



House of Commons  
Energy and Climate Change  
Committee

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**Emissions Performance  
Standards:  
Government Response to  
the Committee's First  
Report of Session 2010–11**

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**Fourth Special Report of Session 2010–11**

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## The Energy and Climate Change Committee

The Energy and Climate Change Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department of Energy and Climate Change and associated public bodies.

### Current membership

Mr Tim Yeo MP (*Conservative, South Suffolk*) (Chair)  
Dan Byles MP (*Conservative, North Warwickshire*)  
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The following members were also members of the committee during the parliament:

Gemma Doyle MP (*Labour/Co operative, West Dunbartonshire*)  
Tom Greatrex MP (*Labour, Rutherglen and Hamilton West*)

### Powers

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at [www.parliament.uk/ecc](http://www.parliament.uk/ecc).

### Committee staff

The current staff of the Committee are Nerys Welfoot (Clerk), Richard Benwell (Second Clerk), Dr Michael H. O'Brien (Committee Specialist), Jenny Bird (Committee Specialist), Francene Graham (Senior Committee Assistant), Jonathan Olivier Wright (Committee Assistant), Emily Harrison (Committee Support Assistant), Estelita Manalo (Office Support Assistant), and Nick Davies (Media Officer).

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# Fourth Special Report

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On 2 December 2010 the Energy and Climate Change Committee published its First Report of Session 2010-11, *Emissions Performance Standards* [HC 523]. On 8 February 2011 the Committee received the Government's response to the Report. It is appended below.

## Appendix: Government Response

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### Introduction

The Department is grateful for the Energy and Climate Change Select Committee's detailed consideration of an Emissions Performance Standard (EPS).

In the Coalition's Programme for Government, it was stated that the Government will establish an EPS that will prevent coal-fired power stations being built unless they are equipped with sufficient carbon capture and storage to meet the EPS. In the 2010 Annual Energy Statement, the Government announced its intention to consult on the EPS as part of a wider consultation on reform of the electricity market.

On 16<sup>th</sup> December the Government launched the Electricity Market Reform (EMR) consultation. This contains more detailed proposals on the design of an EPS as a complementary mechanism to a package of reforms, including the introduction of Feed-in-Tariffs, Carbon Price Support and Capacity Payments.

The Committee will appreciate that, as we are in consultation on the EPS proposals as part of a potentially complex and far-reaching series of interventions in the electricity market, the Government cannot make any firm commitments on the outcome as regards EPS, but we will have more to say on this subject as part of a White Paper later this year. **For the moment, everything which we say here about Government's views and intentions in connection with the EPS proposals and the other elements of the proposed EMR package of reforms has to be read as representing conclusions which at this stage are only provisional and remain subject to the outcome of the ongoing consultation.** Accordingly we have tried to respond in a timely fashion to the Committee's recommendations, whilst recognising that Government will need to analyse the responses and feedback on the consultation carefully before making any final decisions on the design and approach to the EPS or other aspects of EMR.

This Government is fully committed to decarbonising the power sector, and must do so in a way which is affordable for consumers and maintains security of supply. We consider that the package we are consulting on provides an effective way to do this, by giving revenue certainty to low carbon generation and adequately rewarding back up capacity. As part of this package, the EPS would provide assurance that no new coal power stations are built or operated unless they abate a proportion of their carbon emissions.

The ECC Select Committee made 19 recommendations and conclusions in its report. These are detailed below, together with the Government's response.

## Energy and Climate Change Select Committee recommendations and Government responses

### *The UK power sector: trends and targets*

**1. We believe that the policy framework as it currently stands is grossly inadequate and will not deliver adequate investment in new low-carbon generating capacity for the 2020s and 2030s. The Government has acknowledged this fact and plans to consult shortly on a number of reforms to the electricity market. Reforms to the electricity market are required urgently in order to ensure sufficient investment is made now to deliver infrastructure for the 2020s. The Government must not delay in conducting its consultation and delivering a White Paper in Spring 2011. Any slippage of the timetable will jeopardise climate change and energy security objectives. (Paragraph 18)**

The Government believes that transforming our electricity system is crucial to meeting our security of supply and climate change goals. Our electricity system has served us well up to now, but new objectives and challenges over the next few decades mean that reforming our electricity market is essential to deliver the investment we need in new plant, and in particular low-carbon generation.

