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## INTRODUCTION

Getting the price of energy right for UK firms is fundamental to delivering the UK's industrial strategy.

This important issue has not received sufficient attention to match the disparity in electricity prices UK firms have faced in recent years, with evidence from Eurostat and analysis by our competitors such as Belgium<sup>1</sup> and Germany<sup>2</sup> all showing the UK to have some of the highest bills in Europe.

We welcomed the recognition of this issue in the industrial strategy green paper and later the Conservative manifesto and their commitment to tackle it. Professor Helm's Cost of Energy Review is an important step towards that. The evidence from the Review is clear – all energy consumers, from domestic to industrial, are paying too much for energy, and more than has been necessary to meet the UK's decarbonisation ambitions.

We support the evidence and rationale for a renewed approach to achieving internationally competitive energy prices for industrial firms outlined in the Review. We provide further analysis of the problems at hand and our recommended solutions in this paper.

Professor Helm found no single 'silver bullet' to resolve these concerns. Instead, multiple tools are needed.

However, we believe far more rapid intervention is needed by the UK government and regulator than he proposed. The Roadmap to Minimise Business Energy Costs must be extended to tackle price issues as soon as possible and not focus on energy efficiency which will only yield results in the medium to long term and does not address the underlying reason that UK firms are at a disadvantage.

Make UK and its members are keen to work with government and other decision makers to continue discussions in this area in the coming months.

The Cost of Energy Review has been an important step in understanding the uncompetitive electricity costs UK firms face compared to international rivals, but more analysis is needed to catalogue and act on these disparities.

Clear, tangible action is needed now from Government and the Regulator to ensure UK industry can access affordable, competitively priced energy as soon as possible to support the UK's industrial strategy and clean growth ambitions.

## 3 KEY CONCLUSIONS AND RECOMMENDATIONS FOLLOWING THE COST OF ENERGY REVIEW

In this section, we distil the 16 main findings and recommendations from the Cost of Energy Review into four key issues relevant to industrial consumers, and set out steps that BEIS, Ofgem and National Grid should take to address these.

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<sup>1</sup> PWC for CREG, A European comparison of electricity and gas prices for large industrial consumers, Final Report, 2017 Update, 29 March 2017

<sup>2</sup> ECOFYS and Fraunhofer ISI for the German Ministry of Economic Affairs and Energy, Electricity Costs of Energy Intensive Industries: An International Comparison, July 2015

## **1. Electricity consumers are paying too much, and the legacy policy costs are impacting competitiveness today. More clarity is needed as to exactly what these costs are and continued protection must be provided for vulnerable sectors.**

Helm has provided a clear view that all consumers, from households to industrial firms, are facing high energy costs, and more than is needed to achieve UK climate change ambitions. Furthermore, consumers are not benefitting from the falling costs that should be derived from the technology change experienced.

While the Clean Growth Strategy sets out ambitions to create more opportunities for UK businesses from the low carbon transition, it must be acknowledged that for the majority of UK firms the costs of decarbonisation have tended to come before these opportunities.

For a number of energy intensive industries (EIs), the cost of energy is a critical business issue. The EI Relief Package has taken most of this decade to reach full implementation and even now there are issues still to be resolved. Our Western European competitors have acted faster and more extensively to address similar issues.

The direct impact of low-carbon support via the Levy Control Framework (LCF) in particular has ballooned from £2.4bn in 2010 to £7.4bn in 2016. This is a significant increase that has been passed to industrial energy bills. It is not meaningful to net energy efficiency savings against these costs, as energy efficiency is an area that international competitors also engage in. The transparency around these costs has been limited and opportunities to keep costs down, missed. For example, the Competition and Market Authority's analysis suggests that consumers are paying around £300 million more per year as a result of the first round of Contracts for Difference (CfD) not having been subject to competition.

There is even less transparency on the additional costs from managing intermittency and more distributed generation, e.g. increases in balancing and network costs. This must be addressed.

The Autumn Budget's announcements on the Control for Low Carbon Levies and Total Carbon Price will provide welcome predictability and limits to overall costs in the medium term. However considerable issues remain, for instance around increases to, and redistribution of, network charges.

For EIs there is particular disappointment that this autumn's various energy related policy announcements haven't resulted in more immediate measures to address the disparities mentioned above.

