise I am walking". Now, if that is your number one demand, to have a tighter cap, are they all going to say, "Gosh, if we do not have a tighter cap, the UK is going to leave and therefore we are in trouble", or are they going to say, "We are not going to do that. Off you go"?

John Lanchbery: It would not be particularly useful to the other member states for us to leave the EU ETS. I do not see why that would help them particularly. If you are from one of the poorer countries, they can potentially sell allowances to us, so it is to their benefit. Ironically, they are often the countries that are strongest on having a tight cap and getting rid of emission allowances. Having the UK in or linked very strongly to EU ETS would be beneficial to those countries. There is a certain leverage we could apply.

Q71 **Richard Fuller:** It does not sound too powerful a set of cards. Maybe you are coming from a slightly different angle, Mr McDermott, but we heard earlier on that, if you believe in environmental controls, we are the progressive voice in the ETS and we are achieving those targets. If you take us out there is a risk, perhaps not that it all falls apart, but that the



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goals that Mr Lanchbery was talking about are not going to be set and, in fact, will become more lenient. What does that mean for you? From your point of view, does it mean we should just forget about phase 4 because, if that happens, you are happy, since you use a lot of energy and you do not like this system anyway?

Andrew McDermott: We need to seize the opportunity of Brexit for a deep reassessment of our climate policy.

Q72 **Richard Fuller:** Is that code for get rid of it?

Andrew McDermott: No, it is code for needing to take a step back and review all the opportunities that are there. Yes, there is emissions trading, but there is a whole range of other policy alternatives. I mentioned the climate change agreements scheme. It works. It has been in place for 15-plus years. It covers 50 sectors already. It is relatively easy to roll that out in terms of manufacturing industry. You still have the same overarching goals, but you are achieving that via a different methodology. We have the opportunity to stand back, take stock and assess all the possible options. ETS is one of them. Climate change agreements is another. There is a suite of things and, as we have the opportunity, we absolutely must seize it.

Q73 **Richard Fuller:** The ETS sounds like it provides, at least on the positive side, some benefit of intra-industry competitiveness for British energy-intensive industries, because everyone is under this umbrella constraint. Then along come the UK Government and say, "We are going to put an extra tax on you". Why are you not focusing on that?

Andrew McDermott: We are not looking at competitiveness just in terms of what is happening within the EU. It is competitiveness globally as well. It is not just looking at it through the one lens. We are competing on a global playing field. Yes, it is competitiveness against the EU but also against the rest of the world as well.

Q74 **Richard Fuller:** I hate the phrase, but that sounds like a race to the bottom on these issues. It sounds like you see the opportunity of us leaving the ETS as an issue where we can recalibrate against our competitiveness not only with EU companies but against the rest of the world, and that ought to be the focus of government policy.

Andrew McDermott: We do not see the overarching targets would change, just the mechanism by which you achieve those targets. It is a different mechanism. We see it as a golden opportunity to have less stick and more carrot: this means less of the green taxes and charges that reduce our competitiveness and our ability to invest, and more positive incentives to invest.

Q75 **Richard Fuller:** Such as?

Andrew McDermott: We need positive incentives in terms of proven technologies, so things you could do in terms of the tax code in order to improve investment incentives, enhanced capital allowances. We had



been discussing an energy efficiency fund for energy-intensive industries with BEIS, and I was disappointed that that was not forthcoming at the Autumn Statement. We need positive incentives to tip the balance in favour of investment and innovation, so targets, but less stick and more carrot.

Sara Vaughan: Can I come back on the point that you just raised? A really key thing is that we do not want a weak EU ETS. This goes to the point about tightening the cap, but also the point about the impact of the UK leaving the ETS. One of the points we put to you in our evidence was around the need for greater convergence between the carbon price floor and the ETS. Clearly, if you have a weak ETS and the price stays on the floor, then the chances of achieving that are going to get slimmer and slimmer. While I understand that for Mr McDermott it is very much a global issue, for a number of UK businesses it is very much an EU and European issue. The importance of trying to get the carbon price floor and EU ETS prices more aligned is still a really key point for us.

Q76 **Richard Fuller:** That sounds right.

