confederation of paper industries

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Dear Sir

HM Treasury Consultation on a Carbon Price Floor Carbon Price Support Rates Comments from the Confederation of Paper Industries – summary of concerns

The Confederation of Paper Industries (CPI) is the trade association for the paper industry in the UK and has within its membership paper manufacturers, corrugated packaging manufacturers and mill-owned and independent recovered paper merchants and exporters.

Paper is a sustainable material and while substantial improvements have been made in energy efficiency (in part driven by Climate Change Agreements); by its nature, production is still energy intensive. The UK manufactures just under 5,000,000 tonnes of paper each year with over 50 paper mills still in production. Around 20,000 people are employed directly by the sector. With over 10,000,000 tonnes of paper consumed annually in the UK, manufacture of pulp & paper should be well placed to play an important role in the growth envisaged for the manufacturing sector.

The Pulp & Paper sector has already responded positively to the green agenda, with paper mills and associated converting companies providing the key market for recycled paper collected in the UK; making major investments in general energy efficiency; and widely deploying CHP including an increasing the use of biomass. A commitment to a low carbon economy resource efficient economy is clear.

We are concerned that these proposals will cause serious damage to the competitiveness of UK industry.

In summary:

- We are not convinced the new taxation is required. EU ETS is the European Union wide scheme designed to price carbon used by Energy Intensive Industries and it is this scheme that should be used on a pan European and better global scale to price carbon.
- We are not convinced the policy will achieve the desired objective of stimulating investment in low carbon generation as it offer price support at the revenue stage when support is required at the construction stage. The "contracts for difference" initiative may be a more appropriate methodology.

- We are concerned that windfall profits will go to incumbent generators with no guarantee of re-investment. There is also likelihood that generators will take the opportunity to increase profit margins as there is no clarity on the cost pass through mechanisms.
- If the CPS is implemented, it should be at the lower trajectories. We note that the additional cost to the sector in 2030 is £240 million (at 2009 prices) against an estimated 2009 sector profit of £125 million.
- If the CPS is implemented, then the taxation should be included in the provisions of a renewed CCA scheme as is the existing CCL. CCA participants could simply reclaim a portion of the CPS element of purchased electricity via a rebate set at the effective grid average CPS rate.
- We have particular concerns about the impact of the proposals on the viability of industrial CHP and urge that the Government simply exempt CHP from the new CCL CPS as it is already exempted from the existing CCL via the current 'good quality' CHP scheme.
- If the Government is concerned about the loss of revenue, then we note that the auctioning of EU ETS permits will already form a significant stream of revenue.

Detailed comments from the Confederation of Paper Industries

We have already welcomed Government proposals to rebalance the economy and see the pulp & paper sector as one of those well placed to play an important role. The CPS proposals run counter to providing an incentive to rebalance the UK economy towards manufacturing. By reducing competitiveness and increased operating costs, damage is caused at two levels, both putting the future of existing sites in jeopardy and making future investment in the UK unattractive. For a sector such as ours, where profitability is marginal, the net result will be increased imports, reduce exports and increased unemployment. Consequences will reach well beyond the directly-employed labour force.

The Government have acknowledged the overlapping and confused nature of climate change policies. Most of these policies have an impact on the cost of energy and it is the cumulative impact of these policies on cost that is critical. Looked at in isolation, the costs of each scheme are manageable – cumulatively they are not. The CPS proposals add yet another layer of cost and are unaffordable without damaging the future of Energy Intensive Industries in the UK. Information on the cumulative impact of policies has been provided by the Energy Intensive User Group (EIUG) and we have contributed to the updated report that has been provided as part of the EIUG response.

We note with concern that the consultation is unbalanced and seems more directed to the electricity generation industry rather than electricity consumers. Accordingly consultation questions are structured in such a way that there is no opportunity to raise a number of key issues that do not seem to have been fully considered. Because of this we raise these key issues outside the formal consultation questions.

Impact on international competitiveness and carbon leakage
With a captive market for electricity supply, there is clearly no problem for generators in passing through additional costs caused by the CPS to customers. The policy impact

analysis (with no justification) suggests that manufacturers will be able to pass through to customers much of this increased cost.