### **Recommended action to tackle prices:**

- Continued implementation of the Energy Intensive Industries (EIs) Relief Package and successful expansion to create a level playing field for UK firms directly competing with those eligible for relief.
- Analysis of how legacy costs can be better managed, including through a 'legacy bank'. This needs further exploration and cost benefit analysis but would at least enable legacy costs to be transparently reported on UK energy bills and managed as a single unit.
- A formal review – similar to that done by other countries<sup>3</sup> – of the macro-economic case for exempting industry from legacy costs, either en masse or for sectors particularly exposed to electricity prices and international competition.

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<sup>3</sup> ECOFYS and Fraunhofer ISI for the German Ministry of Economic Affairs and Energy, Electricity Costs of Energy Intensive Industries: An International Comparison, July 2015 <http://www.ecofys.com/files/files/ecofys-fraunhoferisi-2015-electricity-costs-of-energy-intensive-industries.pdf>

- Consideration of the merits of other immediate measures to support EIs exposed to international competition, including potential exemption from the indirect costs of the Capacity Market and tariff reductions for network charges (see later).
- Where further auctions are provided for subsidies, this should move to a technology neutral approach as soon as possible to drive down the cost of decarbonisation. Alternative measures should be sought to support early stage technologies.

## **Actions decision makers must take to better track competitiveness impacts:**

- Establishment of an Annual Energy Policy Statement to ensure transparent reporting by BEIS and Ofgem of direct and indirect impacts of energy and climate policy on consumers and taxpayers.
- Ofgem tasked with developing a framework and metric for annual assessment of the impacts of UK electricity prices on industrial competitiveness. This could be based on the analysis done by Belgian Regulator CREG<sup>4</sup> for the past three years.
- BEIS, Ofgem and National Grid must deem 'internationally competitive industrial energy prices' as the key objective in achieving affordability and fairness for industrial consumers. Providing a consistent approach in this area across government and the regulator could also be one of the benefits of an Annual Energy Policy Statement.
- Ofgem and the energy industry to explicitly analyse effects on small, medium, large and extra-large industrial consumers in all impact assessments

## **Linking electricity costs to the clean growth agenda:**

- Government should review the wider innovation and business opportunity benefits delivered by Feed in Tariffs and Contracts for Difference (CfDs) to compare with the cost to consumers.
- Government must develop annual metrics to measure the business opportunities arising from decarbonisation policies.
- There should be a focus on cross-economy decarbonisation at lowest cost, not just decarbonising the electricity system, as recommended by Professor Helm. There has been substantial investment in decarbonising the power sector, currently estimated to be at a cost of over £100/tCO<sub>2</sub><sup>5</sup>, when far cheaper options are available in other fields, including industrial energy efficiency.

## **2. 'Electricity Market Reform' may not be fit for purpose for the 2020s. Complexity and high levels of intervention make decision-making very challenging.**

We would agree with Professor Helm that high levels of complexity, difficulties in forecasting, modelling, and adapting policy based on quickly changing evidence bases, and the sheer volume of policy and regulatory changes is making it difficult for decision makers, never mind consumers and their representatives, to understand the consequences of intervention. This advantages the energy industry, for which this is 'core business' and which has a wealth of resource

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<sup>4</sup> PWC for CREG, A European comparison of electricity and gas prices for large industrial consumers, Final Report, 2017 Update, 29 March 2017 [http://www.creg.be/sites/default/files/assets/Publications/Studies/2017-PwC\\_Report\\_A\\_European\\_comparison\\_of\\_electricity\\_and\\_gas\\_for\\_large\\_industrial\\_consumers\\_0.pdf](http://www.creg.be/sites/default/files/assets/Publications/Studies/2017-PwC_Report_A_European_comparison_of_electricity_and_gas_for_large_industrial_consumers_0.pdf)

<sup>5</sup> Ofgem, State of the Energy Market 2017 Report, 31 October 2017 <https://www.ofgem.gov.uk/publications-and-updates/state-energy-market-2017>

and expertise to draw upon, over consumers even though the decisions being made can have critical impacts on industry.

We welcome the development of the Charging Futures Forum (CFF) to address this issue in respect to network charging, but more is needed to ensure industrial consumers can provide evidence and feedback in a less resource-intensive way earlier in decision-making processes.

Forecasting and modelling is both helping and hindering government and regulatory decision making. Decisions and interventions need to be more nimble and resilient to different visions of the future. The current regulatory regime also needs to be more agile in responding to the quickly changing roles of energy sector entities. We agree with Helm's prognosis that 'radical simplification' is required.