Dr William Kyte: If we were trying to tighten the cap, we would certainly have very strong friends in Germany and France at the moment, unless, of course, the policies change in France with the upcoming election. Certainly Germany wants a tighter cap, because its domestic cap is tighter than the EU cap at the moment, in the same way that the British cap is tighter than the EU cap. It is not so much that we want to have a tighter cap to raise the price. The present EU ETS cap does not meet the Paris agreement.

Q77 **Richard Fuller:** It is focusing on a target, then.

Dr William Kyte: Yes. You have to focus on the target that meets the international agreement, which the UK and the EU have signed up to.

Q78 **Richard Fuller:** Sara, you were just talking about the carbon price floor. How many other members of the EU ETS have carbon price floors?

Sara Vaughan: I would have to take that away. I am sorry.

Andrew McDermott: Zero. It is a unilateral UK-only measure, which increases industrial electricity prices by about 10% and makes us less competitive versus our EU competitors, let alone our international competitors.

Sara Vaughan: I agree with that.

Q79 **Richard Fuller:** Nobody else has this.

Dr William Kyte: Germany has a pseudo one.

Richard Fuller: Nobody else has it—pseudo-schmeudo. We have this, which seems to be much more impactful than the ETS. Why do we not just say “goodbye, off you go” to the ETS? We can influence our



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competitiveness on a global scale. We do not need to worry just about the European Union. We have this tax mechanism that seems to enable us to hit those targets. ETS is not even hitting those targets. There is no indication that phase 4 is going to do that. There is no influence from the UK because we are leaving, unless we sign up to it for another four years. Let us just focus. If we want to clarify uncertainty, we ought to make a decision. Forget ETS; we are off. Now let us discuss those other things that, as Sara was saying, look complicated and uncertain right now. Let us get more certainty around those. You are chasing a dream, are you not?

Dr William Kyte: On the surface, a tax looks very, very attractive. The difficulty is that, if you put a tax on, you have no means of knowing what the outcome is. You do not know how much the carbon reduction will be. How do you guess at what price that tax has to be in order to make the reduction? Usually, taxes will be set too low to achieve a target, because of the public outcry that there will be against any tax. The ETS sets the target and the price is what the price is to meet that target.

Q80 **Richard Fuller:** So the combination of a target and a tax, or a smoothing effect, is a better outcome than just going with one of the two.

Dr William Kyte: No, an ETS without tax, or any interference, is by far the best.

Andrew McDermott: Climate change agreements have that element of stick and carrot. You have a carrot there in terms of tax reduction. Those elements already exist, so we have the opportunity to look at other things.

Q81 **Chair:** We have focused almost exclusively, and deliberately so, on the EU ETS. In the last five minutes, are there any other aspects of UK climate change policy that need to be prioritised as part of our Brexit negotiations?

Dr William Kyte: If we have a complete hard Brexit, we need to look at how the UK is going to build up and work in the international scheme. At the moment, we are part of the EU, which is a large enough bloc to negotiate in the international scheme. We have to look at whom we would ally ourselves with. Each country goes in there with different allies and we would have to look and see how we could build up an alliance of like-minded states, with the same aims as us, in order to amplify our voice on the international stage.

John Lanchbery: I completely agree with that approach. As I said, when we leave the EU we will leave a large and powerful bloc. Although we would be independently influential—as Norway is quite influential in climate talks—we would not have the sheer clout. It would be a good idea to try to build a bigger and better bloc. Apart from staying quite close to the European Union, there are a number of institutions you could look at. The Commonwealth might be an option. That would be an interesting option. The UK and many, but not all, of the EU countries



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have been part of the Green Growth Group, with many of the least developed countries and the Alliance of Small Island States. That has been quite influential—in fact, very influential at times. It has a broad spectrum of players from very well off countries to very, very poor countries. That might be an interesting vehicle to try to take up internationally.

Andrew McDermott: All EU-led climate policies need to be reviewed through the lens of international competitiveness and a supportive and stable policy environment. We need to see how this impacts competitiveness.

Q82 **Chair:** Thank you very much. Sara, you have been a fantastic witness so I feel slightly rude about this but, while I have you, we had npower in last week. We were talking about the energy market for domestic customers. Three days later, they put their electricity prices up by 15%. While we have you, is there anything you want to tell us?