This is simply not the case as our sector is exposed to growing international competition. Indeed for the development of EU ETS Phase III (post 2012) it has been accepted that the sector is at risk of carbon leakage and so cannot pass through additional costs not imposed on competitors outside the EU without a loss of market to imports and a consequent loss of manufacturing jobs. Even after this analysis, the sector has been allocated no free allocations for electricity use or generation, leading to an estimate of additional cost in the region of £45 million per annum to UK paper mills (assumed EU ETS price £15 per allowance, cost of purchased allowances for generation plus pass through at cost from generators). Already a number of companies have said that extra costs already identified through EU ETS will make them uncompetitive – these new cost are on top of the EU ETS burden.

The CPS proposals add a new layer of costs and no account is taken of these carbon leakage issues and no weight is given to the carbon leakage debate. Put simply, sectors at risk of carbon leakage cannot afford an increased cost of carbon when competitors operate in economies that are not constrained in the same way. There can be no doubt that these carbon leakage issues are of equal or even greater relevance when applied to trade between Member States. These additional costs (imposed on UK installations only) can only serve to drive jobs and investment out of the UK. It is disappointing to note the lack of attention paid to this issue.

The basis of the Climate Change Levy

The Climate Change Agreement (CCA) system and the associated reduced rate of Climate Change Levy (CCL) was based on the premise that UK taxation on energy, that did not apply to competitors elsewhere in the EU, could not be afforded by UK based energy intensive industry without damage to competitiveness. This situation is unchanged and uncertainly over the future of the CCA scheme and the cost to industry of other climate related policies caused by the ongoing DECC review is causing great uncertainly and concern. Already the cost of the existing CCL levy will be almost doubled in April – a much higher overall increase than that required by the provisions of the Energy Product Directive. We urge that the future of the CCA system is quickly confirmed and the provisions extended to also include a discount on the CPS rates for eligible companies. **This would be easy to arrange for CCA members via a proportionate rebate for purchased electricity based on the average grid CPS rate.**

Divergence between European and UK energy policies

A divide seems to be evolving between energy policy at a European level and that in the UK. On the one hand policies continue to be developed by the Commission to provide an interconnected liberalised energy market across Europe, while on the other, Member States (including the UK through the CPS and other policies) are developing an incentives bidding war to attract investment to their country. Assuming the pool of capital is limited, the only winners will be the energy developers who are guaranteed high rates of return but at the expense of energy consumers. There is a particular risk in the case of nuclear development, where the support is essentially required during the capital intensive construction phase and no support is required during the low cost operational phase. The CPS policy has exactly the reverse effect; offering no support when actually required. While CPS is a long-term proposal, no Government can bind its successors. Policy changes on CHP, the CRC change to a straightforward tax and in other areas has already eroded confidence in Government promises.

Green Investment Bank and support for energy efficiency
The current structure of the proposals indicates an intention by the Government to retain the CPS revenue. Some at least of the tax should be allocated to support investment in energy efficiency. Higher fuel prices hit the most energy intensive firms hardest and serve to reduce the small amounts of capital potentially available for investment.

One of the few mechanisms to support industry in moving towards a low carbon economy is financial support via the Carbon Trust managed Industrial Energy Efficiency Accelerator programme (the IEEA) and we note with concern this funding seems likely to be cut just as our sector completes an assessment process through which potential areas for investment have been identified. This cut should be reversed, or the remit passed urgently to the Green Investment Bank.

Impact of the viability of Combined Heat & Power operation
Paper mills are one of the main industrial users of CHP in the UK. We have a particular concern over the impact of the proposals on the future commercial viability of combined heat and power (CHP) installations. The CPS proposal to impose a new tax on fossil fuels used in the plant, has the potential to seriously impact on the operation of CHP in the UK and so we have written to Ministers under separate cover both in our own name and in partnership with the Combined Heat & Power Association and other large industrial users to draw your attention to the unintended consequences of the proposals as presented. **Accordingly we urge that the Government simply exempt CHP from the new CCL CPS as it is already exempted from the existing CCL via the current 'good quality' CHP scheme.**

Please see the reply to question 4.C2 below for more information.

Affordability of the proposals (sector profitability)
In the UK, CPI assessments estimate that members actually made a loss in 2008 of around £25 million and a small profit of around £125 million in 2009 (on a UK turnover in the region of £4 billion) – these figures before provisions for pension deficits. If it were possible to pass higher costs to customers these figures would not be accepted and prices would be raised to restore long term viability.