The UK Climate Change Act (2008) sets out a requirement to reduce our greenhouse gas emissions by at least 80% by 2050 relative to 1990 levels.

The UK will need to achieve these emissions reductions while at the same time safeguarding energy security, by replacing plant that is already scheduled to close and by ensuring that the system is sufficiently flexible to balance supply and demand and avoid outages. The transformation of the electricity system will require large scale investment and the Government is also keen to maximise the economic opportunities for UK business presented by national and global decarbonisation.

The Government's own analysis, including the 2050 Pathways Analysis, has identified conclusions about actions which appear to be common to many of the plausible pathways to meeting our targets.

Key among these conclusions was the need to change the way we use energy and the need to transform our energy supply. A new policy framework is essential to help change the way energy is used and deliver the investment required to build a low carbon power system that provides security of supply at a price affordable for consumers.

As a result of this analysis the Government launched a consultation on its proposals for Electricity Market Reform (EMR) on the 16 December, and is on track to deliver the White Paper later this year. The Government recognises the importance of providing early certainty to investors but must balance this with the need to get the detail of these major reforms right.

The Government's objectives for reform of the electricity market are security of supply, decarbonisation and affordability. Alongside this the Government is using four broad principles of cost effectiveness, durability and flexibility, practicality and coherence to judge the effectiveness of different market design options.

The EMR consultation contains a number a of proposals, and the preferred package of reform measures includes:

- carbon price support, which would encourage investment in low carbon technologies by increasing the cost of fossil fuel generation;
- feed-in tariffs, which would be long-term contracts to provide more certainty on the revenues for low-carbon generation;
- capacity payments, targeted to encourage security of supply through the construction of flexible reserve plant or demand reduction measures; and
- an Emissions Performance Standard to provide a backstop to limit how much carbon new coal plant are permitted to emit.

Taken together, the proposals are designed to ensure that low-carbon technologies becomes a more attractive choice for investors and adequately reward back up capacity to ensure security of supply.

### ***The role for an emissions performance standard***

**2. We welcome the Government’s decision to consider an EPS alongside a wider package of market reforms, rather than in isolation. However, we are concerned that interactions and overlaps with existing policies as well as proposed new market reforms are insufficiently understood. We therefore recommend that the Government commissions an independent review of regulations and market reforms in the electricity sector. The review should investigate the combined impact of new and proposed policy measures on energy costs, greenhouse gas emissions, energy security and the cost of compliance and should be conducted alongside the Government’s own consultation. (Paragraph 22)**

The Government fully understands that the attractiveness of the UK electricity market is affected by other areas of policy including the planning system, technology licensing and grid connection regime that all support the development of major infrastructure. The EMR is not seeking to address these wider factors, but Government recognise that they are critical enablers for investment decisions that have the potential to significantly reduce investment costs and are being considered in other areas and consultations.

The market design should deliver its objectives efficiently to minimise cost increases for consumers and ensure that the UK is an attractive place for energy companies to do business. The Impact Assessment accompanying the consultation considers the impact of the range of measures, and, among other things, includes assessment of the overall costs to society, affordability and efficiency.

It is expected that the consultation will elicit a large number of views from stakeholders, and there will be extensive engagement by DECC over the consultation period to elicit further responses and discuss the issues in more detail and receive expert input. This will enable the Government to take a range of independent views into account in developing its response to the consultation in the White Paper. Furthermore, there have

already been a large number of reports from independent commentators on what should be done to reform the electricity market, and these have been taken into account when developing the proposed framework. The responses of stakeholders will add to the analytical work already undertaken by the Government and will add to the large evidence base already existing.

**3. We conclude that it would not be sensible to introduce an EPS if its sole aim is to drive immediate emissions reductions from the power sector since the EU ETS already exists to do this. However, we also note that the EU ETS cap needs to be significantly tighter than its current and planned future level if it is to be effective in achieving reductions. (Paragraph 32)**

The Government's proposals for an EPS are not designed to drive immediate emission reductions from the power sector. The Government remains committed to the EU ETS as the primary means of driving emission reductions across Europe, and is not seeking to design a market framework which undermines this. However, we are also clear that the ETS on its own is very likely to be insufficient to deliver the significant investment we need in the UK in low carbon generating capacity in the UK over the coming years, and as it stands the electricity market is not appropriately structured to achieve the balance between decarbonisation, security of supply and affordability. This is why we are proposing a package of reforms to the way in which the market operates, which includes supporting the carbon price as part of an HM Treasury and HMRC-led proposal to reform the climate change levy (and fuel duty).

