CHEMICAL INDUSTRIES ASSOCIATION

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Energy Supply Probe – Initial Findings Report

Response from Chemical Industries Association

Dear Neil,

The Chemical Industries Association represents 150 member companies from the UK's important chemical manufacturing sector. The industry has £60 bn turnover, employs over 180,000 skilled people, generates a consistent trade surplus and its value added contributes around 1.5% of GDP. We are hereby making a formal response to your recent "Energy Supply Probe".

We note the overwhelming emphasis on the domestic consumer. Ofgem defines the target audience as "Energy suppliers and generators, consumers, consumer organisations and representatives, academics and other interested parties" and says the probe was undertaken in response to "Concerns ... expressed about the operation of Great Britain's gas and electricity retail supply markets for domestic and small business consumers."

Since large industrial consumers are not explicitly acknowledged, we are therefore among the "other interested parties" and wish to record our severe disappointment at the narrow scope of the investigation and its almost complete failure to consider the fundamental importance of the working of the wholesale gas market. We would have expected, not least after the BERR Select Committee's hearings last summer, which was completed well before your report was published, that you would have investigated the role of the wholesale gas markets in setting the baseline for domestic gas supply pricing, and its role in influencing electricity markets too. Instead of effectively accepting the wholesale price as a "given", and concentrating on the mark-up and leads and lags between it and domestic prices, it would have been relevant to look at UK wholesale gas prices themselves, and ask why, especially in forward markets, they have often been well above those available to our competitors in Continental Europe and elsewhere. High volatility is also a feature, which contributes to the high-risk premium in forward markets and therefore pushes up the average prices paid by industrial users and retail consumers alike. Why does Europe's most liberalised energy market deliver consistently higher wholesale prices than those in Continental Europe? Considering the results, it is hardly any wonder that our Continental friends are reluctant to join us in this market laboratory.

The BERR Select Committee's report into energy prices highlighted a number of concerns with both Ofgem and the wholesale markets. We were disappointed that this major report was only given a paragraph long response in your probe. On the back of Ofgem's statement that *"We will respond to the BERR select committee's wholesale market concerns, as well as other issues raised in the BESC report, in the near future"* we would strongly urge that a dedicated action plan and timeline is communicated as soon as possible. **An uncompetitive, volatile and highly priced wholesale market will only lead to high uncompetitive retail prices for domestic users, the issues raised must be investigated as a matter of urgency.**

As the UK becomes ever more dependent on imported gas, it is surely clear that we desperately need more gas storage, and a more dependable flow of gas through the LNG terminals that have been built, and are still waiting to be commissioned. It is painfully apparent that the principal gas suppliers see no self interest in constructing storage facilities - after all, they profit from high volatility and prices - and although there exists a list of projects supposedly in prospect, many have not yet reached the stage of submitting a planning application, while many that have, have had it refused! The largest single project on the list, the "Esmond/Gordon" 4 bcm offshore cavity, now looks highly unlikely to be feasible: following the most recent appraisal drilling a financial analyst's report dated 5 November (see https://research.tristonecapital.com/EO_08-11-05.pdf) reduced its estimate of the chances of completion from 67% to only 5%. LNG terminals have been built, but the owners remain coy about whether they will be used, and no long-term supply contracts appear to be associated with them.

Generating capacity in power markets is also giving increasing cause for concern. This, rather than retail supply margin, should be the big story. With no new nuclear capacity remotely likely to be available within 10 years, several coal fired plants closing because of old age and/or the constraints of the LCPD, new ones having difficulty obtaining planning permission because carbon capture and storage remains a distant vision, and wind power being not only unreliable but increasingly expensive to construct, we face the real risk of the lights going out before 2015.

These are the issues we believe Ofgem should be urgently addressing, for the benefit of **ALL** UK energy consumers and to regain the markets confidence with the energy regulator.

Yours sincerely,

Stephen Elliott
Chief Executive
Chemical Industries Association