For corroboration, PricewaterhouseCoopers (PwC) produce a global annual assessment of the financial performance of the top 100 Forest, Paper & Packaging Companies. The survey reveals that ROCE has greatly fallen in recent years to 2.3% in 2008 and 2.7% in 2009.

By contrast the Electricity Supply Industry – low risk and a captive market with the expectation of pass through of costs – is being offered ROCE of around 11-12% through these proposals.

Grid purchased electricity - We estimate that UK paper mills purchase around 2.5 billion kWh of electricity each year from the grid. Assuming the CPS starts at a level of £1 per tonne of carbon we estimate (using the carbon grid factor used for CRC) this means a direct increase in the wholesale cost of each kWh of .054 pence meaning **a cost increase to our sector of £1.35 million pa for each £1 added to the cost of carbon by CPS**.

This is additional to the cost increase already locked in by changes to EU ETS from 2013 when no free allowances will be granted for electricity generation. Assuming a cost of EU ETS allowance of £15 then this will cause an added cost of around £20 million each year. Of course these figures may be higher as electricity distribution companies take the opportunity to increase profits.

Fuel purchase for CHP – We estimate that UK paper mills purchase in the region of 9 billion kWh (gas equivalent) fuel for use in CHP plant each year. **This means a direct increase in the cost of CHP fuel to our sector of £1.6 million pa for each £1 added to the cost of carbon by CPS**. This is additional to the cost increase already locked in by changes to EU ETS from 2013, when no free allowances will be granted for electricity generation. Assuming a cost of EU ETS allowance of £15 then this will cause an added cost of around £24 million each year.

From the profitability issues discussed above, the additional costs imposed by the changes in EU ETS of around £44 million pa will be difficult to manage, but at least they will be applied equally across the EU. The additional annual cost of CPS (to UK installations only) of between £3 million pa and £9 million pa in 2013 (depending of £1 or £3 rate) is clearly unaffordable.

The increase to £70 per tonne in 2030 - arising from the escalating CPS - means an additional cost (on top of the underlying cost of fuel) of £210 million pa to the sector.

Additionally every 1p increase in the unit cost of electricity increases annual costs by £25 million for the sector.

Changing energy markets
A number of factors are conspiring to create uncertainly in energy markets suggesting that options should be kept open to take advantage of new opportunities rather than committing the UK to a long term high electricity price from expensive existing renewable generation technologies;

- Natural gas. Throughout the report the assumption is that the cost of gas will increase and this assumption partially leads to the eventual cost savings arising in the long term. This assumption is increasingly being questioned due to an increased global availability of gas, greater diversity of supply (including massive potential from shale) as well as new sources and associated transport and storage infrastructure. As gas generation releases only around half of the amount of carbon than would be released by an equivalent coal fired station, then the possibility of decarbonising by replacing coal with gas should be seriously considered as an alternative to the present proposals, at least as a lower cost interim measure. At the very least the proposals should be re-examined to reflect the latest situation in the global gas market.

- Greater use of electricity interconnectors. A number of interconnectors are being built or considered as a liberalised trans-European energy market develops. These offer the option of considering energy diversity and decarbonisation on a wider geographic scale and taking advantage of new developments such as solar in Southern Europe, biomass/hydro in Scandinavia, and wind over a much wider area than just the UK. The affordability of outcomes should be given much greater priority.

- Allowing more time for the development of new technologies. CCS is economically and environmentally unproven on a commercial scale and the inherent additional energy use required to offset the reduced efficiency and carbon capture and sequestration may mean it is never viable without massive subsidy.

Windfall profits for incumbents
Existing operators of low carbon generating equipment (both nuclear and wind) have demonstrated they have no need for the CPS subsidy which will only serve to increase their profits. Accordingly there should be some form of clawback to prevent this transfer of finance from electricity users to generators for no benefit to the generation mix.

We also note that the new subsidy is not actually required until the new low carbon generation actually comes on line – certainly not before 2018 and on a large scale not until new nuclear plant is commissioned. **While the enabling legislation could be passed now, the rate should be set at zero until the support is actually required by new equipment.**

Responses to specific questions;

3.A1. What are your expectation about the carbon price in 2020 & 2030? How important a factor will it be when considering investment in low-carbon generation.

The question is answered assuming the question refers to the price set by EU ETS, though the price of energy (as so partially carbon) is also increased by other instruments such as the existing CCL, ROC's and FIT's; it is the cumulative effect of these policies that it critical.