Sara Vaughan: Chairman, you will know that, as an energy company, we keep our prices under review all the time, but there is absolutely nothing that I can tell you about our intentions or otherwise in relation to pricing. I am sorry.

Chair: So we might read it on Friday.

Sara Vaughan: There is nothing I can say.

Chair: Okay. Thank you. Can I thank you all for your evidence? That was really helpful.

Examination of Witnesses

Witnesses: Isaac Occhipinti, Philip Sellwood, Stew Horne and Joanne Wade.

Q83 **Chair:** Thank you for coming to give evidence to us. We are very grateful. For the purposes of the record, do you mind telling us who you are and which organisation you represent?

Isaac Occhipinti: I am Isaac Occhipinti. I am head of external affairs for Energy and Utilities Alliance. We represent the heating supply chain in the UK.

Philip Sellwood: I am Philip Sellwood. I am the chief executive of the Energy Saving Trust.

Stew Horne: I am Stew Horne, principal policy manager for energy regulation at Citizens Advice. We help 3,000 consumers a day with energy-related problems.

Joanne Wade: I am Joanne Wade. I am vice president of the European Council for an Energy Efficient Economy. That is the hat I am wearing this morning. So that you know where I am coming from, you should



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also be aware that I am the chief executive of the Association for the Conservation of Energy here in the UK.

Q84 Chair: I would like to start, if I may, with building regulations and how building regulations here are aligned with the EU. Emissions from our buildings make up 20% to 25% of our total emissions. To what extent are the directives and the regulations relating to this from the EU rather than domestically inspired?

Philip Sellwood: They are intimately linked, but it would be a fallacy to think that European legislation always leads UK legislation. The UK has been fairly influential over the years in terms of supporting ERDF; and, through concerted actions, UK organisations have been quite prominent.

Q85 Chair: That is an important point. We have been leading this in terms of EU policy.

Philip Sellwood: We have been leading in certain areas. It would be false to say we have been leading, but it would also be false to say that we are reliant on the EU forcing us to do things.

Q86 Chair: Which areas do we lead on and which do we tend to follow on?

Philip Sellwood: In terms of areas we may or may not have been as enthusiastic about, the development of energy performance certificates, for instance, would not have had either its genesis or, I suspect, its sustainability, if it had not been part of an EU package. Those sorts of regulations have definitely had their ownership and genesis in EU policy. On the other hand, rather sadly, we were leading the way in terms of zero-carbon homes and the move towards zero-carbon homes. Twice, and some might say three times, at the 11th hour, the Government resiled from implementing zero-carbon homes. That was an area of activity where we were seen to be leading. Unfortunately, that has now fallen by the wayside.

Isaac Occhipinti: With regards to building regulations, the EU has been quite good at pushing slightly more unpopular positions, which the UK has then followed. One of the question marks it raises is: would those decisions now be made, if we are outside the EU, without that external pressure? With regards to zero-carbon homes, there is going to be a pressure to build more and more homes, so will there be a pressure to lessen those building regulations as we go forward?

Stew Horne: We have a very narrow view on building policy in general, but, if you think about the products that go into making buildings more energy efficient, EU regulations have had quite a significant impact in reducing the emissions that have come from heating, with a 30% reduction in household gas use since 2005 and a 12% reduction in electricity usage since 2005. Those products, and therefore the standards that have influenced them, have made a useful contribution to those reductions.



Joanne Wade: I have nothing further to add at this point.

Q87 **Chair:** Isaac, you mentioned building more houses. We have a housing White Paper about to be launched and a statement in an hour or so. Will there be a trade-off between building more homes and energy efficiency requirements; and where does our membership of the EU fit in with this?

Isaac Occhipinti: It is often seen that there is a conflict there. There is a view that, if you increase that to a specific level, it becomes too expensive to build homes. Evidence that was produced in the past by the Zero Carbon Hub has proved that the incremental cost is relatively small. Therefore, it should not be a barrier. There is a political element to this, though, and therefore there is a risk that, politically, it is seen as the right thing to do to cut regulations in this area, in order to build more homes.

