

# **Energy UK's – Written evidence (EEH0009)**

**February 2021**

## **Introduction**

Energy UK is the trade association for the energy industry with over 100 members spanning every aspect of the energy sector – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership. We represent the diverse nature of the UK's energy industry with our members delivering over 80% of both the UK's power generation and energy supply for the 28 million UK homes as well as businesses. The energy industry invests £13bn annually, delivers £31bn in gross value added on top of the £95bn in economic activity through its supply chain and interaction with other sectors, and supports 738,000 jobs in every corner of the country.

Energy UK welcomes the opportunity to respond to the EU Environment Sub-Committee's call for evidence on the Trade and Cooperation Agreement (TCA) between the UK and the EU. The Energy sector plays a key role in the decarbonisation of the UK economy and has ambitious climate targets which make the UK a global leader in the fight against climate change. The TCA provide an opportunity for both the UK and the EU to continue to demonstrate leadership in energy and climate policy which needs to be seized.

## **Please indicate which of the following industries or policy areas you are responding in relation to.**

- 1.1. Energy UK is the trade association for the energy industry and is therefore directly concerned with energy and climate change policy areas.

## **What is your assessment of the relevant provisions in the UK-EU Trade and Cooperation Agreement, and their impact on your business or policy area?**

- 2.1. Energy UK welcomed the deal on 24 December and was pleased to see the Title and Annexes dedicated to energy, as well as the commitments on climate. The deal is not as comprehensive as we would have liked, but at least removes tariffs and quotas with the EU which will mitigate to some degree the impact of the changes to trading arrangements.
- 2.2. On energy and climate specifically, Energy UK feels the TCA provides space for collaboration in several areas of importance to the sector and of relevance to the UK government's decarbonisation agenda. It is worth noting however that most of the work that now needs to take place centres on building new platforms for cooperation with our EU counterparts as the deal was not able to preserve the UK's participation in existing platforms.

2.3. As such we note the following:

- UK Transmission System Operators (TSOs) will be able to cooperate with the European Network Transmission System Operators for electricity (ENTSO-E) and gas (ENTSO-G), but are no longer members of these associations.
- The British national regulator, Ofgem, will be able to cooperate with the Association for the Cooperation of Energy Regulators (ACER), but is no longer a member of ACER.

2.4. In both cases, work needs to start to develop these new platforms for cooperation. These are needed to drive the work in the following areas:

- Alternative cross-border trading arrangements: a new system must be developed by April 2022 for the allocation of Day-Ahead electricity interconnector capacity based on “multi-region loose volume coupling”. The UK has reverted to less efficient trading arrangements and this work should allow a return to a higher level of efficiency. BEIS and their EU counterpart are due to send out letters to their respective TSOs to get the work going.
- Coordination of capacity allocation and congestion management across electricity interconnectors between concerned EU TSOs and UK TSOs through the development of arrangements for all relevant timeframes.
- Cooperation to facilitate the timely development and interoperability of energy infrastructure connecting UK and concerned EU territories.
- Cooperation on security of supply of electricity and natural gas.
- Cooperation in the development of offshore renewable energy by sharing best practices and, where appropriate, by facilitating the development of specific projects.
- Implementation of a system to maintain non-discrimination and third party access to gas and electricity networks.
- Cooperation between the regulators and standardisation bodies to facilitate the development of international standards on energy efficiency and renewable energy.

2.5. Energy UK welcomes the creation of a Specialised Committee on Energy (SEC) which will oversee the implementation of the TCA on energy and is keen to hear more about the functioning, remit and implementation timescale for the Committee.

2.6. Energy UK also welcomes the provision on competition in markets and non-discrimination which will continue to ensure that customers are free to choose, or switch to, the electricity or natural gas supplier of their choice within their respective retail markets.

2.7. A policy area that remains a high priority for Energy UK and the decarbonisation agenda is carbon pricing. The TCA again offers space for

collaboration, proposing cooperation on carbon pricing and noting that “serious consideration” should be given to linking the UK and EU Emissions Trading Schemes (ETS), but, with no set date for completion, this falls short of our expectations.

