CHEMICAL INDUSTRIES
ASSOCIATION

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Project Discovery: Options for delivering secure and sustainable energy supplies

Response from Chemical Industries Association

The Chemical Industries Association[1] welcomes the chance to respond to this consultation. ***Secure and competitively priced energy is essential to our membership who compete in globally traded markets.***

Not wishing to repeat in full the comments the CIA made to the first consultation *Project Discovery – energy market scenarios,* back in November[2], please find below a summary of the key issues. We then go on to consider the specific questions raised in the document**.** We have not, however, offered any opinion on technical grid operation / regulatory questions, on which we believe some industry participants are better qualified to comment.

It is clear that a major amount of investment is required if we are to meet our future energy requirements and that this will come at a cost. We note the documents transparent look at future security of supply issues with many concerns consistent to those highlight by the CIA in recent years. It is clear that there will be significant changes in the generation mix over the next ten years: increasing renewable generation, reducing coal and oil generation as the Large Combustion Plant Directive & the Industrial Emissions Directive take effect, and with gas filling the gap until nuclear can be brought on stream. We are very concerned about the impacts of these changes on future UK energy supply security. Ofgem's document appears to suggest the UK needs investment in gas storage; consistent with the increased need to provide gas generation flexibility. We look for future policy measures that will ensure gas storage requirements are clearly identified and for a gas policy that provides appropriate priority and support to commercial developers of gas storage.

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[1] The CIA has in membership around 150 of the larger companies in the UK chemical and pharmaceutical industry, which has aggregate turnover in excess of £60bn and directly employs almost 200,000 highly skilled people. It is the only major sector to maintain a significant positive trade balance, typically registering a surplus of £5bn annually.

[2] CIA response is stored under the following link on the Ofgem website http://www.ofgem.gov.uk/Markets/WhlMkts/Discovery/Documents1/Chemical%20Industries%20Association.pdf

The current arrangements will not provide adequate investment required to provide secure, competitive and sustainable energy supplies. We welcome Ofgem's work in this area; we simply do not see the current environment (financial, planning, legislative, carbon pricing) encouraging the market to deliver what are significant investments where returns are based upon a very uncertain future outlook. We note that Ofgem highlight that the primary sources of funding for activities such as generation, gas storage and smart meters are pension and infrastructure funds, other private sources of equity and sovereign wealth funds. Given the desire of many of these funds to invest in secure returns for their investors we simply do not see the level of funding being available for investment in the energy sector given the lack of forward vision and certainty on future project returns. Multi-national players can, and are choosing, where to make their investments, many operating in global environments and as such, have a choice as to where they make their investments.

The second phase of Project Discovery identifies possible policy packages that will encourage the large amount of investment required. Significant consultation will be required before the Government decides to takes any policy changes forward. Although we will not comment in detail on the specific details we recognise that the Government has already initially commented through an Energy Market Assessment document[3], published jointly with the Budget. Whilst already ruling out the *Central Energy Buyer* and *Targeted Reforms* options, the Government has highlighted that it will be assessing Ofgem's groups of options in a consultation this autumn followed by a White Paper in spring 2011. One specific comment we would wish to make is the proposal of introducing a minimum carbon price (as included in three of the possible policy packages). ***We are concerned with the competitiveness impacts of introducing a unilateral carbon price floor.*** With a significant number of members in the EU Emissions Trading Scheme any potential carbon floor price could have serious financial implications if the EUA price fell below the floor in the future. We also wish to note that EU ETS is designed to cap total CO2 emissions. A changing carbon price for political reasons will only work against the scheme.

With the current environmental measures such as EU ETS, the Renewables Obligation and the Climate Change Levy (CCL) the initial UK Renewable Energy Strategy estimated that there is a 21% increase to medium sized industrial electricity bills alone.[4] The possible addition of a CCS levy and the Renewable Heat Incentive as well as other measures to pay for low carbon supplies will also increase energy prices significantly. Whatever package / reform is chosen in the future it is important that there is a clear, stable and consistent energy policy in the future, not only to ensure secure and competitive energy prices but to allow overseas investment in UK manufacturing. ***The cumulative impact of climate policies must not deprive UK manufacturing of affordable, and internationally competitively priced energy, nor endanger energy security.***

Following our general comments above please find below responses to the questions asked.

CHAPTER: Three

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[3] http://www.hm-treasury.gov.uk/budget2010_energymarket.htm

[4] UK Renewable Energy Strategy: Consultation document – section 10.5.3 http://www.berr.gov.uk/files/file46799.pdf

Question 1: Do you agree with our assessment of the current arrangements?

As in our general remarks we agree with Ofgem that we simply do not see the current environment (financial, planning, legislative, carbon pricing) encouraging the market to deliver what are significant investments where returns are based upon a very uncertain future outlook. We believe that certain market participants who could invest in such plants operate on a global scale and have choices as to where they make their investment based on the incentives and security of the return on their investments. A number of the market participants are no longer UK companies. We also note that certain market participants have not been immune from the recession and therefore maybe somewhat constrained in their future investment capacity.

Question 2: Are there other aspects of the current arrangements, which could have a negative impact on secure and sustainable energy supplies, or costs to customers?

We would encourage Ofgem to examine what opportunities there are to extend the life of plants that have currently been scheduled to close. For the nuclear sector we note that the initial Project Discovery analysis already assumes that Heysham and Hartlepool stations are extended to 2019. We would ask Ofgem to examine what incentives could be put in place to encourage existing stations (nuclear and opted out coal) to examine lifetime extensions. This would allow the baseload generation capacity to be maintained in some of the scenarios to allow the transition to more carbon neutral forms of generation.

Question 3: Do you agree that the five issues we have highlighted are the most important?

We generally agree with the five issues highlighted however we have some concerns with the comment in regards to short term price signals. As large industrial consumers we do indeed place a value on security of supply. However the increasing integration of intermittent wind power should not result in high price spikes, therefore ensuring that peaking back up generation is invested in. Our membership contracts with a percentage of its electricity use on the day-ahead market (due to uncompetitive forward pricing) and should not be exposed to the intermittency of wind generation and hence volatile pricing. Market mechanisms should be investigated which factor the intermittency and therefore the need for fossil fuel back-up generation in the investment in wind.

CHAPTER: Five

Question 8: Do you agree with the assessment criteria that we have used to evaluate the policy packages?

The criteria seem sensible, however we would weight security of supply and affordability as the main priorities.

CHAPTER: Six

Question 12: Do you agree with our assessment of the timing for important investment decisions?

Yes

Question 13: Do you believe that early actions should be considered?

Yes it is essential to start investment as soon as possible