Philip Sellwood: I would be rather firmer. I spent six years on the Sustainable Buildings Task Group, and the independently assessed evidence said consistently that, at that time, the additional cost of building a new home to sufficiently high standards in terms of energy efficiency would be around 5%. You are probably looking at a false dichotomy. When you think about it, the first thing you should be doing in our new housing stock, which will be here in 50 years' time, is making it future-proof. The most idiotic thing would be to build property to less than energy efficient standards because, in 20 years, we will be doing what we are currently doing with houses that were built 25 years ago: retrofitting them, much more expensively. Get it right first time.

Q88 **Chair:** The Government are publishing a housing White Paper today. There are steps to try to quite dramatically up the number of houses that we have in this country. To what extent are things like building regulations and energy efficiency standards in buildings—we will come on to, perhaps, consumer products in a moment—shaped by the EU rather than arising domestically? We are looking at what happens when we leave the EU. Will this have any impact?

Philip Sellwood: There is no reason why it should at all. Re-implementing the zero-carbon homes target is—or could be—an entirely UK decision. There should not be any trade-off for the people who are going to be occupying those properties, many of which I am hopeful will be social properties. The last thing we want to do is to be building homes for the most vulnerable people in society and saying it is okay to build them to less than energy efficient standards.

Joanne Wade: The view of one of my French colleagues on the ECEEE board is that the European standards set a minimum and that individual countries can go further. That is their perspective. We all comply with those as a minimum, because why would you not? They are a good idea, but we are all looking to go further and faster.

Q89 **Chair:** Are they a minimum? We have been hearing from the previous



panel about the EU emissions trading scheme and the price of carbon. The price of carbon seemed to be relatively low. It was set by the market but it was a fairly minimum standard or price in that regard. Is this a similar thing here? I am trying to ascertain, in respect of negotiating our way out of the European Union, where we are vis-à-vis the EU, as opposed to domestically producing our own regulations, whether in regard to regulations on buildings or on energy efficiency. If the EU standard is there, are we there? I am just trying to get a feel for the Committee.

Philip Sellwood: It depends on each sector. It is very clear that automotive policy is not only pan-European; it is global, so our ability to influence, at scale, that policy is quite limited. In terms of energy efficiency, traditionally we have been either at the front or in the front of the pack, in terms of making and influencing policy. Withdrawal from EU should not affect it. However, in terms of renewables, others might have different views, but I would say we are sadly lagging. Frankly, the very poor performance that we have currently, in terms of both domestic and commercial renewables, is almost entirely dependent on EU regulations. If there were not those regulations, I am not at all confident in terms of renewable heat, for instance, that we would be doing any better than we are doing currently. It depends on each sector.

Q90 **Chair:** You mentioned zero-carbon homes and the decision not to progress with the fund. Do you think that, when we come out of the European Union and we might not have to deal with minimum standards that have been referred to, there will be a race to the bottom—Richard mentioned the phrase in a previous panel, and I do not like it either—when it comes to energy efficiency and building regulations in this regard? What is the mood music coming out of the Government?

Philip Sellwood: It is probably more importantly about what mood music is coming out of the industry. Really interestingly, industry did not pull the plug on zero-carbon homes. There was not overwhelming pressure from the building sector to say that this was something it could not put up with. In fact, after the last resiling from that policy, there was pretty much universal irritation from the construction industry that it had built itself up to develop a level playing field which was suddenly taken away. It is not an industrial-commercial issue, for the reasons I outlined earlier, in terms of cost. This is more a political decision.

Joanne Wade: We have to recognise that, in or out of the EU, we still have our climate change targets and, unless we keep a strong policy focus on that, we are not going to meet them. In some ways, in or out of the EU is a bit of an irrelevance in that sense.

Q91 **Amanda Milling:** I have follow-up points to pick up on. Going back to the minimum standards, to what extent have we driven those minimum standards? To what extent are we the leader in terms of where those standards have got to, to date?



Philip Sellwood: Again, it is quite sectoral. If we are looking at energy efficiency, we are pretty much up there. We belong to most of the influential committees that develop product and appliance regulation. One of the biggest issues we have as a country in Europe is the frustration about compliance. It has not been about whether we are making sensible regulation; it is about the level of compliance that is taking place across Europe. We have very much been leading that charge.

