

UK STEEL – SUBMISSION TO TARGETED CHARGING REVIEW

Date: 5 July 2021

To: TCR@ofgem.gov.uk

About UK Steel

UK Steel, a division of Make UK, is the trade association for the UK steel industry. It represents all the country's steelmakers and a large number of downstream steel processors.

Submission to the Consultation on CMP343 – Minded-to decision and draft impact assessment

Question 1: Do you agree with our assessment of the distributional impacts of the flooring approaches?

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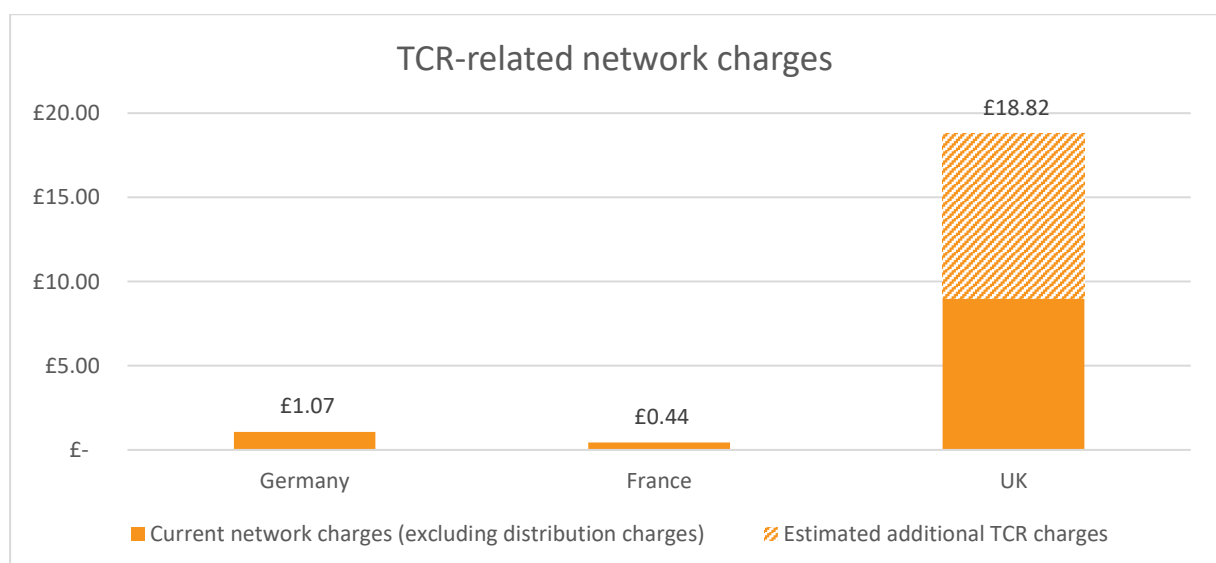
Question 2: Do you agree that, of the flooring options presented, flooring at 0 best meets the TCR Principles and Applicable CUSC Charging Objectives?

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Question 3: Do you agree with our assessment of the distributional impacts of the banding approaches?

No, we do not agree. UK EIs already face some of the highest electricity prices in Europe, with electricity prices 86% higher than in Germany and 62% higher than in France, after compensation and exemptions have been applied. Further cost increases will make the price disparity even higher and damage competitiveness. The cumulative impact of already uncompetitive electricity prices, the TCR, and BSUoS reforms will be felt. UK Steel has already outlined how the price disparity over the past four years has costs the industry over £250m, which could have been reinvested into energy and plant efficiency in the UK Steel sector.