With regard to EU-wide emission reductions, the Government agrees with the Committee that the current cap on the ETS is not sufficient. The Coalition Programme for Government states that the Government will support an increase in the EU emission reduction target to 30% by 2020, and tightening the ETS cap will play a key part in delivering these additional emission reductions.

**4. An EPS will not result in any additional global savings to carbon emissions if they are offset by other participants in the EU ETS. It may also lead to a reduction in the price of carbon. In order to avoid these outcomes, the Government should consider retiring an equivalent number of EU allowances to those saved through the EPS. We recognise that there is some uncertainty about the legality of this option and the Government should seek to clarify this situation. (Paragraph 33)**

As a preventative measure and targeted only at new coal-fired power stations, the Government considers from the evidence that the EPS proposed in the consultation would have a negligible impact on the EU-wide carbon price. In addition, it would be difficult to ascertain the level of emission reductions directly associated with the EPS, as opposed to other measures such as carbon price support and the low carbon support mechanism. The Government will continue to engage with the European Commission to ensure that implementation of any of the EMR proposals is well aligned with the EU ETS.

**5. We note that at this stage, CCS has not yet been proven to work at scale. Even if it is proved to work technically, there are still questions about how much it will cost and**

**whether it would be economically viable to build and operate in the future. An EPS could help ensure that the UK does not become reliant on high carbon electricity in the event that CCS does not work at scale or proves too costly. (Paragraph 36)**

**6. We conclude that an EPS offers a more certain and predictable way to prevent lock-in to high carbon infrastructure than other means. This goal itself provides adequate justification for implementing an EPS. (Paragraph 37)**

As a technology which has the potential to reduce emissions from fossil fuel power stations by up to 90%, CCS is vital in the global battle against climate change. The Government is committed to the successful demonstration of CCS, and has allocated funding of up to £1 billion for the first project and remains committed to a further three projects. It is fully expected that, in time, CCS will be proved commercially viable, and that we will see the market drive retrofit and wider deployment. The proposed low-carbon support mechanism detailed in the EMR consultation could have a key role in making this happen.

The Government agrees that an EPS can be used as a measure to prevent lock-in to high carbon generation (although it should be noted that even if plant are built, there is no guarantee they would operate). The EPS that the Government has proposed would ensure that, while coal continues to play an important role in electricity generation, in the future it does so in a manner consistent with decarbonisation objectives. The Government is required, under the 2010 Energy Act, to produce decarbonisation reports on a rolling basis, and possible future versions of the EPS will naturally fall to be considered as part of this process, including whether it is an appropriate mechanism to drive further use of CCS. In this assessment, the Government will also consider the impact of any future EPS on security of supply.

**7. We conclude that an EPS could play a role in providing a transparent framework for regulating carbon emissions from the electricity sector by making clear the Government's expectations in terms of emission reductions from this sector. This would be an additional justification for its introduction. (Paragraph 40)**

As part of the analysis for the consultation, the Government explored the option of setting an EPS which would act as the key driver in decarbonising the electricity sector. This would be set as an annual limit of CO<sub>2</sub> for all fossil fuel plant, both new and existing, and progressively tightened such that by 2030 only fossil-fuel power station equipped with CCS would be able to operate at baseload. While this could mark out the decarbonisation trajectory, it would entail greater cost, less flexibility, and have greater security of supply risks than the preferred package. It would make it unattractive to build the flexible back-up generation needed to support a low-carbon mix, and investors would have little certainty over the economics of their power station. Furthermore, preventing the construction of fossil-fuel power station would not automatically mean that investment in low-carbon generation would replace it – the UK is competing internationally for investment capital and developers may chose to invest in other markets with lower regulatory risk.

Instead, the Government considers that a mix of incentives and rewards, coupled with an EPS which prevents new unabated coal, is the most efficient way to achieve its

objectives of decarbonisation, security and affordability. It is considered that the preferred package would provide the competitive conditions necessary to drive efficiency in a carbon-constrained market.