Just to give some reasons, because sometimes you question why you would want to do that, every £1 that is invested in energy efficiency, or at least product appliance regulation, is generating about £4 return. In real terms, that means that, in the last 15 years, the energy efficiency of products and appliances have gone up by somewhere between 25% and 35%. That saves individual households about €500 a year. There is very clear economic driver. There is a very clear environmental driver. In that area, we are leading. Going back to what I was saying about renewables, we have been reluctant partners in making regulation in those areas.

Q92 **Amanda Milling:** Take products as an interesting example. If we fast-forward five or 10 years, when we have left the EU, in terms of the regulations that we set here in the UK versus the regulations that are being set in the EU, do you think they will be in the same place? Do you think we will be ahead and they will be behind? What position do you expect us to be in?

Isaac Occhipinti: Our industry would like us to be in the same place, fundamentally. This comes from a business continuity perspective. Our members manufacture heating appliances in the UK and in Europe, and they want regulations and standards for those products to be consistent across Europe.

Q93 **Amanda Milling:** Just picking up on that, there would not be a situation where we were behind. We would still, in essence, be adhering to the EU.

Isaac Occhipinti: Yes. Our members would like us to be adhering to those standards and, because we have the 2050 climate targets, we know that those standards are going to be pushing towards the high enough levels that are going to be required.

Joanne Wade: You get the same impression from our European partners, which is, if you do not comply with them, you will just get the rubbish dumped on you that manufacturers cannot sell somewhere else. Why would you not comply with them? What logic is there in not at least complying? If we do not comply with them, with the trade barriers that will be set up, our exporters will not be able to export into Europe. Why would we not comply? This is the view you get from Europeans. The question they would ask is, "What alternative do you have?"



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Stew Horne: There is quite a complex set of frameworks that sit and drive the standards that we have in products, if we think of appliances, to the point where only about 25% of the standards developed within the European standards forums are derived from European legislation. The rest are industry-driven. It is a commercial imperative that is driving those standards. Based on where we are now, it is really useful for the British Standards Institute to be inside Europe engaging with those forums and to continue to do so even after we have left the European Union. There are a couple of areas where energy policy is moving forwards, and we are grappling with these issues at the same time as the European Union will be grappling with these issues. Those are around flexibility and demand-side response, and around smart appliances. They are both designed to reduce energy use and will both be new areas, so there is a risk that separate standards might develop. We would be really keen to make sure that the current level of consumer protection is maintained and that British industry continues to be influential within the European forums.

Q94 **Amanda Milling:** You are saying, though, that only a quarter of that is based on EU legislation. There is a lot of legislation that we create ourselves or is industry-led.

Stew Horne: That was about standards. Only about a quarter of those standards come from the EU legislation. The rest are derived from some other source, primarily commercial.

Philip Sellwood: It is important to reinforce that we are now well into the second decade of energy efficiency regulation in Europe. It is almost that that regulation now performs the role of dealing with the laggards. What is really interesting is that most of the companies that sit at the top of their tree, in terms of brand, in terms of competitiveness, surprise, surprise, are those that, generally speaking, offer the most energy efficient products. To answer your question, I think it will be the same companies leading that agenda because commercially, for the manufacturers and retailers, that is where customers want to be. Yes, there will be a role for those laggards that do not want to conform, do not want to be part of that competitive landscape. In terms of products and appliances, I would like to think that we are at least there, but hopefully, more importantly, ahead in the race.

Q95 **Michelle Thomson:** You touched on this in terms of the energy efficiency directive. Previously, there was a suggestion that industry had criticised its initial implementation. I wonder, before we move on, whether that was with the content of the energy efficiency directive or the way in which it was implemented. Have we moved on from that?

Philip Sellwood: I will address that in two ways. For the Committee's understanding, my organisation runs the concerted action for energy efficiency for Europe, for the UK and also for renewable energy. It would be our observation that the cycle of industry's response to that directive was not entirely outwith a normal response to a directive. In other



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words, there were a few at the vanguard that were feeling rather threatened. There were equally those that saw a great competitive advantage for UK businesses and manufacturers. There was no doubt that there was quite a discussion at the outset of that directive.

