House of Commons

Business, Energy and Industrial Strategy Committee

Oral evidence: Energy pricing and the future of the energy market, HC 1130

Tuesday 22 March 2022

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Watch the meeting

Members present: Darren Jones (Chair); Tonia Antoniazzi; Alan Brown; Richard Fuller; Ms Nusrat Ghani; Paul Howell; Mark Jenkinson; Andy McDonald; Charlotte Nichols; Alexander Stafford

Questions 185 - 198

Witnesses

III: Dr Richard Leese, Chair, Energy Intensive Users Group; Nishma Patel, Policy Director, Chemical Industries Association; Paul Wilson, Policy Director, Federation of Small Businesses.

Written evidence from witnesses:

– Dr Richard Leese, Chair, Energy Intensive Users Group [EPM0015]

– Nishma Patel, Policy Director, Chemical Industries Association [EPM0006]

Examination of Witnesses

Witnesses: Nishma Patel, Dr Richard Leese and Paul Wilson.

Q185 **Chair:** In the final half hour, we are moving to panel three. On the screen, we welcome Dr Richard Leese back to the Committee from Energy Intensive Users Group and, in the room, we welcome Nishma Patel from the Chemical Industries Association, and Paul Wilson from the Federation of Small Businesses. Good afternoon to all of you, and welcome to the Committee.

My opening question to each of you is about the state of play for your members or member organisations in the context of the current energy crisis.

Nishma Patel: I represent the Chemical Industries Association. Our membership is predominantly chemical and pharmaceutical manufacturing companies. In terms of energy, 2021 saw some energy prices escalating above prices we saw previous to that year. That was due to a range of factors, including a cold winter, storage depletion, and Governments around the world moving through a transition due to climate change and responding to the gas market. The recovery from Covid and the increasing demand meant that we saw increasing prices.

Fast forward to today, and those prices have only escalated again. If we take January year on year, gas was around 200%. In March, we are looking at an increase of about 850%. Similarly, electricity rose by 130% year on year in January. In March, we are seeing a 500% increase year on year. In terms of impact for the sector, the chemicals sector is very heterogeneous. The products vary widely. The energy intensity to make those products varies widely too.

In the short term, businesses have been managing those costs as best they can. It is a very challenging environment, so the impact management is around looking at their operations and at the production that they can manage. Can they absorb the costs for some of that production? Where will they have to pass on the costs? Some companies are even looking at whether they can bring maintenance schedules forward to temporarily manage costs.

All of these are temporary measures that would serve well if this was a blip in energy prices, but we see the forward curves and what is coming in the next 12 to 24 months in terms of energy prices, so those more sustainable interventions are the big thing that companies are very much looking for going forward.

Q186 **Chair:** We saw a particular example not long ago with CF Fertilisers, which needed to do a deal with the Government in order to keep producing carbon dioxide, because it was going to turn off its production. We have not seen any other types of direct arrangements between industries and Government since then. Are any of your members having to stop production because it is too expensive or are they just finding ways of responding?

Nishma Patel: Stopping production, no, but reducing operations in varied ways, yes. We want to avoid being in the situation again where a company gets to the point where it is looking to immediately halt production, with the knock-on impact that that has on the direct supply chain, which, in that case, was fertiliser, as well as the indirect consequences that it had on the CO_2 market. This goes back to the point that we talk about supply chains in a very linear way, but it is very much a multi-web process. Until you know what both the direct and indirect impacts of those are, it is very difficult to know when that impact will hit and how quickly.

Q187 **Chair:** Mr Wilson, if you are a high street retailer, an office, a hotel, a café or a gym, there is no help in place at all, is there? You just have these enormous bills that you have to pay.

Paul Wilson: That is right. Particularly when you look at microbusinesses—those businesses with fewer than 10 employees—Ofgem has long acknowledged, and the FSB has long argued, that they act a lot like domestic consumers when it comes to energy markets. They do not have the bargaining power that a bigger business might have. They will not have an energy or facilities manager. The extent to which they can get a good deal depends on the time that the owner can spend shopping around. What we have seen in the last year is that, even if they have been able to get a good deal, the supplier might have failed, in which case that good deal evaporates overnight.