There is also considerable uncertainty over whether the current market structure (CfDs and the Capacity Market) is still fit for purpose given increasing volumes of intermittent, zero marginal cost plant.

#### **Industrial recommendations:**

- Improved representation is needed of consumer interests with less resource.
- BEIS/Ofgem should review the success of the CFF in coordinating change and improving consumer engagement after one year, and consider whether it can be extended to wider energy sector change.
- The compound, annual impact of energy industry code changes on consumers needs to be assessed. Current attempts at coordinating industry code modifications should be taken further by representing the potential impact on industrial consumer bills from the very beginning of the industry process. Code administrators/Ofgem should report the annual, compound impact of code modification changes on all consumers.
- All impacts should be reported in £/MWh, including network charge impacts. This would help industrial consumers understand the relevance and importance of energy industry change proposals, and how to support decision makers in assessing them.
- Impact assessments should set out the effectiveness of policy outcomes in extreme scenarios (e.g. different fossil fuel price assumptions), not just a single, optimal 'central scenario'.
- Clarity on whether the Capacity Mechanism is a short or long term measure and, if it is the former, what will come next.

### **3. Network costs and charging reform are quickly becoming a key industrial competitiveness concern.**

The combination of top-down and bottom-up change to UK network costs for the 2020s are currently a significant unknown, with an unparalleled volume of change already in progress. The top-down change stems from Ofgem's preparation for the second round of RIIO network price controls, and the bottom-up element from its Targeted Charging Review and other industry code modification proposals launched by the energy industry in the past two years in an uncoordinated, confusing fashion. None of this has allowed industrial consumers to engage easily. Furthermore, there is considerable technological change anticipated for the 2020s that could fundamentally alter the nature and operation of the UK energy networks.

The key concern for UK industry is that this combination of top-down and bottom-up change could aggravate the already uncompetitive network charges it faces compared to counterparts in other European countries. Other governments have introduced aggressive network charge reductions to improve the overall competitiveness of their industrial bases.

Whilst we recognise the reasons for Professor Helm's call for reconstitution of UK energy networks there is already considerable change and uncertainty facing industrial consumers as a result of Brexit. We would prefer any reform in this area to be light touch until at least the early 2020s.

## Recommendations from industry:

- Regulators should not exacerbate already high network charges for industry and instead seek to reduce the disparity between charges faced by UK firms and their Western European competitors.
- Ofgem should devote more time to engaging with industry and understanding its needs as part of its Targeted Charging Review. This is necessary in part to ensure valuable signals to the market around demand management are not eroded, which could counteract broader government policy in this area.
- As mentioned above, greater transparency is needed around proposed changes in this area and measures to involve a wider range of stakeholders, including carrying out more thorough impacts assessments and communicating likely impacts in £/MWh.

## 4. The volume and timing of changes to climate and energy policy need to account for Brexit:

Professor Helm's recommendations for addressing energy market issues over the longer term merit close consideration and analysis. However, there is also a need to minimise unnecessary disruption in what is already a period of considerable uncertainty. Government and stakeholders have limited bandwidth with which to undertake and scrutinise major reforms, much of which is focused on Brexit at this point.

This is true for all market reforms but the carbon pricing proposals are particularly complex and uncertain given the engagement the UK will be carrying out on trade deals and lack of clarity around our future relationship with the EU Emissions Trading System (EU ETS). Partial implementation of Professor Helm's recommendations in this area, eg imposition of higher carbon prices without proper carbon leakage protection for at-risk sectors, would be very damaging for industry.

Border tax adjustments have been considered and abandoned in the past due to complexity and look even more unfeasible in a post-Brexit trade scenario.

## Our recommended approach:

- Reforms in this area need to be approached very cautiously while so much attention is, necessarily, focused on Brexit.
- The UK Government needs to be clear on its broad aims and ambitions for regulation of the sectors currently covered by the EU ETS so stakeholders can feed in more detailed views than is currently the case. Until there is at least some sense of what the UK might be aiming for in this area, including any trade-related impacts, it is difficult to advise on wider carbon pricing approaches.

# Make UK Response to the Independent Cost of Energy Review



## Make UK

Make UK champions British manufacturing. We are a powerful voice at local, national and international level for small and medium sized businesses and corporates in the manufacturing and engineering sectors.

We're determined to create the most supportive environment for UK manufacturing growth and success, and we represent the issues that are most important to our members, working hard to ensure UK Manufacturing remains in the government and media spotlight.

Together, we build a platform for the evolution of UK manufacturing.