Again, this is just an observation, having managed a number of these directives now, but that is normal business. What tends to happen is that UK business generally gets behind it and, in these areas, it is generally at the forefront. It is really important not to be distracted by one or two outliers that would probably not be in favour of directives that were much less strong in their implementation. It is not something we should be overly concerned about. I would be interested in Isaac's view, but British industry will get to grips with that post-Brexit, whether that is our own legislation or whether that is working ever closer with a post-Brexit world.

Isaac Occhipinti: To echo the points that Philip raised, with regards to energy efficient products, British industry wants a bit of certainty and clarity over what standards are going to be required, going forward. Because many of these products are made in a pan-European fashion, either with components that are sourced from Europe or manufactured themselves in Europe, there is going to be a requirement that they know where product standards will be. It takes two or three years to redesign products. You do not necessarily want to have two or three production lines, one making a product for the UK, one making a product for Europe, when they could be one and the same, thereby reducing costs and ultimately reducing costs for homeowners.

Joanne Wade: The response I have had from industry is that they are looking for certainty. They do not have a problem with regulation. If they know what it is going to be and have time to react to it, they prefer that because they know what they are aiming for. What they do not like is uncertainty.

Q96 **Michelle Thomson:** We touched with an earlier panel on so-called transitional arrangements or a mechanism by which you smooth from one state to another. What are your thoughts in your specific areas about how that can best be handled? We keep talking about certainty but what are the key triggers: we must know about this, whereas we could understand a level of flexibility about that?

Isaac Occhipinti: With regards to product-specific regulation, there is going to need to be certainty. To be honest, industry are telling us that they want to the current directive—the Energy-related Products Directive—transposed directly through into UK law because they want that level of certainty going forward.

Q97 **Michelle Thomson:** How long for?

Isaac Occhipinti: Ideally, they would like that to continue to mirror the EU legislation as it changes, because they are not just UK manufacturers. Because they have interests across Europe, any deviation from those



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standards means that their production costs increase. That would be their key point.

Philip Sellwood: The other practical example of what we could do in that area is what the Swiss do. They basically transpose the majority of EU law in this area into their own law, but then have an annual review and choose those areas that are applicable to the Swiss market. They have developed a hybrid, if you like, of taking on board probably 90% of that legislation. They can choose not to—and they famously chose not to on coffee machines, for reasons that you might understand—go with particular legislation from the EU directive. There are other mechanisms by which it can be engaged at transition.

Q98 **Michelle Thomson:** There is the potential to optimise some assets with this hybrid approach. What are other examples, quickly before we move on?

Philip Sellwood: You could do a Norway. You could decide to continue to pay into and be part of the influencing mechanism, more than the Swiss are, but you are still paying quite a heavy price for relatively low levels of influence. The reality is, as panellists have already said, I could not imagine a situation where we would not want to transpose the vast majority of that law into UK law. As the Norwegians have found out, paying to do the 10% is not necessarily the cost-effective solution.

Stew Horne: Looking at the timeline, the clean energy package is due to come in in 2019, so the exact final timing will be important. That means that the clean energy package should be transposed into the great repeal Bill. We will probably get on to this later, but there are other aspects of continuing relationships that are really important. For example, we have a number of physical interconnectors, which connect us to electricity markets abroad: to France, to Ireland, to Belgium. It will be really important for our regulators and our industry to continue to engage with the forums and play a strong role in developing a policy for how that cross-border trade develops and continues over time.

Q99 **Richard Fuller:** We are leaving the EU. Let us start with the area of consumer protection. What should we look forward to? What can we do new and different? If you had to mention one specific priority, what would you say we should be encouraging the Government to take on board?

Philip Sellwood: The single biggest priority is not to miss the opportunity, with the introduction of the winter package in Europe, to take a strong ownership of energy efficiency as the first principle. What does that mean? That means that we have the opportunity outside of Europe to mirror the view that, rather than automatically investing in the supply chain infrastructure, which is clearly expensive and needs to be sustained and maintained, doing everything we can in terms of energy efficiency, both on the industrial and commercial scale and also domestically, for all the reasons that we know, is economically, socially



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and environmentally right. You might say, "We are already doing that. That is not very new". In fact, we are not doing that. We do energy efficiency after the event. I am suggesting that we take energy efficiency and we put it as the first fuel, not as the fifth fuel, which is where it currently sits.