- 2.8. Energy UK has always been clear that a standalone UK ETS can only be a short term solution and the vehicle to linking the UK and EU ETS to restore the benefits of a wide ranging, liquid and mature carbon market. This is therefore an area of priority where we would like to see the work on linking start as soon as feasibly possible. We suggest that BEIS and their EU counterpart set out the timetable and process to get this work going and inform affected parties as soon as it is clear when a linkage can be reached.
- 2.9. Lastly, a provision that raises longer term concerns relates to the termination of the Energy Title VIII on 30 June 2026, with the need to renew it on an annual basis. The TCA recognises climate change as a threat to humanity yet does not provide a long term vision for the energy sector, a central actor in the fight against climate change. Long term projects, investment and challenges define the energy sector and cooperation on energy is needed to support the transformation that the energy system has to go through in order to drive the decarbonisation agenda.

### **What do those provisions achieve?**

- 3.1. As noted in the previous section, the provisions on energy and climate provide space for cooperation which is welcome as absolutely necessary if we are to successfully build our low carbon future. However, these provisions are high level and do not provide any concept of timescale, processes and delivery.
- 3.2. The UK government has an ambition of building 40GW of offshore wind generation in the North Seas by 2030. While this might seem far away at this stage, this is a gigantic and complex project. We have built 10GW over 20 years so far. The EU aims to create over 250GW of renewable energy in the northern seas. Without cooperation platforms in place between TSOs, regulators, standard bodies and energy companies, we are at risk of seeing two gigantic projects being developed in parallel and in exclusion of one another.
- 3.3. This would run counter to the main objective of the Energy Title, “to facilitate trade and investment between the Parties in the areas of energy [...], and to support security of supply and environmental sustainability, notably in contributing to the fight against climate change [...]” and to the recurring aim of ensuring the efficient use of electricity interconnectors and reducing barriers to trade between the EU and the UK.
- 3.4. Energy UK urges both Parties to publish their work plans and timescale to deliver on all the provisions in the Energy Title, as well as on carbon pricing and the linking of the ETS.

**What, if any, challenges arise because of those provisions? How could these challenges be resolved?**

- 4.1. As noted previously, the UK has lost its membership of ENTSO-E, ENTSG and ACER, therefore losing our most direct way to influence the future development of energy policy at an international level and at EU energy policy which the UK used to drive.
- 4.2. The lack of timeframes to set up new forums for cooperation, of clear remit and of the processes for these forums to operate, means that it is difficult at this stage for industry to get involved in the work and understand how we will be involved in the future.
- 4.3. On the EU side, we know that the European Commission has decided to establish a new Service for the EU-UK Agreements (UKS). The UKS will only be operational as of 1 March 2021.
- 4.4. From our engagement with BEIS up to this point, it is not clear how the work will proceed, neither with the EU nor internally. We therefore ask that BEIS urgently publish their work programme on the implementation of the TCA provisions and how they plan to engage with and involve industry.
- 4.5. Delays create risks of divergence, especially in new areas of policy and climate action, where both the UK and the EU are still in exploring mode. Starting with two separate sheets of paper, with no collaboration, we might end up with two very different approaches, which could ultimately lead to two systems that are not compatible. Taking the example of the decarbonisation of gas, we could see different sets of standards on hydrogen blending which could prevent trade in blended gas in the near future.
- 4.6. Regarding, the Specialised Energy Committee (SEC), the text in the provision is too vague to provide a clear vision on the importance and the role of the Committee is driving the work required under the various provisions. Our understanding so far is that the SEC would meet once a year and review and assess the work done to date and the implementation of the provisions. Further clarification on the role and remit of the SEC are urgently needed.
- 4.7. Energy UK notes that the issue of Guarantees of Origin (GoOs) (used in fuel mix disclosure) is not addressed in the TCA. The UK government currently continues to accept EU GoOs, but plans to review this in 2021 to achieve mutual recognition as the EU no longer accepts UK GoOs (REGOs). We would like to stress that importers of GoOs will need a lead time before any changes to the current arrangements are made and that any changes to the validity of EUs GoOs should not take place during a compliance period.
- 4.8. Finally, Energy UK members are finding that complex rules of origin mean that the import of energy-related parts from EU suppliers that move in and out of the UK are incurring VAT and tariffs. For pan-European businesses working with pan-European supply chains (e.g. electric vehicle-related parts

and renewable generation components), this is inefficient and could undermine the cost benefit of undertaking some projects. Further guidance could help unlock more efficient supply chains.

