

Call for Evidence: Cost of Energy Review

Response from the Energy Intensive Users Group

General Comments

The Energy Intensive Users Group (EIUG) represents the UK's energy intensive industries (EIs) including manufacturers of steel, chemicals, fertilisers, paper, cement, lime, glass, ceramics, gypsum, aluminium and industrial gases that compete in global markets and depend on access to secure, internationally competitive energy supplies to remain in business.

EIUG has for many years criticised the economic inefficiency and complexity of energy and climate policy, noting the negative impact this has had on the international competitiveness of UK EIs and the resulting increase in the risk of carbon leakage. We therefore welcomed BEIS' appointment of Dieter Helm to lead the independent Cost of Energy Review, and are pleased to have the opportunity to contribute to this Call for Evidence. In particular, we endorse his central observation that 'Much more decarbonisation could have been achieved for less; costs should be lower, and they should be falling further', and look to BEIS to ensure this issue is addressed as swiftly as possible.

Electricity Generation

Longer-term challenges for electricity generation

The principal challenge is to rebuild public confidence in the energy sector by delivering secure and internationally competitive electricity supplies for businesses and households.

Security of Supply and Demand: The primary challenge is to ensure sufficient power is available to meet peak consumer demands. Given recent and anticipated technological developments in smart metering, appliances, vehicles and battery storage, we agree there will be increasing uncertainties around peak demand levels, and also importantly in the timings of demands, as behaviours adapt.

Source & Risks: Power should be provided from the least cost, secure solution irrespective of carbon mix or energy source. This might be through imported supplies with an economic or environmental advantage, or generated within the UK market.

Importation Risks: Government and System Operators should set and review targets for a prudent mix, recognising the increasing reliance on imported power from markets outside the UK's direct control. Interconnectors should be funded according to common mechanisms across borders. These mechanisms should be market based, and avoid barriers to flows such as emergency supply rationing or other intervention measures.

The 'cap and floor' regulatory mechanism for interconnectors ensures UK consumers underpin investment costs. This arrangement may distort the market for onshore generation. It also differs from most border party arrangements and may have little understood or unintended consequences.

We agree that a System Operator independent of government or shareholder influence is best positioned to forecast emerging demand levels and corresponding generation requirements, and to assess the risks of interconnection.

Matters the Government should take into account in considering the policy framework for electricity generation

We agree that the System Operator is best placed to assess and manage risks on an ongoing and regular basis, recognising the trade-offs between security of supply and the significant cost of investment in long term generation assets, interconnectors, and network infrastructure.

We agree that the market may not deliver investment in a timely manner without some form of consumer underpinning of investment in both network and generation capacity. Recognising this, we agree that the System Operator should run a unified auction to commercially underpin generation investment in a timely manner and at least cost for consumers.

We support a rapid transition away from technology-specific subsidy mechanisms or policies, and that the unification of bids into an auction based on carbon pricing impacts should determine the economic merit order. Furthermore, we agree that CfD auctions, if continued, should be awarded for the constituent parts of a generators lifecycle as these costs will vary considerably over time and as technologies mature. We also agree that the System Operator should also award network investment solutions to competing providers, and that these should also be awarded through competitive mechanisms.

Legacy Costs: We support Helms' proposal that the massive and still rapidly growing legacy costs of unnecessarily expensive renewable promotion policies should be partly funded through general taxation and no longer recovered through levies on industrial energy users. If Government prefers not to accept this specific proposal, it must identify and implement measures that provide an equivalent level of relief (e.g. the broadening and deepening of existing EII compensation and exemption measures) comparable with that already available to EIIs in competitor economies. In the meantime, greater transparency is needed on the cumulative impact of these and other low carbon policies on UK industrial electricity prices (currently the highest in Europe) and hence on UK industrial competitiveness.

Source of Commodity: The technological mix and carbon impact of generation should be determined by carbon pricing signals across the economy as a whole, including interconnected economies. The mix should not be distorted by subsidies or other policies intended to promote specific forms of renewable or other low carbon technologies.

Costs of Intermittency: We strongly support the principle that the costs of intermittency should be internalised, on a similar basis to carbon emissions externalities, so that generation technologies can compete on a non-discriminatory basis. It should be for energy producers to manage the risks internally of providing a portfolio of secure low carbon generation, backup and storage.