There are lots of estimates going around, but we estimate that between February last year and February this year, electricity prices have risen by 145% and gas prices by 258%, and that is before the more extreme price fluctuations that we have seen more recently. We should also put that in the context of an unprecedented level of cost pressure that small businesses are facing.

FSB runs a quarterly confidence survey. In the last three quarters in which we have run that, we have seen consecutive drops in small business confidence at a time when we have been coming out of the pandemic, a lot of which is to do with these cost pressures. So 78% of small businesses said that their costs went up in the previous three months. For 20% of small businesses, their costs went up by more than 10% in the last three months, not only in terms of energy but across the board. That shows the scale of the impact. It is not just utilities but also fuel prices, input costs, labour costs and, very soon, tax increases that are going to come in in April.

There is a degree of crossover, unfortunately, between those businesses that have been worst affected by the pandemic and those that are now being impacted by the energy price increases. Take the example of hotels, which would traditionally be looking to discount to attract consumers back after what has been an astonishingly difficult couple of years. They want to give consumers the confidence. To give one example, the Crescent Hotel in Scarborough saw its gas supplier go bust last November. It had been paying around £2,000 a month for gas, but that went up to £10,000 a month.

I will also give you the example of a brewer, which is expecting to see increasing energy bills of between £22,000 and £24,000 a year. Their tariff for electricity has gone up from 11 pence per kilowatt hour to 38 pence per kilowatt hour. They are painfully aware that they cannot afford just to pass those costs on to customers, and they do not want to have to do that either, because they know that going to the pub is a discretionary purchase and that people could stop doing that. Instead, they are thinking, "Well, that is potentially the cost of a member of staff, or how else do I make those cost savings?"

The decisions will be up to individual businesses in terms of how they are best able to cope, but I am afraid it is going to mean a mixture of higher prices for consumers—which will contribute negatively to the cost of living crisis that we are seeing—cuts in other costs, and reductions in investment. For some businesses, it might be the final straw, which is why now is the time for not only Ofgem but also the Government to step in and do more to support businesses with these costs.

Q188 **Chair:** Presumably, there are no financial products available that are comparable to the £200 loan and repayment scheme that is being put on to residential bills.

Paul Wilson: That is absolutely right. The one exception to that is that, if you are a small business or self-employed and working from home, you might be on a domestic tariff, in which case you may benefit from that, but people on business tariffs are not. FSB is arguing that, given the scale of the cost increases that businesses are facing, it would be right for the Chancellor to step in and provide something analogous to the support provided to households through council tax.

You could provide some degree of rebate through the business rates system, as the Government have done quite effectively over the last couple of years to help manage the pandemic. For those businesses that are not paying rates, because they are too small or do not have relevant premises, you could provide a discretionary fund akin to the £150 million.

Those kinds of interventions would be justified tomorrow at the spring statement, given the scale of the challenges, but we would also acknowledge that it is not easy to intervene in energy markets. There are other tax levers that the Chancellor has at his disposal, and I would highlight a couple. One is the national insurance contribution increase that is due to come in, which is something that FSB has vehemently opposed. We do believe that it is a jobs tax.

The impact of that on the smallest employers could be offset to a great degree by uprating something called the employment allowance from £4,000 to £5,000. That would be a big help with the costs across the board and would help manage these challenges that small businesses are seeing on their energy bills.

Similarly, he could choose to take more businesses out of the business rates system and to increase small business rates relief from £12,000 from £25,000, so that more businesses do not have to pay business rates and are, therefore, much better able to cope with these cost pressures. There is a range of ways in which the Chancellor could and, we think should, intervene tomorrow.

Q189 **Chair:** We will wait to see what he has to say. Dr Leese, from your members' perspectives, are we seeing production being turned off or halted in any way?

Dr Leese: If we just take a step back to the energy prices, back in April 2021 UK wholesale electricity prices rose to £50 a megawatt hour compared to just £30 a megawatt hour a year before, before soaring to £100 a megawatt hour in August. We then saw extreme volatility through September, where the monthly averaged reached around £200 a megawatt hour, which was almost double the French and German averages. At that time, the Energy Intensive Users Group wrote to BEIS and outlined the measures that were necessary to alleviate that pressure.