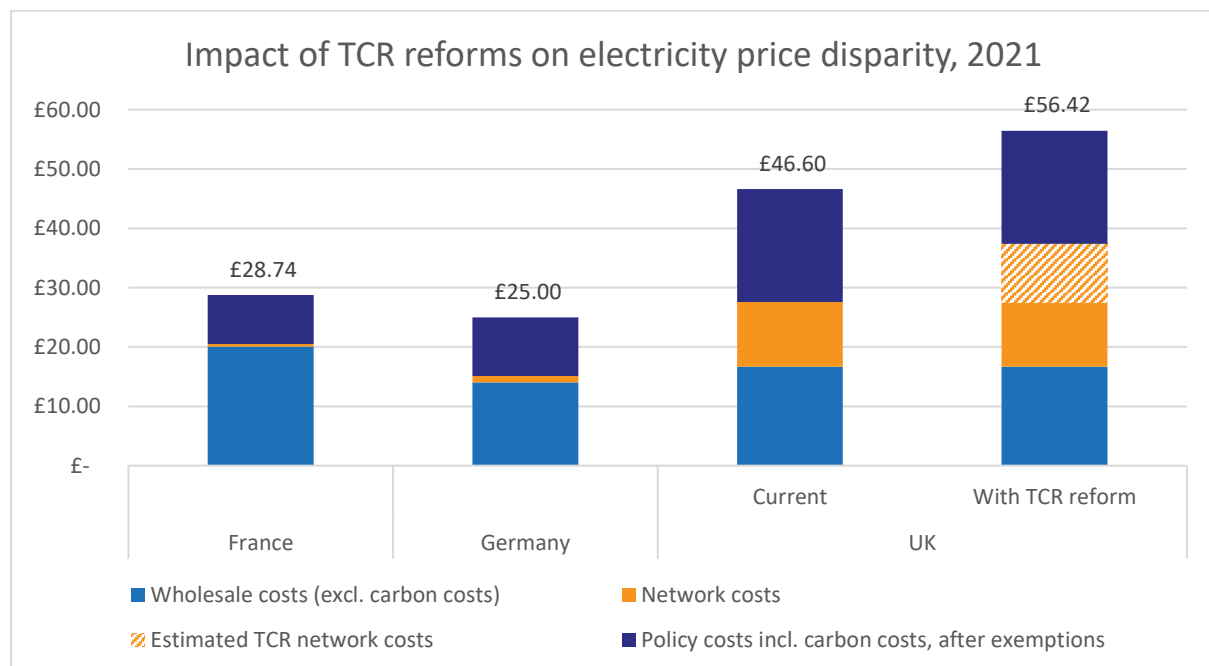
Currently, UK steelmakers face network charges 8-10 times higher than their key competitors in France and Germany. However, with the proposed minded-to decision, this will increase to almost 18 times higher charges.



The above chart represents the average costs of the proposed TCR code modification on steelmakers in the UK, showing an increase of £9.82/MWh.

The direct impact of the TCR reforms is on the steel manufacturers' international competitiveness. Raw materials such as iron ore and coal are sold in global markets, and there will, therefore, be little difference in the price of iron ore used in France and the UK. It is where there are national and regional variations in costs that competitiveness issues arise. Electricity costs can represent up to 120% of UK steel producers' GVA and around 20% of their conversion costs. As they are competing in an international market, they are unable to pass on any additional costs over and above those faced by their competitors. A consistently higher energy price, therefore, impacts their ability to compete and diminishes their profitability.

It is very disappointing that Ofgem and the CUCS panel has not taken industrial vulnerability into account and consider the broader distributional implications of the minded-to proposal, including on jobs, economic activity, and the ability to compete. The TCR reforms will, as such, increase the disparity of industrial electricity prices as per the chart below, with UK electricity prices being 125% higher than the German equivalent. It is estimated that the additional cost of the TCR for the steel sector alone will range from **£17m to £20m annually**.



Besides the impact on direct competition, the more insidious impact is on long-term investment. All the major steel producers in the UK are part of multi-national companies with facilities in the EU and four also operating outside the EU. In this context, the cost competitiveness of each particular market is crucial to attracting investment. Persistent cost disadvantages in the UK lead to underinvestment, which in turn leads to further erosion of competitiveness. This also has huge ramifications for investment in decarbonisation and meeting the Net Zero target.

Over the past five years, the industry has paid £256m more for their electricity than their competitors in Germany and £227m more than steelmakers in France. The average annual capital investment in the UK sectors is £200 million to place this in context.

Ofgem must also consider the impact of its reform on broader aims of the energy system, such as facilitating decarbonisation and meeting the Net Zero target. It is clear that the TCR reform at best ignores this solely to focus on the efficiency of the electricity system, and at worst, it blatantly disregards it as someone else's problem. This silo-thinking ignores the implications of higher electricity prices for industry's ability to decarbonise, and although it may have a positive impact on the decarbonisation of the energy system, it significantly worsens industry's ability to do the same.