Carbon Taxation: Ideally carbon taxation should be economy wide and linked to a (currently hypothetical) global carbon price in order to prevent carbon leakage and ensure emissions are reduced at least cost globally. If the Government wishes to retain a unilateral approach to carbon taxation in the power and industrial sectors but considers Helm's specific suggestion of border tax adjustment to be impractical, it will need to consider alternative equivalent measures to address the consequent carbon leakage threat to UK EIIs.

Policy Framework: Government should clearly consider the recommendations to negate its policy influence in both the electricity and wider energy market. Its focus should be on the determination and monitoring of targets in matters such as security of supply, standards of performance of market participants, and benchmarking of emerging costs and risks relative to competing economies.

Additional evidence the Government should consider to reduce the cost of electricity generation in the longer term

It is inevitably difficult to balance the risks of insufficient or surplus generation capacity, which depends on a multiplicity of evolving factors including demand, generation technologies, renewable deployment and import dependency. The government and System Operator should consult with the market to better understand the lead times necessary to deliver capacity network investment or other remedial solutions which are necessary to resolving investment need. Equally, the Government and System Operator need to understand and work more closely with industry as well as researchers, developers and manufacturers of smart appliances, battery solutions and electric vehicles. By doing so they would be better able to understand the pace of development and potential impacts on our energy landscape.

Electricity transmission and distribution

Longer-term challenges for electricity transmission and distribution

The evolution of new technologies has already transformed the energy landscape, undermining traditional sources and changing the geography of energy flows through the transmission and distribution networks. This evolution is likely to continue at an increasing rate, with significant engineering and financial impacts for both networks and the consumers who ultimately fund them. We agree that if the UK continues to operate a legacy supply chain driven by an outdated regulatory investment and funding framework this may further increase costs for consumers, and erode international competitiveness and public confidence.

Matters Government should take in account in considering the framework for network regulation

We agree that independent System Operators are best placed to understand and assess the evolving needs within transmission and distribution networks. We support them developing and delivering a framework that would enable them to assess no regrets, just in time investment solutions to any market participant. The timely award of solutions or the development of solutions should be through auctions or other competitive means.

Additional evidence the Government should consider to reduce the cost of electricity networks in the longer term

The government should consider researching and reporting on better insights into network costs and security of supply standards comparative economies and provide more transparent benchmarking of performance. Arguably rather too much attention has been paid to theoretical benefits of smart metering and digitisation not enough on addressing 'big ticket' issues, such as planning reform, which might have a greater potential to reduce network development costs.

Electricity Supply

Longer term challenges for electricity supply

To deliver safe and secure supplies, and to restore industrial competitiveness within Europe and internationally. In addition, it is necessary to rebuild public confidence in the energy sector and

more effectively realise the significant benefits that competition can deliver in terms of cost reductions, security of supply, and efficient and timely investment.

To ensure effective and meaningful competition in the provision of asset related investment across the entire energy landscape. This should be achieved by rapidly transitioning away from increasingly outdated industry structures, geographic monopolies and regulatory funding frameworks that are unable to adapt in a sufficiently agile manner to the evolving landscape.

To ensure effective and meaningful competition in the retailing of electricity and the services around the supply of electricity such as demand management services, data collection and provision.

Matters the Government should take into account in considering the longer-term operation of the retail market

Transparency, clarity and simplicity of all elements of costs associated with the provision of power are fundamental to regaining consumer confidence and ensuring competition amongst providers.

We support the proposed mechanism of simplification and streamlining of explicit fixed cost elements for consumers bills, alongside publication of outturn wholesale costs. This would provide a clear comparator which, alongside international cost benchmarking, could drive greater efficiencies.

We strongly support government clearly determining how costs are allocated between consumer groups, and doing so regularly, to ensure international competitiveness across the UK economy and affordability for domestic consumers.

Additional evidence should the Government consider to reduce the cost of electricity supply in the longer term

The Government and its regulators should focus on determining targets for security of supply and performance standards for market participants. Efforts should be focused on benchmarking emerging costs and risks in relation to competitor economies to ensure UK industrial competitiveness.

Cross Cutting

Matters the Government should take into account in considering the wider recommendations of the Review

Rapid decisions from Government are needed over the general direction of energy policy reform, and the principles being adopted, deferred or discounted. Clarity is required in the process and timings of reform, and the engagement required from stakeholders – including energy intensive industrial users.

Other matters the Government should consider to reduce the cost of energy in the longer term

EIUG believes the Government should pay greater attention to the need for more intensive research and development into lower cost energy technologies, the development of shale and unconventional gas supplies, and energy efficiency improvements where these have the potential to be achieved at lower cost than supply side alternatives.