



**CHEMICAL INDUSTRIES**  
ASSOCIATION

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Dear Mr Chapman,

I am writing in response to Sir John Mogg's letter of 1 September. The chemical industry continues to be the largest user of electricity in the manufacturing sector, accounting for approximately 20% of electricity and 30% of gas, equivalent in each case to about 5% of all UK supply. The sectors' combined gas and electricity bill is in the order of £1 billion. The industry's combined energy and feedstock bill amounts to approximately £2.5 billion. We therefore very much welcome this opportunity to help shape OFGEM's future work programme.

I attach our position statement on energy policy, which was revised less than a month ago. Many of the issues it addresses relate to OFGEM's areas of work and with regard to OFGEM's strategic plan, I would summarise our views as follows:

- i. Key areas where the CIA would like to see greater OFGEM focus and resource are:
  - a. **Gas Network Investment** - OFGEM should review the present arrangements with a view to maximising network investment in order to make sure that competitive gas gets to market today and that Britain is strategically prepared to receive foreign gas in the longer term.
  - b. **BETTA** - OFGEM should increase efforts to communicate its benefits and press for legislation sooner, rather than later.
  - c. **NETA** - OFGEM should focus on ensuring the facts and benefits are communicated and on making sure supply and demand-side response flexibility is maximised.
  - d. **Transparency of gas market information** - OFGEM should focus on areas where it has powers or leverage to press for greater transparency in the interests of improved wholesale market functioning.
- ii. Areas where the CIA would like to see OFGEM focus less or stop work are:

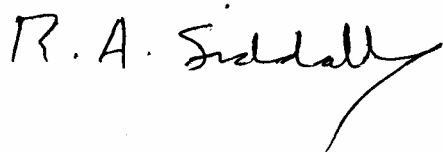


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- a. **Reform of exit capacity arrangements** - We welcome OFGEM's decision to reconsider this area and believe the current arrangements are practical and straightforward and therefore should continue.
- b. **Reform of Transmission access** - we welcome OFGEM's decision not to pursue a strategy of radical reform in this area and do not believe that the benefits of reform to consumers justify changes to the arrangements.

I trust this input is useful and we look forward to contributing to the further shaping of OFGEM's strategic plan in due course.

Yours sincerely,



Robert Siddall  
Utilities Policy Manager



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**CIA POSITION STATEMENT  
ENERGY POLICY AND PRICING**

**Summary of the CIA position**

The CIA believes that energy policy must be progressively set within a sustainable framework and that properly functioning markets are the best tools to underpin both economic and environmental sustainability. The main requirement of energy policy for the chemical industry is a framework that gives producers access to secure supplies of energy, and feedstock, at internationally competitive prices. Chemical companies desire minimum tax and administrative burdens, and a choice of supplier, product and contract. The CIA supports the government's creation of the sustainable energy policy network (SEPN) to the extent that it can better co-ordinate energy policy and believes that it must give due weighting to the economic aspects of sustainability, as well as environmental objectives. We recognise the success of the regulatory model and support the continued emphasis on economic efficiency of an independent Office of Gas and Electricity Markets (OFGEM).

**The chemical industry's objectives and proposals**

On Energy Policy in general:

1. Domestic policy should focus on making competitive energy commodity markets work, while maintaining simple network regulation. Building on the success of recent European directives, the Government should now press hard for a rapid liberalisation of European energy markets and ensure careful harmonisation with UK arrangements.

On Electricity:

2. The New Electricity Trading Arrangements (NETA), the UK's first genuine market in wholesale electricity, should not be subject to intervention, either in response to pressure from special interest groups, or because of a perception that it would help environmental objectives. Genuine externalities being reflected in prices should not be confused with monopoly rents being internalised in the same way. The CIA believes that a framework where prices reflect costs is the basis for a sustainable energy policy, rather than something that detracts from it. We are disappointed by the delays, due to lack of parliamentary time, that have occurred in creating a UK-wide electricity market and urge the Government to accelerate NETA's extension to Scotland as the British Transmission and Trading Arrangements (BETTA).
3. Electricity transmission is generally well organised under current arrangements. The CIA does not support the reform of

transmission arrangements and charging unless benefits to consumers can be clearly demonstrated.

4. A renewables target of 20% by 2020 is overly ambitious. Over-dependence on renewables is likely to lead to additional cost, and security of supply risks in the case of technologies such as wind. The CIA supports research to develop competitive renewable technologies, but believes that the generation mix is best left to the market. We disagree with specific subsidies such as the Renewables Obligation, which result in costs being directly passed through to industry and an associated loss of competitiveness.
5. The CIA agrees with the Government that a nuclear build programme should not be ruled out, but believes that any decision to do so should depend, not least, on its economic viability.
6. The Government's target of 10GWe of installed Combined Heat & Power (CHP) by 2010 now appears to be at risk. CHP could be encouraged by a more long-term and consistent approach to policy on CHP in order to provide stable signals to industry about long-term investment decisions.

On Gas:

7. The CIA has continued concerns about the competitiveness of the UK's wholesale gas market, and believes that questions about the sharp price rise at the beginning of 2000 would be best analysed through a comprehensive and independent review. A Government-led programme of gas market information release would increase transparency and further underpin market functioning.
8. The existing UK-Continental interconnector has a greater capacity for export than import, which means that European competitors benefit from cheap UK gas in the summer, without the associated quid pro quo in the winter. The CIA believes the Government must accelerate the changes already underway to upgrade the interconnector in order to address this situation.
9. Transco has struggled to deliver timely network investment and we believe network constraints are still putting a premium on gas prices. The CIA considers that the relatively small cost of a marginally over-engineered network is justified to take pressure off prices in short term and attract competitive gas in long term. OFGEM should closely monitor its recently introduced long-term auction arrangements. If these arrangements fail to deliver a badly needed boost to levels of network investment, the regulator should adopt a more prescriptive approach in ensuring that Transco meets its 2007 targets.
10. The CIA also believes that offshore and onshore regulation should be harmonised under a single body. This would address the difficulties created by the UK Department of Trade & Industry's (DTI's) current dual-role as sponsor and regulator of offshore industry.

#### **Position Background**

The chemical industry accounts for two per cent of GDP and is the UK's top manufacturing export earner. It continues to be the largest manufacturing user of electricity and natural gas, accounting for 6% of total UK supply in each case at a cost of approximately £1bn. Chemical producers are increasingly price-takers in global markets, where competition is extremely fierce. Efficient operation is key and companies must maintain a laser like focus on raw material costs, of which energy can represent up to 30%.

In addition to its consumption of energy for fuel and power, the industry uses energy as an essential feedstock for the start of many chemical processes, such as chlorine production, which add value to the basic raw materials. The industry's combined energy and feedstock bill amounts to around £2.5bn.

The industry also has an excellent record of improving energy efficiency. Between 1967 and 1990 the output of chemical products more than doubled, while energy consumption per unit output was reduced by almost 60%, similarly between 1990 and 1998 further improvements of 19% were achieved. The CIA is currently participating in a negotiated Climate Change Agreement with the UK Government and expects to deliver a further aggregate improvement in energy efficiency 1990 - 2010 of 34% across its membership.

The CIA played a full part in the review of energy policy, which led to the February 2003 Energy White Paper. It submitted detailed written responses to the Cabinet Office Performance and Innovation Unit's (PIU) 'Energy Review' at the end of 2001 and also to the DTI's 'Energy Key Issues for Consultation' in summer 2002. It continues to make input to the Government about the detailed implementation of the White Paper's objectives.