Q100 Richard Fuller: You are saying that, at the moment, we are concentrating on loads of things in the EU. Now we are out, our priorities can be our own priorities and we should put energy efficiency as number one.

Philip Sellwood: Yes. I do not just mean number one in insulating homes. I am talking about number one in terms of our industrial strategy, our commercial strategy, our economic strategy.

Isaac Occhipinti: The one area that we would see where potentially there could be conflict with the current EU goals is on energy policy. We have an opportunity to customise energy policy in a way that better meets the specific needs of the UK. That is with regards to the fact that 80% of homes are on the gas grid. The EU is tending to move towards electricity and heat networks. We have an opportunity to maybe customise that policy to better benefit UK consumers.

Q101 Richard Fuller: That is very interesting. Here is a very clear difference. In the EU, where we pool our interests, they are much more interested to talk about electricity. For us, that is not so interesting because we are really into gas. Now we are on our own, we can focus on that. That is really good. I like that. What can we do?

Isaac Occhipinti: We need to emphasise decarbonising the gas grid.

Q102 Richard Fuller: That sounds expensive.

Isaac Occhipinti: Not as expensive as electrifying the grid. To move towards an all-in-all electric heating system would cost about £12,000 per householder. It is not the same with gas. As I say, 80% of people use gas currently in the UK. Decarbonising that gas for the UK is a much better practical solution, and better for UK consumers, than a pan-European approach. That is energy policy in the round. There are specifics with regards to product regulation that benefit from a more pan-European approach.

Richard Fuller: Carry on. You are on fire. Come on, what else?

Isaac Occhipinti: That is my point made on that front.

Joanne Wade: Can I come back on that slightly? It is about decarbonising our heating in the best way for the UK, which will, in some instances, mean decarbonising the gas grid. In other instances, it will mean completely different things.

Q103 Richard Fuller: Can we do that in the EU?



Joanne Wade: Yes.

Richard Fuller: That is not my question then. My question is not: what is a good thing to do? My question is: now that we have left the EU, what new freedoms do we have—changing our priorities, setting new priorities, doing something that is not of interest to the EU because it is not such an important part for them? What would be your choices? Now we are out of the EU, we can do things differently. What is the most important thing, in either consumer protection or energy standards, that we should be doing and we could not really do, or not do as well, in the EU?

Joanne Wade: I am not convinced that there are things that we could not really do in the EU. We would put the efficiency first agenda up there, as Philip said.

Q104 **Richard Fuller:** You think that, in the EU, that is not happening.

Joanne Wade: No, I am saying it would happen in the EU. My point is that I am not sure there are things we can do that we could not have done in the EU. There are lots of things we can do, and we should do, but we probably could have done them if we were still in, but we are not.

Q105 **Richard Fuller:** I am glad you raise that, because it seems that, not just in this, but in many other aspects, the thinking of many groups is that everyone is used to doing business in the EU, so we think, “We will just do it through the EU”. The idea of taking up these opportunities now we are out is new. It has not even been a year since the public voted to leave, so it is going to take time to refocus our attention and embrace these new opportunities and freedoms. Is that a fair observation: that the policymakers should not be trying to be too descriptive too early because to find out what those good ideas are, balance those priorities and get input is going to take some time?

Isaac Occhipinti: From a product perspective, that is not the case. We need certainty on product regulation because, if there is a cliff edge with regards to product regulation, let us say in 2019 when we leave, and there is no product regulation—

Q106 **Richard Fuller:** That is not going to happen, is it, because we are going to grandfather it all in?

Isaac Occhipinti: But we need certainty that it is going to be the current EU ERP product regulation, because it maintains a level of certainty across. There are other areas, as you have said, where there may be opportunities: the renewable energy directive, the EU policies on energy.

Q107 **Richard Fuller:** I want to keep up the steam, because what Philip was saying sounds really interesting. Your point, Isaac, sounds interesting and new. If we are leaving the EU in this area, we ought to be thinking, particularly on consumer protection, about what we can do differently.