We note that the fundamental design of EU ETS is to allow the carbon savings to be made at the lowest cost anywhere in the EU. Links to the Kyoto mandated Clean Development Mechanism and Joint Implementation schemes allow a certain amount of the savings to be made in developing nations if this is at lower cost. These schemes are all international and we reiterate that schemes to increase the cost of carbon must be considered on a global basis.

European Commission calculations assume an allowance cost through Phase III (ie to 2020) rising to €30 and this is the figure we use for our calculations when advising our members. However we draw attention to the amount of fluctuation in the actual market price of allowances (rather than the straight line indicated in Chart 4.A). These fluctuations in the market price make the setting of the CPS in advance impossible if the intention is to increase the cost of EUA's to a particular price when the underlying price of EUA's is set by trading.

While forecasting the price to 2020 is difficult, forecasting the price to 2030 is not possible and any estimates given can have no serious credibility until formal details of the EU ETS scheme have been given for the period post 2020; critical is an indication of the overall cap – almost certain to be lower than for Phase III.

As the CPS mechanism will guarantee high prices for the UK (compared to a lower variable price elsewhere in the EU) then UK based sites will be relatively disadvantaged and less likely to secure investment when compared to alterative locations elsewhere in the EU, let alone sites outside the EU not subject to the same carbon cost.

3.A2. If investors have greater certainty in the long term price of carbon, would this increase investment in low-carbon electricity generation in the UK? If so please explain why.

The fundamental effect of the CPS mechanism will be to mean less new investment in the UK by Energy Intensive Industries. Existing installations will need to stay internationally competitive and so will be faced with the choice of investment in low carbon generation or moving out of the UK. The lack of support for CHP means UK investment would be less likely, meaning the long term impact would be a further loss of UK manufacturing.

The ESI sector, unlike the Paper Sector and other industries, operates in a secure and captive market with inherent low risk with the ability to pass through costs. The ESI has the certainty of UK Government and EC policies in introducing low-carbon measures thus there is already confidence there will be a long term increase in the cost of electricity , already guaranteed by EU ETS and other policies. There should be no doubt that their investments will be profitable. The issue is the relative cost of alternative generation relative to generation via conventional fossil fired generation. On this basis the ESI already has the encouragement to invest without the added cost of the CPS which included an additional element of taxation to be retained by Government. It is clearly unfair that the electricity generators should be favoured at the expense of other industries being faced with ever increasing input costs.

3.A3. How much certainty would investors attribute to a carbon price support mechanism if it were to be delivered through the tax system?

Fundamental changes to the CRC scheme, uncertainty on the future of CCA's and the loss of support for CHP (promised as recently as 2009) all indicate that industry cannot place credence on Government promises and all add uncertainty to investment decisions.

3.A4. In addition to carbon price support, is further reform of the electricity market necessary to decarbonise the power sector in the UK?

The primary means to decarbonise the market is via EU ETS and a genuine global agreement. This is the level intervention should be at. It is at this level where intervention should be and not at UK level where the intervention will be damaging.

4.B1. What changes would you need to make to your procedures and accounting systems to ensure you correctly account for CCL on supplies to electricity generators?

Accounting for the changed taxation regimes does not seem onerous, nor would be a system to claim a rebate for the CPS offered via a revised CCA and based on a network average CPS rate calculation.

4.B2. How long would you need to make the necessary changes to your systems to account for CCL on supplies to electricity generators?

No comment.

4.B3. Please provide an estimate of how much system change would cost, both one off and continuing?

No comment.

4.C1. Do you agree that all types of electricity generators should be treated equally under the proposed changes? If not please explain why.

No.

CHP on industrial sites helps diversify the grid, spread the investment requirement in overall UK electricity generation amongst more companies and helps increase efficiency by reducing transmission loss.

Industrial uses have the choice to simply purchase electricity off the grid (and so increase the overall demand that needs to be met) or to install their own generation equipment (with associated added cost of capital and operational management). Clearly an increased amount of CHP is good for the UK and this should be incentivised by an exemption from CPS to reflect the advantages and reduced emissions from this technology. Particularly since investors in CHP incur additional emissions and cost, to the ultimate benefit of the electricity grid.

4.C2. Is there a case for providing additional or more preferential treatment for CHP? If so, what is the best way of achieving this?

Yes.