**8. An EPS has the potential to provide certainty to investors that there will be a future market for low-carbon electricity. However, it is important to design an EPS which avoids the risk of undermining investor confidence by increasing policy and political uncertainty. We conclude that an EPS is more likely to be successful in encouraging the development of CCS technology and indeed other low carbon electricity generation, if it is introduced as part of a package of measures rather than in isolation. This should include some form of financing help in order to help reduce risk for investors. This could be an extension to the CCS levy, beyond the initial four demonstration plants, or some other mechanism. (Paragraph 50)**

**9. We are not convinced that generators will use CCS as a matter of course once the technology has been proven. This is because the current fiscal and regulatory framework does not currently provide a strong enough incentive to do this. In particular, the carbon price under the EU ETS is not high enough to make the roll out of CCS technology economically viable. We therefore believe that there is a role for an EPS in ensuring the deployment and operation of CCS in the future. (Paragraph 53)**

The proposals outlined in the consultation seek to support the successful demonstration of CCS, whilst also providing a clear and unambiguous regulatory backstop against the construction and operation of new unabated coal-fired power stations. Given the early stages of CCS development, in our proposals we have sought to achieve this through a number of design factors:

- The Government has presented two options for the level of the EPS, both intended to provide the necessary flexibility to allow demonstration of the full range of approaches to CCS. The first proposal is for a level consistent with demonstrating CCS on around  $\frac{1}{4}$  of the capacity of a new, coal-fired power station (equivalent to 600g/kWh). The second proposal is for a tighter EPS, set at equivalent of 450g/kWh, but to allow demonstration projects exemptions.
- Both options would be applied as a total amount of CO<sub>2</sub> that a plant can emit in any given year, based on the size of the plant and the operating regime; the proposal is to base the limit on baseload operation, and to apply it per kW of installed capacity. While CCS is a demonstration technology, there will inevitably be times when the equipment will need fine tuning, may not operate at full efficiency, and will need to be turned off to be maintained. The Government considers that an annual limit EPS would allow plant to do this, without undermining the economics of the plant, as it would allow for reducing running hours to meet the EPS.

As a demonstration technology, we cannot yet expect plant to fit more CCS than can be funded through the Demonstration Programme. As noted above, we are proposing that the EPS be reviewed in line with the decarbonisation reports required through the 2010 Energy Act to assess if and when the EPS will have a role to play in driving greater use of CCS. Any future version of the EPS would also need to be weighed against the impacts on security of supply.



The Committee will also have noted that, under the package of reforms proposed, the Government is seeking to provide support to all low-carbon technologies, including CCS. The preferred option is to achieve this through a Feed-in-Tariff with a Contract for Difference, which would provide generators with a contracted tariff over the average electricity price in order to support investment. The Government appreciates that there are a number of design issues that need to be resolved, and will be working on detailed implementation plans for the White Paper.

**10. There is clearly some ambiguity about why the Government intends to introduce an EPS. The rationale must be made clear in the forthcoming consultation on electricity market reforms.(Paragraph 54)**

**11. An EPS could be introduced for a number of different reasons, including: to reduce the UK's greenhouse gas emissions; to avoid "lock-in" to high carbon infrastructure; to provide greater clarity about the expected level of emission reductions from the power sector; to stimulate the development of CCS technology; and to ensure the deployment and use of CCS technology. We believe that an EPS would be most usefully employed in providing a transparent emission reduction framework for the power sector, in avoiding lock-in to high carbon infrastructure and in helping to stimulate the development and deployment of CCS and other low-carbon technologies. It is clear to us that an EPS by itself will not deliver CCS, but it could play a useful role as part of a package of wider measures that address the other barriers to its introduction. (Paragraph 55)**

As outlined in the EMR consultation, the proposed purpose of the EPS is to provide a regulatory backstop against the construction and operation of new unabated coal plant. A large proportion of electricity generation in Great Britain comes from unabated coal-fired plants<sup>1</sup>. This will need to decrease as more low-carbon sources come online. Coal, however, has a valuable role in providing secure and affordable electricity: it is a reliable fuel, can provide effective backup generation when the generating capacity of intermittent power sources such as wind are predicted to be low and is available from a wide range of geographical locations, contributing to a diverse energy mix. The Government considers that CCS is critical in preserving these benefits while also decarbonising the electricity system, and that no new power stations which use coal (or coal-derived fuel) should be built in the UK unless a proportion of their emissions are abated. The EPS is intended to ensure that this happens, and prevent lock-in to high-carbon, unabated coal generation. In addition, by establishing an EPS as an annual limit of CO<sub>2</sub>, there would be certainty over the maximum emissions that can come from new coal plant.