At the same time, as you mentioned, we saw two fertiliser plants stop production. One remains closed, to the best of my knowledge. We have seen other plants and businesses trying to manage themselves through what has been an extremely difficult situation. The CIA mentioned some of the ways that businesses have managed that, through bringing forward some of the winter shutdowns and maintenance programmes to try to get through the winter, at which time we thought it was the worst of it. With the barbaric invasion of Ukraine, we have seen things get even worse for energy intensive industries.

This is not new news to the regulator and Government, though, because, back in July last year, Ofgem produced a research report into GB electricity prices for energy intensive industries. That report highlights the fact that although there are differences in wholesale prices, GB prices tend to be higher than those of our continental competitors. Although we have some policy cost relief on energy intensive industries, even the residual costs for those that get the reliefs—and not all do—mean that GB costs are higher than those of our competitors.

The problem is recognised but we have not seen any action on what Government are going to do about it. Back in October, if action had been taken on the measures outlined by EIUG, energy intensive businesses would be in a better place right now.

Q190 **Charlotte Nichols:** Coming back to some of the points that you raised there, Richard, in terms of the experience of UK energy intensive industries compared to European competitors, I am interested to know your thoughts on how the UK emissions trading scheme has compared to the EU emissions trading scheme throughout the energy price crisis and how this is affecting your members.

Dr Leese: The CO_2 prices within the UK ETS have pitched above the EU ETS quite consistently over the last year or so. We saw a dip in the market just recently as a result of the invasion, but the CO_2 prices in both the EU and UK markets are beginning to tick up again. The important difference is that the UK prices are pitching above the EU prices, and we have the UK-only carbon price support tax, which is an added burden on energy intensive industries.

The authority that manages the UK emissions trading scheme had an opportunity over the winter to intervene in the CO_2 market in order to make prices in the UK more comparable with the EU, using what is called a cost containment mechanism. On two occasions, that CCM was triggered and the authority chose not to take action, which was a missed opportunity to bring our CO_2 prices in line with those of the EU.

Nishma Patel: UK prices have traded, on average, at a premium of about £5 to EU prices. The cost containment measure was triggered twice. The justification for no action was that the price differential was due to market fundamentals; in other words, the policy set out is doing what it is supposed to be doing. If you look at recent prices, the price tanked as energy prices increased. If it was due to market fundamentals, the carbon price would also increase with energy prices going up, because there would be a shift to coal or other energy sources.

The fact that we had the tank shows that that was due to speculators, with the UK ETS being much smaller, volatile and liquid, meaning that more speculators were involved in the price. That justification in itself was flawed, and the recent trend that we have seen has shown that. Going forward, the key thing is that there is a clear, accountable reason and justification for triggers and any action taken beyond them.

Q191 **Charlotte Nichols:** How effective is Ofgem's remit and performance for business and industrial users? What, if any, reforms are needed?

Nishma Patel: Ofgem's remit is quite clear. It has a legal framework in which it operates. It is clear that it does what it can to be fair and consistent to the range of consumers, which is by no means an easy job. From an industry perspective, what we have been pushing and asking for is the accountability part around impacts and assessment. What I mean by that is that the most vulnerable should be protected against high and escalating prices.

Equally, there needs to be a fair impact on what that means for other parts of business and the business community, and in particular energy intensive businesses that are trade exposed and subject to competitiveness. That is equally key to ensuring that those parts of business and manufacturing get a level playing field in order to continue operating. It is about accountability and transparency around the impacts and the decisions that are made based on them.

Dr Leese: The energy White Paper back in December 2020 outlined that the Government were going to consult on a strategy and policy statement for Ofgem by the end of 2021. That has not happened. In some respects, you could say that Ofgem was operating rudderless, because it does not have the direction from BEIS to ensure that all customers are treated equally. We have plenty of evidence whereby energy intensives have not had the attention from Ofgem that we deserve. Particularly through this energy crisis, we have seen little action from the regulator.