Stew Horne: On consumer protection, we will be able to do our own thing. We will be able to take decisions. We have been at the forefront of developing consumer protection in Europe in the past. Therefore, the consumer protections very much reflect what we would want to see for energy consumers. If Parliament decides to make changes to consumer protection, we would really like to see the Government carry out cost-benefit analysis to make sure that they are the right changes and they benefit consumers. We will have the freedom to do different things, but we will have to think carefully about what those divergences might be.

On the other hand, we will have more freedom outside the European Union to make changes to VAT. Removing VAT from energy bills is one of the most progressive tax changes that can be made, because it would largely benefit those on lower incomes, proportionately more so than those on higher incomes, to the tune of about £60 per year for every bill-payer. It would mean moving VAT to general taxation, but we think it is a move that would be very well worth making. You could also make a similar move on energy efficiency products and take VAT taxation away from those. That would be good for the economy in general; it would help to deliver carbon reduction and cuts to fuel poverty; and it would really get to the heart of the problem, because you build in a year-on-year reduction and year-on-year savings on bills.

Q108 **Richard Fuller:** I was interested, Mr Sellwood, between you and Mr Horne, in whether you would still support cutting VAT, given that you say we should be putting energy efficiency at the top of our agenda? Is there consensus that the social benefits make it a good idea and you can still heat your house?

Philip Sellwood: Absolutely, yes, and we have always been of that view, because the reality is that you are penalising people for doing the right thing. If you are using a product that is not deemed energy efficient, it is attracting one level of tax. If it is energy efficient, you are attracting another, which is regressive because most of the people who are benefitting from those measures are those who are socially vulnerable. Therefore, yes, we would support it.

Finally, on the energy efficiency first thing, going back to what we can do differently, the reason why there is such excitement for the UK is that we have the opportunity to make energy efficiency part of our infrastructure agenda. In structural terms, we have more or less the poorest housing in Europe. There is a massive opportunity for us, which would not have prevailed as part of a European package of measures, that the Government have the ability to make happen now.

Joanne Wade: On the VAT issue, we need to be careful because higher income consumers spend more on energy than lower income consumers. If you cut VAT, you give them more back than you give lower income consumers. Lower income consumers spend a higher proportion of their spending on energy.



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Q109 **Richard Fuller:** It is a bit like the income tax allowance.

Joanne Wade: Yes. If you cut VAT on energy-saving materials and allow people to manage their bills better, then the people who are spending more of their income on their bills get that control over their bills. Of course, we are completely in favour of cutting VAT on energy-saving measures. Cutting VAT on energy is a tricky one. You end up with more money in the pockets of low-income consumers. You also end up with more money in the pockets of high-income consumers and you potentially end up with higher carbon emissions. I am not so convinced about that one.

Q110 **Chair:** This is an important point. As part of the referendum campaign, cutting VAT on fuel was one of the instances given as to how we could take our country back. It was maybe not as prominent as the £350 million a week for the NHS

Richard Fuller: It was £100 million a week and it will happen.

Chair: It is not necessarily about Brexit negotiations but, in terms of priority for energy and climate change policy and, by implication, fiscal policy, would you recommend to us that we recommend to the Government that VAT on fuel should be cut as a means of providing greater flexibility and control for ourselves?

Stew Horne: Yes, we would. We would do it on the grounds that it would help those consumers who are really struggling to pay their energy bills.

Q111 **Chair:** Would that be a trade-off, though, with, as Joanne said, higher carbon emissions? If there was a cut in VAT, would people turn the heating up a bit more?

Stew Horne: To an extent, but the benefit of alleviating that problem is much greater than the harm it causes on the other side.

Joanne Wade: Rather than cutting VAT, if you invest more in energy efficiency, people are warmer without turning the heating up. They are just not wasting as much, so to me cutting VAT should not be a priority.

Philip Sellwood: It is not a reason for not doing something, but it is a reason, as the previous member said, for us to be clear and rational in our approach. There is a direct relationship in terms of the reduction, whether it is the tax element or otherwise in terms of fuel, and the number of miles driven. It is almost linear. We have to accept that if we are going to do that we are likely to look forward to more people using more cars for more miles. That is a trade-off, again, that we have to accept.

Chair: That has been really helpful. Thank you very much for your time. We really appreciate it.