The Government's Net-Zero target will require fundamental changes to steel production in the UK and will necessitate substantial investment in new processes and equipment over the next dozen years. The Climate Change Committee has recommended that the ore-based steelmaking sites be near-zero emissions by 2035. Should this recommendation be adopted by the Government, then billions will need

to be invested in the UK to enable this transition. Although separate support will be required for this and the further decarbonisation of the electric arc furnace sites, high industrial electricity prices remain a substantial barrier to persuading the multi-national steel companies to invest in the UK.

The options for decarbonising the integrated steelmaking process involve CCS, electrification, and fuel switching (e.g., hydrogen). All these options lead to increased electricity consumption. Carbon Capture and Storage (CCS) experience energy losses of 8-15% when capturing 15-28% of emissions, so it would likely see much higher energy losses when capturing 80-90%, and thus much higher electricity consumption. If the integrated sites electrified, power consumption would increase more than 300%, and hydrogen-based steel production would increase the entire sector's electricity demand by over 800% if based on green hydrogen. A systemically higher electricity price would be a substantial barrier to any investment in decarbonisation options, as this would further worsen the industry's ability to compete with European and global steelmakers. Thus, lower industrial energy prices are a basic necessity for the industry to start decarbonising its production and, therefore, play an integral part in helping the UK meet its 2050 target. Ofgem must work to help the decarbonisation of the consumers it regulates, and with the TCR, it has failed to do just that.

Question 4: Do you agree that, of the banding options presented, four bands best meets the TCR Principles and Applicable CUSC Charging Objectives?

No, we do not agree that the proposed banding meets the TCR principles of fairness and proportionality. We do not believe the wider implications of EII's competitiveness have been taken sufficiently into account. The TCR process did not sufficiently address nor recognise the vulnerability of energy intensive industries and the significant impact of network charges on their businesses. As such, we do not believe the proposal can effectively meet all the objectives set out, particularly fairness.

As outlined above, UK steel producers and other EIIs already face significantly higher industrial electricity prices than their main competitors in Europe. Adding additional costs and charges through the TCR does not match with the principles of fairness and proportionality. The consultation document attempts to minimise the impact of the TCR in section 3.83 by outlining the other elements of electricity prices industrial users face. But this is a disingenuous comparison, as it does not consider the compensations and exemptions available to industry. Ofgem's own analysis also supports this analysis of industrial electricity prices, which was conducted in late 2020 and early 2021. When these are accounted for, the additional TCR charges will make network charges the single biggest element of the power bill for steelmakers. The 3.83 assessment also ignores the significantly lower charges faced by competitors in Germany and France, where in comparison, UK steelmakers will pay network charges 18 times higher.

Finally, we would question the representativeness of the CUSC panel, which is made up predominantly of utility and generator representatives with no EII representatives. We question whether suppliers can truly "act as a proxy for customers' interests" as this principle has not been applied in the general Government stakeholder engagement, especially when the utilities have such a large, diverse customer base, ranging from domestic customers to commercial users, and vulnerable industrial customers.

Question 5: Do you consider that any of the options presented adequately addresses very small users (including those associated with mixed use sites)?

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Question 6: Do you agree with our minded-to decision to approve CMP343 WACM2?

No. We do not agree with the minded-to decision. It is clear that this has so substantially changed from the original analysis and assessment presented to stakeholder earlier in the TCR consultation process and in the Impact Analysis published by Ofgem. We do not believe that CMP343 WACM2 should be approved as it will allocate significant additional charges to industrial users, which will significantly impact their competitiveness and ability to decarbonise. By proceeding with CMP343 WACM2, Ofgem will have completely ignored concerns and warnings from industrial users about the impact.

Question 7: Do you agree with on our minded-to decision that implementation should be delayed by a year, until April 2023?

Yes, we believe this should be delayed, but beyond 2023, as it is not appropriate to implement in the first place. As is clear from our consultation response, we do not believe the CMP343 WACM2 match the criteria of fairness and proportionality, and it should not be implemented in the first place.

It is also an absurd suggestion that the additional time will allow EIs to participate in schemes such as the Capacity Market to offset some of the costs of the TCR, as such contracts will not likely match the overall impact of the TCR reforms.

For further information, contact:

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