Q192 **Alan Brown:** I just want to ask a couple of questions about industrial dependency on Gazprom UK. I understand that Gazprom UK supplies something like 21% of the industrial market for gas. Nishma, are industrial users trying to cut their ties with Gazprom and, if so, what challenges are they facing because of that?

Nishma Patel: Correct; one in five is the proportion of Gazprom supplying to the business community overall. Whether it is for geopolitical reactions or whether they are taking ethical or commercial decisions, businesses are thinking feet first in terms of those decisions that are being made. The key challenge is those contracts and commercial agreements that businesses have with Gazprom. If they are short term, how long will they take to unwind? Is the framework that is currently provided by the regulator fit to allow commercial organisations and businesses to unwind those contracts, and what are the legal consequences of doing so?

We have good examples of what it means for a company if it decides to unwind and what penalties it faces and, equally, what it means if a supplier decides to rightfully reject unwinding a contract because there are terms and payments outstanding. There is a legal framework around this. Does it work, given the current situation and crisis we are in? That is the bit that companies are really struggling to unwind at the moment.

Q193 **Alan Brown:** Have the Government had any discussions with industry in terms of the legality of longer contracts or Government direction on whether they should be withdrawing from Gazprom? Has there been any dialogue or direction given?

Nishma Patel: Yes, there has been dialogue. What we have been asking for from Government is that, if there is a supplier failure—if Gazprom fails as a supplier—there is an orderly exit from the market. What we mean by that is that there is consideration and that the special administration regime, which would be applied in this instance, because it is a major supplier failure, has been stress tested to work in terms of the framework and the industrial codes that are there. Does it work in practice and has it been tested?

We have been pushing for two other things, one of which is around what exposure companies have to Gazprom. Will Government be honouring the contracts that are there? There will be hedge positions and longer-term contracts there. If not, what temporary emergency measures will be there to support companies? For example, in the EU, we know that there will be discussions this week about competition in terms of large supplier failure and what those emergency measures will be if there is a large supplier failure.

The three key things for any supplier failure are an orderly exit, knowing what the risk is in terms of the businesses that they supply, and what emergency measures are needed in the short term.

Q194 **Alan Brown:** Breaking news seems to suggest that, if people abandoned Gazprom, it might be the taxpayer who steps in under the special administration regime. Is that how you would expect things to unfold, or are there any companies out there that would have the capacity to pick up a withdrawal of Gazprom?

Nishma Patel: Not that I am aware of.

Alan Brown: Dr Leese, is there anything else that you would want to add that is any different from what we heard there?

Dr Leese: While the average exposure of non-domestics to Gazprom is 21%, we do have certain strategically important sectors and subsectors within the Energy Intensive Users Group that have a much higher exposure to Gazprom, where 50% or two-thirds of sectors are exposed. There is a real importance here to have that managed exit that Nishma talked about, and it is really important that those healthy businesses that have done the responsible thing, which is to hedge their energy exposure to Gazprom, are honoured in terms of contractual obligations. The prices need to be honoured, when or if that business is transferred to either an administrator or new ownership.

Q195 **Alan Brown:** You said that something like 50% of your representatives are reliant on Gazprom. Are you able to make a high-level estimate? If the contracts had to be honoured by the taxpayer stepping in, should Gazprom be forced to withdraw from the market, what kind of differential would there be in terms of the contracts that your industry has now compared to what the current wholesale prices are?

Dr Leese: It is a really good question, and I do not have sight of the prices in those contracts. We can see what the wholesale market is doing right now. It is pitching five times above its price this day last year. Normally, hedges are set a year or two in advance. If a company was coming out of the slowdown of Covid, hedging in probably a good 50% or 60% of its energy, it would expect to have that within a contract for a couple of years. That leads to an element of exposure to the wholesale market and spot prices, which are at eyewatering levels right now.

Q196 **Alan Brown:** Have the Government not been asking the same question about what it would mean for big industry in terms of the likely liabilities that would need to be picked up?