The Government considers that the EPS can provide a level of certainty over regulatory requirements to demonstrate CCS, but that it is too early to use the mechanism to drive wider deployment. CCS has not yet been demonstrated at commercial scale for electricity production, and the costs have yet to be fully understood. As such, the market will not invest in the technology therefore requiring public support. The Government considers that the most cost effective way to do this is through the UK CCS Demonstration Programme, demonstrating CCS on a mix of generation technologies, which could include

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<sup>1</sup> By the third quarter, around 25% of generation came from coal in 2010. Source: Energy Trends, Dec 2010

new coal, existing coal, IGCC<sup>2</sup> and gas. However, the Government expects the technology to become commercially and technologically viable in time, and an EPS may have a role to play in ensuring deployment at this stage. The proposed review linked to the 2010 Energy Act decarbonisation reports will provide the opportunity to assess the EPS's role in driving deployment. However, the Government agrees with the Committee, that an EPS cannot be used in isolation, and that a package of reforms is necessary.

### **EPS Design**

**12. There are many design options for an EPS, some of which may be more beneficial than others. We welcome the fact that the Government is considering a range of options in designing the EPS. In its forthcoming consultation and review of electricity market reform, the Government must consider all the alternatives set out here and analyse the potential impacts of each option on energy security, energy prices and environmental sustainability in order to avoid unwanted outcomes. (Paragraph 89)**

As part of the EMR consultation, we have considered a number of different design options for the EPS, including scope, level and how to apply it. It is proposed that the level be set so as to affect new coal generation only, and that it be applied to individual plant. To affect new gas generation at this stage could have significant impacts on energy security. While over the longer term the UK will need gas plant operating at baseload to be equipped with CCS if we are to meet decarbonisation objectives, unabated gas plant have an important role as we make the transition, particularly due to the capacity closure in the latter part of this decade, and in the longer-term to provide flexible, peaking capacity to support intermittent low-carbon generation.

It is proposed that the EPS not apply to existing plant; to do so could force closure and exacerbate security of supply risks, as well as set a precedent which could affect investment in new, low carbon generation. Furthermore, under the proposed package of reforms, analysis shows that those coal plants remaining on the system in the 2020s would operate at increasingly limited hours. This would enable them to play an important role in backup generation, and could avoid the need to build new unabated gas plant in the early 2020s, which could easily remain on the system for 40 years.

The Government has also considered whether the EPS should apply at plant-level, or to a suite of plants, for example in a generator's portfolio. It has proposed that it apply at plant-level, as this would provide the most clear and transparent approach to regulation, and avoids many of the complexities and uncertainties that a 'suite' approach could elicit.

Further considerations have been detailed in the EMR consultation.

**13. To ensure that an EPS acts as an incentive to new investment in low carbon generating capacity and a disincentive to investment in high carbon generating capacity it is essential that the timescale for its introduction respects the investment cycle of the technology involved. It is also important that it is designed in a way which increases investor certainty and thereby reduces the cost of capital. An EPS must also protect the possibility that, as long as baseload generating capacity is low carbon, there may remain**

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<sup>2</sup> Integrated Gasification Combined Cycle

**a role for high carbon power stations to operate for brief periods of exceptionally high demand. (Paragraph 90)**

The UK needs significant investment in energy infrastructure if it is to successfully move to a low carbon, secure and affordable energy mix. Some £110 billion is needed in new generation and transmission in the period to 2020, over double the rate of the last decade<sup>3</sup>. Part of this is caused by significant closure of plant over the next 10 years, including around 8GW of coal capacity. The Government, therefore, believes that now is the right time to be proposing reforms, but is aware that there are a number of detailed implementation questions that need to be answered if investors are to have the certainty they require at the right time. We will be looking to address these and make final decisions on the reform package by the time of the White Paper.

As more renewables enter on to the system, there will be more intermittency, and the market will need to respond accordingly. This could, for example, be through management of demand (so called negawatts), or from short-term increase in generation from other sources, often at short notice. Some types of gas plant are particularly good at providing 'peaking' services, being able to start up quickly and operating for short period of time. Low carbon plant are less able to provide this service, and, for example, flexibility of plant fitted with CCS is currently untested. As such, the Government recognises the need to retain unabated fossil plant and allow them to operate when there is insufficient generation from other sources or particularly high demand. The design of the EPS seeks to address this principally by applying an annual limit of CO<sub>2</sub>, which would allow infrequently used peaking plant (such as Open Cycle Gas Turbines) to operate unconstrained by the EPS.