**What should the UK seek to accomplish with the EU in relation to your industry or policy area within the parameters of the Agreement in the short- and mid-term?**

Linking ETS

- 5.1. Energy UK remains strongly in favour of agreeing a link between the UK ETS and the EU ETS as soon as is practicable, with the ambitions of covering 2021 emissions. Energy UK has always been clear that any fall-back solution, including a standalone UK ETS, should only serve as a bridging mechanism in the interim period ahead of linkage to the EU ETS.
- 5.2. Owing to a number of current operational issues with the UK ETS scheme, including a delayed start to auctions, the standalone UK ETS is not delivering a strong and stable carbon price signal in 2021 so far, nor is it likely to, until auctions start in Q2. Starting an ETS without full auctioning nor existing allowances in the market has made it extremely challenging to manage the price risks for an important input cost for electricity generation in GB. This is compounded by the lack of a secondary market to trade derivatives of UK allowances (UKAs) also until Q2 2021.
- 5.3. Electricity trading in the first quarter of 2021 will therefore be accounting for, and pricing in, this additional carbon price risk, adding avoidable costs to the supply of electricity which could ultimately compromise the smooth operation of the power generation sector and wider GB electricity market.
- 5.4. A standalone UK ETS is significantly smaller in size compared to the EU ETS, with UK participants only, resulting in a much greater geographical concentration and a lower level of diversity between and within sectors. The combination of these characteristics means that the supply-demand balance in the UK ETS (and resulting carbon price) is likely to be more volatile than the EU ETS. Energy UK believes that the sooner a linkage with the EU can be agreed, the quicker this damaging uncertainty for GB electricity markets can be removed.
- 5.5. We understand that the current government position is to leave the door open to linkage to other carbon markets. The EU ETS is the largest and most mature emissions trading system in the world and offers increased liquidity, price stability and lower vulnerability to market shocks as a result. Energy UK supports linking to the EU ETS as the optimal solution, providing the widest benefits in support of the UK's decarbonisation agenda, and does not believe that linking to other carbon markets would provide such benefits.
- 5.6. Given that the trade of goods and services is set to continue with the EU under the TCA including power through the interconnectors, linkage between our respective ETS facilitates an equitable trading relationship with the EU

and performs a similar function for the Single Electricity Market (SEM) in Ireland. Avoiding cross-border distortions, covering aviation and shipping between the UK and EU, as well as regulatory divergence between Great Britain and Northern Ireland, are important benefits from linking the UK and EU ETS. This will also support the development of large and complex offshore grid projects in the North Seas.

- 5.7. From a technical perspective, establishing a link between the UK ETS and EU ETS should be relatively quick and straight forward, especially considering that the UK ETS design is very similar to the EU ETS. It is also possible for the UK and EU ETS to operate under an agreed linked scheme in 2021 without an IT link yet secured between UK and EU Registries until the compliance deadline in April 2022.
- 5.8. Energy UK believes that the UK government and the EU should clearly state their desire to link and give the go ahead for the work on linking to begin now in order to be able to demonstrate their international commitment to tackling climate change ahead of COP26 in November this year. There is strong cross-industry support for linking and both Scotland and Wales have stated their strong preference to link the UK ETS to the EU ETS.
- 5.9. Energy UK recommends that BEIS kick off the process with the EU and set up a platform for engagement with industry here in the UK to ensure we are involved throughout the process. Auctions need to run as soon as possible so that the UK ETS is seen to be functioning properly as this is likely to be a prerequisite to agreement of linkage with the EU ETS. The longer the delay in agreeing linkage, the more likely it is that there will be divergence between the UK ETS and EU ETS in design, scope and price.

#### Trading arrangements and interconnectors

- 5.10. The UK and the EU have enjoyed the harmonisation of cross-border trading across interconnectors for many years. As a result of Brexit, the UK has left the Internal Energy Market (IEM), and all the associated platforms and mechanisms. The UK has reverted to explicit trading, which implies booking the power and the capacity over interconnectors separately, leading to less efficient trading.
- 5.11. As noted in the second question, alternative cross-border trading arrangements must be developed by April 2022 for the allocation of Day-Ahead electricity interconnector capacity. This project will allow the UK to return to more efficient trading arrangements that it is now operating under since 1 January. 15 months is an ambitious target and will require real commitments on both sides to deliver the new arrangements on schedule. This work should now have started and we are engaging with BEIS to ensure that industry is involved.
- 5.12. Common platforms for trading electricity allow power to go to the right places at the right time, enabling efficient transmission of power between countries and creating the right incentives and signals. This needs to be

done as efficiently as possible, both in terms of delivery and cost, and needs to support security of supply while the energy system transforms itself to reach carbon neutrality.

