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DG Competition Energy Sector Inquiry - Preliminary Report Consultation

The Chemical Industries Association (CIA) is pleased to have the opportunity respond to the DG Competition's energy sector inquiry. We represent around 140 companies from a sector which, in total, has 200,000 employees across every region of the UK. The industry converts both mineral and plant based raw materials into key intermediates for use by other manufacturing sectors as well as final products for households, ranging from paints to detergents, fragrances to pharmaceuticals. The chemical industry faces global competition and UK assets are predominantly owned by companies headquartered overseas. As well as being major consumers of both gas and electricity for heating and power our members use gas and oil as feedstocks. The chemical industry is one of the UK's most important industrial sectors, accounting for 11% of manufacturing gross value added [1] and maintaining the largest positive trade balance [2], registering a surplus of over £4bn in 2005 even when severely handicapped by having to pay energy prices far higher than those available to most of its competitors on the Continent or elsewhere.

General Comments

It is vital for UK manufacturing industry that EU energy markets are liberalised as quickly as possible, and that a fully competitive energy market be allowed to develop with the price of gas set by the underlying supply/demand fundamentals. We fully support the work of DG Competition into their Energy Sector Inquiry and we believe that action should be taken as soon as possible. The main issue for customers in the UK's liberalised energy markets is that similar rules do not apply in the Continental markets to which we are attached, and on which we are increasingly dependent for physical supplies of gas. Central to the creation of a liberalised and competitive EU energy market is:

- the unbundling of integrated energy companies that control transmission and distribution systems, production and supply;
- clear and transparent third party access to infrastructure based on a common charging basis that is applied equitably, with effective Use it or Lose it (UIOLI) requirements placed on both infrastructure owners and capacity rights holders to ensure there is no possibility for hoarding;
- an unbiased and equitable access to all the relevant information that is required to set prices based on market fundamentals;
- the requirement to ensure that mergers or acquisitions do not stifle competition; and
- national regulators must ensure the timely release of data to all market participants on an equitable basis.

Comments on Section E : The Way Forward

Competition Law

CIA agrees with the current findings of DG Competition that (i) market concentration, (ii) vertical foreclosure, and (iii) market integration will need further attention during the final phase of the inquiry. We are concerned that long term contracts are inhibiting new entrants and the development of competitive markets, we are also concerned that there is a lack of market integration which is vital for the formation of regional and ultimately European energy markets. Market

1 UK Office for National Statistics (ONS), Annual Business Inquiry
2 ONS, Trade in goods by industry (MQ10)

concentration is an issue which needs to be tackled to ensure markets can be truly competitive and offer choice to consumers.

Regulatory
We agree that transparency is an issue in all Member States and that transparency obligations should be strengthened. We also believe that it is important to ensure that the remaining "grandfathering rights" which can act as a barrier to entry are removed. We support the proposal for surveillance of the conditions and prices for Third Party Access in order to make pro-competitive markets work and allow consumers benefit.

Issues under Review
CIA would like to comment on the main issues that DG Competition have identified for review:

- *gas-oil linkage in many contracts*

CIA's view of an ideal gas market is one where buyers should have the freedom to negotiate contracts. Market liberalisation and new entrants help to create competition, therefore, for contracts between suppliers and customers we support the position that consumers should be free to choose length of contract and pricing mechanism. Our members in the UK who purchase gas in other Member States have commented that adequate cost transparency is lacking in many Continental gas contracts. The UK believes that if there is genuine competition in gas, then you don't actually need the oil product index.

- *exemption from Third Party Access in the cases of new investment in pipelines, storage and LNG terminals.*

The CIA believes that national regulators should determine the conditions, tariffs, access and use of networks in consultation with the entire gas market including customers in order to improve the efficient operation and integrity of networks. If exemption from Third Party Access (TPA) is required because all capacity has been contracted, then effective UIOLI requirements should be placed on both infrastructure owners and infrastructure capacity owners.

- *a possible more generalised use of gas and electricity release programmes under regulation in order to reduce the effect of concentration in the upstream supply level and inject liquidity into the market, as well as other measures reducing the effects of concentration*

CIA supports gas and electricity release scheme but we request that proper conditions and terms when applying gas release programs to ensure that markets are created with sufficient liquidity and that these schemes do actually reduce the effect of market concentration.

- *further measures to reduce upstream supply concentration*

We believe that market consolidation is stifling competition. Measures need to be taken to ensure that gas producers into the EU (e.g. Gazprom, Sonatrach, gas producers in Norway) sell an increasingly significant proportion of gas directly to consumers in lieu of the traditional wholesalers.

- *the impact of the Emissions Trading Scheme on prices in the electricity market.*

Power prices are set by marginal costs of generation, and these include the costs of CO_2 allowances. Despite the UK generating sector having received a largely free allocation of allowances the opportunity cost of carbon has been included in electricity prices. The generating sector has made windfall profits at the expense of industry, the domestic sector and the economy as a whole. Energy-intensive manufacturing industry, competing in a global marketplace, has been unable to pass these additional costs onto its customers. Combined with the very high energy prices seen in the UK over the last 18 months energy-related operating costs for our companies have risen to an unsustainable level. Some are failing now for these reasons. It is vital that EU Commission notes the concerns of our industries and engages in further discussion on how to ensure that only the incurred cost of carbon is factored into electricity prices, as well as fully appreciating the competitive disadvantage for European manufacturers which ETS causes. Transparency of electricity pricing and fuel costing is also required so that companies can understand exactly how the prices they are expected to pay are formed.

Structural - observations from the UK market regarding unbundling
CIA agrees that the content of the second electricity and gas directives on unbundling need to be fully implemented, and we agree that full structural unbundling should be considered. The UK market's experience means that full structural unbundling is required so that there are no commercial conflicts of interest, gas release schemes to enable gas to be traded and plant divestment. Finally, action is required now in Europe as the process took many years to complete.

If you have any comments, please do not hesitate to contact Helen Bray, brayh@cia.org.uk, +44 (0)20 7963 6718

Kind regards,

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