**14. We urge the Government to make every effort to minimise the impact of an EPS on energy prices, particularly for vulnerable groups and the fuel poor whose numbers may increase as a result. In particular, the Government must prioritise the delivery of domestic energy efficiency programmes in addition to other policies such as the Social Price Support Scheme to vulnerable groups and the fuel poor in order to keep their energy bills as low as possible. (Paragraph 91)**

As part of the analysis for the consultation, the Government explored two primary options for the EPS: one targeted at new, unabated coal, which is the proposal, and one used as the principal mechanism to drive decarbonisation of the power sector, as discussed above. The impact on energy prices was a key factor in determining the proposal for a targeted EPS in the consultation.

An EPS used as the mechanism to drive decarbonisation would need to be set for all fossil fuel plant, both new and existing, and progressively tightened such that by 2030 only fossil-fuel power station equipped with CCS would be able to operate at baseload. The principle behind this option is to increase the costs of electricity to a level where low-carbon investment becomes attractive. Domestic energy bills would on average be around 1.8% higher between 2010 and 2030 than they would otherwise have been, and an equivalent figure of 2.6% for non-domestic customers. This compares to the preferred package of measures, including a targeted EPS, where the average increase is around 0.9% and 1.3% respectively.

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<sup>3</sup> DECC analysis

As opposed to an EPS used to drive decarbonisation, an EPS targeted at preventing the construction and operation of new unabated coal-fired power stations has a minimal impact on energy prices. Acting as a regulatory back-stop, as a preventative measure as opposed to a measure which proactively shifts the market towards low carbon generation, the Government does not consider that it would have a discernible impact on energy prices (subject to views expressed as part of the consultation). The Government has used this as one of the principal reasons for recommending a package of options which includes the targeted EPS – the package provides a more affordable solution to decarbonisation and energy security.

The Government recognises the need to help more of the most vulnerable to keep their homes warm at an affordable cost. We are considering the ways in which we can make further progress towards our 2016 fuel poverty target and are committed to doing all that is reasonably practicable to eradicate fuel poverty.

The Government is committed to radically improving and refocusing existing policy measures and bringing in completely new measures to deliver a real step change in ambition for energy efficiency in this country. The Energy Bill was introduced to Parliament in December, and includes provision for a new 'Green Deal' which the Government believes will revolutionise the energy efficiency of British properties.

The domestic Green Deal policy is an opportunity for householders to improve the energy efficiency of their homes at no up-front cost. It will help protect people against price rises through greater energy saving, with special support for the most vulnerable.

Furthermore, the Government will ensure that additional support will be available for those who most need it, including low income vulnerable households and those in 'hard to treat' homes, through a new Energy Company Obligation.

The Government has also recently extended CERT, introducing a greater focus on targeting energy efficiency measures at the most vulnerable households by introducing a Super Priority Group of low income pensioners and families. We require that each benefiting household receive at least one major insulation or heating measure so as to maximise the impact on fuel bills. The CERT extension is expected to remove 185,000 from fuel poverty in the longer-term and help many others heat their homes for less.

The consultation on the structure of the Warm Home Discount Scheme closed on 14<sup>th</sup> January 2011. Government is currently reviewing responses and will publish a response shortly that will set out the eligibility and delivery proposals.

### ***Increasing the UK's International Influence***

**15. The UK is an influential member of the EU and action taken by the UK in reducing its carbon emissions could provide an example for others. Several other Member States have expressed an interest in introducing their own EPSs and a UK EPS could provide a model for others to emulate. This is a valuable opportunity for the UK to shape the EU's approach to an important area of policy and we recommend that the Government must seize it. Equally, there may be lessons for the UK to learn from others. The Government must engage more closely with other Member States that are considering**

**EPSs in order to share best practice and learning on EPS design and implementation (Paragraph 99)**

**16. We conclude that the risk that the introduction of a UK-based EPS could undermine the reputation of the EU ETS is easily outweighed by the positive leadership it would demonstrate. There is already a widespread acknowledgement that the EU ETS is not by itself delivering low-carbon investment, so any reputational damage caused would be minimal. (Paragraph 104)**

As discussed above, the primary means of reducing emissions across Europe is the EU ETS. The Government believes that the EPS proposed would not undermine the operation or reputation of the EU ETS, and remains committed to using the ETS to drive down overall emissions. The Government agrees, however, that the scale of investment necessary cannot be achieved through the EU ETS alone and that sectoral approaches are necessary. Different Member States have, for example, taken different approaches to encouraging and developing investment in low carbon technology, and renewables in particular. The Government has explored the various mechanisms in existence, and in particular has sought to take best practice in developing proposals for low carbon support mechanisms.