- 5.13. With large cross-border projects in the pipelines, involving interconnectors, it is important that the work on alternative trading arrangements is completed on time, setting the way for future projects to be developed with the most efficient trading arrangements in place from day one.
- 5.14. It is important to note that leaving the IEM on 1 January had led to the legislation that supported the coupling of the Day-Ahead market in GB to fall away. This means GB Power Exchanges no longer share order books to deliver a single day ahead price. This has led to the two day ahead auctions often clearing at different prices, leading to additional risk for market participants (especially renewable generators) and ultimately additional cost for customers. Although we hope that the new cross-border trading arrangements in April 2022 will solve this problem, this cannot yet be guaranteed. As such, we suggest that Government use secondary legislation to enable the Power Exchanges to go back to being able to share order books and deliver a single Day-Ahead price.

#### North Seas Cooperation

- 5.15. Article 23 of the TCA calls for cooperation in the development of offshore renewable energy and proposes the creation of a forum for technical discussions, similar to the already existing North Seas Energy Cooperation.
- 5.16. The UK and EU's ambitions on decarbonisation give the northern seas a leading role, to welcome the vast majority of the 100GW target of offshore wind by 2030 and close to 400GW by 2050 – from less than 25GW today. The UK and the EU have pretty much aligned climate targets and stringent environmental legislations, providing a shared vision.
- 5.17. A well-designed and well-built offshore grid can deliver at the lowest cost and in the most efficient way, allowing power to flow to the right place at the right time. This will involve interconnection and cooperation between the UK and neighbouring countries through a harmonised approach.
- 5.18. Presently, each offshore wind farm connects directly to the mainland. While this is feasible on the current scale, this will not be the case on a bigger scale. A move from individual connection points to a better coordinated collection of power across the various windfarms is needed. This will require more interconnection capacity to bring power to the mainland but also to transport it between the different countries involved.
- 5.19. There are various existing forums that allow for cooperation and facilitate discussions. Unfortunately, the UK is no longer part of them, and some of the work this year will be to establish new forums and new ways to work together.

- 5.20. From a regulatory perspective, a common approach to regulation for large infrastructure projects will be required to make end-to-end systems work together. While UK and EU regulatory models do not have to be exactly the same, they will definitely need to be compatible. Technically, the various bits of equipment need to work together and talk to each other to avoid incompatibility issues.
- 5.21. Harmonising and aligning standards and regulations related to safety and certification of equipment will also be valuable. It will allow equipment to be installed anywhere across the offshore system and for people with the right training and certificates to go anywhere required. From a commercial point of view, this also creates a bigger market for UK businesses.
- 5.22. Many Energy UK members with an interest in the North Seas have European or international parent companies with projects in many parts of the world. It is easy to see how poor coordination and synchronisation could make the creation of the offshore grid inefficient and costly for all, including energy consumers. With billions of pounds of investment required, intergovernmental cooperation will be needed to develop market frameworks for such large and complex projects.
- 5.23. Attracting investment will remain key. This relies on creating confidence in the viability and profitability of these projects. The Contracts for Difference, the main mechanism in the UK for procuring offshore wind, has been very successful in driving prices down, by providing certainty and visibility for investors, creating a commercial route for projects. The TCA allows for subsidies for large cross border cooperation projects, recognising the need for government support where necessary.
- 5.24. While offshore renewable energy mainly refers to offshore wind, this is not the only space for cooperation in the North Seas. Alongside cross-border transport of renewable electricity, there are also mutual benefits to establishing collaboration in the production and transport of low carbon hydrogen as well as the transport and storage of CO<sub>2</sub>.
- 5.25. The North Seas offers solutions for the capture, transport and storage of CO<sub>2</sub> (CCS) from industry in depleted gas fields. Several countries, including the UK have plans for this and should therefore work together to develop standards, regulations and market frameworks.
- 5.26. Low carbon hydrogen can play a key role in decarbonising difficult parts of the economy, including high energy-intensive processes. Green hydrogen can be produced using low carbon electricity such as nuclear or renewables. Green hydrogen produced from offshore wind would offer another way to utilise the North Seas potential. Policy development is also needed in this field and again cooperation is required if all parties are to benefit fully.