Dr Leese: We know that BEIS officials are taking evidence from individual businesses. Because this information is market sensitive for those businesses, that bilateral conversation is taking place, sometimes facilitated by the individual sector associations.

Q197 **Andy McDonald:** Can I ask you all about the immediate measures that could be taken by Ofgem or the Chancellor? Mr Wilson has already given us an impressive list around rebate systems, a discretionary fund, national insurance contributions, employment allowances and increased small business tax relief. Are there any other measures that you would be looking for immediately that would help your members?

Paul Wilson: I would highlight a couple of other options. There has been noise about fuel duty reduction tomorrow. We were looking at the cost of filling up a van for a year and average travelling for a business, which has gone up by about £1,000 over the last year with increased prices at the pump. That is something that could help alleviate cost pressures.

I would also point to something that will make a positive difference in a couple of ways, which is around net zero. Small businesses have generally taken steps towards net zero and are generally passionate about it, but they are incredibly cash and time constrained at the moment. FSB has proposed something called help to green vouchers, modelled on the help to grow digital scheme, where Government could provide contributory vouchers that allow small businesses to invest in solar panels, heat pumps and better insulation, fundamentally reducing demand and helping on the journey to net zero at a time when, otherwise, cash and time may be too constrained to do so. I would highlight those two.

Nishma Patel: Beyond those broader measures, there are two key areas for energy intensives. One is around uncompetitive policy costs. What I mean by that is that there are some, as Richard mentioned, around the carbon price support that we currently pay for, but there is no policy objective any more, because it has fundamentally been met.

The other key area is what is known as the EII compensation package. This partly provides relief on some of those carbon price support costs that our industry absorbs. The current compensation package is due to come to an end next week, at the end of the month. We do not yet have clarity on what that new compensation package will contain, and to what extent, so that would be a key one for industry to hear about over the coming days.

Dr Leese: I agree with what Nishma has said. The carbon price support is a UK-only tax and is no longer needed. Neither NGOs nor industry has ever liked it. It has never really serviced what it was supposed to serve.

It has just been a tax-raising instrument. Carbon prices now in the UK are pitching above EU prices, so it is no longer needed.

We want action on network costs. We would like to see the same level of discounts that are applied to some of our continental competitors applied in the UK. We would like to see gas emergency measures modified. At the moment, the asset value threshold is £50 million, so you are only eligible for a firm supply over and above that, and we would like to bring that down to £1 million, particularly for kilns and furnaces that are dependent on gas. If you turn them off and you lose that energy source, they quite often collapse and cause millions of pounds' worth of damage. We need that firm supply.

There has been talk over recent years about moving those policy costs that Nishma mentioned and adding them on to gas in addition to the policy costs that are already on electricity. This will just add to the cumulative burden that is on energy intensive businesses, so we want to see a delay in that policy of adding new policy costs on to gas.

We recognise that new fuels like hydrogen and electricity as a heat source are important, but now is not the time to load additional costs on energy intensive businesses. First and foremost, we need to make sure that those businesses that are supplied by Gazprom continue to get that supply in a consistent and managed manner.

Q198 **Andy McDonald:** Some of my other questions have already been addressed, so can I finish with this? To what extent are you satisfied with the engagement with the Government on these various requests for support for your industries? Are you finding good engagement? Are your demands and requests being well received? How is that working more broadly? Do you have a view about that?

Dr Leese: Our requests were submitted to BEIS back in October, when we saw the start of unprecedented energy prices. While we have good engagement with officials and the Minister and Secretary of State in terms of them listening and understanding, what we are not seeing collectively across Whitehall is sufficient action. I am hopeful for tomorrow that we see the Chancellor address these points.

Paul Wilson: Very similar—we have seen good engagement and good listening. We have been talking about these issues for a number of months, and we very much understand why so much attention is on domestic consumers, but the test will be what actions are taken tomorrow in light of the severity of the challenges.

Chair: Thank you to the three of you. That brings our final panel and this morning to an end. Thank you, on the screen, to Richard Leese and, in the room, Nishma Patel and Paul Wilson for your contributions, and to our previous witnesses. I will now call this session to an end.