The Government will provide any Member States who decide to take a sectoral approach such as an EPS with information and models on how this could be done. It is important to note, however, that the markets in different Member States across the EU operate in different ways, and the particular approach the Government is proposing is specific to the UK market, and to the reforms proposed. The EPS has a valuable role to play, but the Government considers that it is only one of the tools necessary. The Government agrees that the UK can demonstrate positive leadership in Europe, but that it is the package of reforms as a whole that can do this, rather than one particular part of them. The EPS would demonstrate the Government's commitment to preventing lock-in to high carbon generation in the form of unabated coal-fired power stations, and that, along with the financial commitment it has made, it is serious about the development of CCS. However, the model proposed may not be appropriate across the EU. The Government's focus has been on exploring the options for the UK, but it agrees that there will be greater opportunity to work with European counterparts to learn lessons and share best practice should it be appropriate.

**17. It is not clear whether a UK-based EPS would be permitted under the EU Industrial Emissions Directive. Article 9 of the Directive prohibits the use of emission limit values for greenhouse gases and although the preamble states that Member States may introduce more stringent measures, it is not clear whether an EPS might in fact be considered an additional measure. There is therefore a risk that the introduction of an EPS may result in a legal challenge. We call on Government to clarify the legality or otherwise of an EPS in its response to this report. (Paragraph 106)**

Ultimately, the interpretation of any law is a matter for the courts – including, in this case, the Court of Justice of the EU. However, the Government's view is that, notwithstanding Article 9 of the Directive (and its equivalent in the current IPPC Directive), it is possible for a Member State to implement an EPS which is compatible with EU law. That is not to say that any Member State EPS would necessarily be compatible, and this is an area where detail matters, so until a proposal is developed in some detail it cannot definitely be judged

to be compatible. However, in general terms, as Recital 10 to the IED points out, it is important in this context that a proposed EPS should not infringe the general applicable principles of EU law derived from the Treaties (for example by unjustifiably interfering with single market freedoms, or breaking the rules on competition or state aid) – we would add that it should not actively undermine the operation of the EU ETS – and, at a procedural level, the European Commission must be informed of the proposed EPS. As noted in the EMR consultation, the Government intends to take forward any EMR-related proposals in a manner which is compatible with our EU and other relevant legal obligations, and EU law considerations will obviously figure in the design of any more detailed EPS proposals.

**18. Even though the introduction of an EPS may not be as influential at the international level as a successful demonstration of CCS technology, we nevertheless believe that it could bring significant benefits. We call on the Government to work with other countries to share best practice on EPS in order to facilitate global emissions reductions from the power sector. (Paragraph 112)**

**19. The introduction of a UK-based EPS would bring a number of benefits at the international level. Within Europe, it would provide a template for other Member States to follow. Other Member States are considering EPSs of their own and leadership from the UK could help to encourage the uptake of EPSs elsewhere in Europe, particularly since the UK is viewed as a leader on climate change within the EU. At the international level, the introduction of a UK EPS would demonstrate commitment to tackling climate change. Providing a model for other countries to emulate could help bring forward sectoral agreements and help to achieve global emission reductions from the power sector. (Paragraph 113)**

As discussed above, the Government will provide any Member States who decide to take a sectoral approach such as an EPS with information and models on how this could be done. It will look to provide leadership on decarbonisation as a whole, while recognising that any one particular tool may not be suitable across all markets and regulatory regimes.

Advancements in UK domestic policy are also of interest on the international stage, including in the context of the UNFCCC process. The UK is tracking closely the development of sectoral approaches in 3rd countries, for example the United States, in recognition of the role that these might play in reducing power sector emissions. Developing countries are also in the process of putting together low carbon development strategies to help deliver their UNFCCC commitments and aid a transition to a low carbon economy - electricity market measures, such as an EPS and other low carbon policies, could play a role in that process. The UK is also proposing to reform the global carbon market to allow for a greater contribution by large-scale, or sectoral, market mechanisms. This could also help support a role for an EPS, particularly in advanced developing countries.