CHP generation allows heat wasted in conventional electricity generation to also be used with corresponding savings in emissions. CHP is amongst the lowest cost means of cutting CO_2 emissions from industry and has been widely deployed by the UK paper industry with nineteen of the fifty two UK paper mills utilising CHP. With fossil fuel still playing an important role in UK generation it makes sense to use the fuel in the most efficient way. Simply, many existing CHP schemes could be made uneconomic compared to the current alternative of sourcing power from the grid and heat from on-site boilers: yet the CHP solution is at least 10% more efficient thermodynamically and also reduces CO2 emissions for the nation as a whole.

UK Government policy is to support the development and continued operation of CHP and yet we note that targets for expansion continue to be missed by a wide margin – only around 5.5 GW of the targeted 10 GW by 2010, has actually been installed. Moreover, the existing level of support is just enough to sustain existing plant and makes investment decisions for CHP at new mills marginal – of the two new UK paper mills one has CHP and one does not.

The CPS proposals are that CHP will be subject to the CCL carbon price support rates and not exempted as at present with the standard CCL. If enacted, this will directly undermine the viability of existing CHP and make the installation of new plant far less likely resulting in the loss of a further 1,000,000 tonnes pa of potential CO_2 savings in industry and risks the current saving of 14,000,000 tonnes pa that would need to be replaced through other policies at greater cost.

We are sure this threat to the viability of CHP is not intended by the proposals and nor is it intended to make the use of a carbon saving technology uneconomic and penalise industrial investments already saving carbon. This is clearly unfair, especially as exemption for CHP from CCL, until at least 2023, was restated by Government as recently as 2009. Reversing this decision now sends all the wrong signals to long term investors and will undermine confidence in the CPS proposals for investors.

Our analysis indicates that each £1 per tonne increase on the cost of carbon in CHP fuel adds around £1.6 million pa to the operating costs of the sector CHP installations.

CPS should not be applied to inputs for heat from CHP as this is inequitable. There is also a strong case for CHP power to continue to receive preferential treatment – this would be consistent with the Government's previously established CHP target and the current incentives for domestic CHP. More details are given in response to the question on CHP in the consultation.

The existing Good quality CHP scheme (GQCHP) provides a proven methodology to assess and rate CHP operation and preferential support should be offered to plant classified as of good quality by the scheme as this guarantees environmental gains.

Accordingly we urge that the Government simply exempt CHP from the new CCL CPS as it is already exempted from the existing CCL via the current 'good quality' CHP scheme.

4.C3. Do you agree that tax relief should be considered for power stations with CCS?

Yes provided the technology can be proven to be economic on a commercial scale within a realistic timetable. The proposal to exempt the additional energy requirement required to drive the CCS part of the installation from CPS is not unreasonable but we raise concern over the scale and cost of the additional amount of energy required to drive the CCS process. Much work needs to be done before the question of tax relief arises.

4.D1. What impact would the Government proposals have on electricity generators and suppliers that export or import electricity?

The greater interconnection with European electricity networks is to be welcomed and indeed essential as the role of intermittent renewable energy grows. However it seems perverse that electricity generated in the UK and exported, will be subject to CPS, while energy imported will not be. The UK level could be set to reflect the network average of fossil carbon and the imported electricity taxed at the level of carbon from the exporting grid. If this is not allowed under EC Directives this highlights the competitive dangers to UK industry from this UK only tax.

Other things being equal, then non taxation of imported electricity means it would be more sensible to build a new fossil fuel powered generation plant outside the UK at the other end of an interconnector and export the electricity with consequent losses to UK jobs and investment.

4.D2. What impact might the proposals have on trading arrangements for electricity?

No comment.

4.D3. What impacts might the proposals have in Northern Ireland?

No comment.

4.E1. How should the carbon price support rates be set in order to increase certainty for investors, in particular over the medium and long term?

EU ETS is designed to facilitate carbon reductions across the whole of the EU in the most cost effective manner. If the set targets are achieved at a low cost this is to be welcomed, not criticised. If the targets are too low then it is only at the level of the EU and in a global contest they can be addressed. The linking of the CPS with EU ETS in the UK alone further confuses climate change related regulation and serves to guarantee higher carbon cost in the UK whilst competitors in other Member States are likely to benefit from lower carbon cost. Changes to EU ETS Phase III, together with tighter targets will severely impact on our sector. We estimate that the removal of free allocations for electricity generation, the use of product benchmarks set by the 10% most efficient sites plus the tightening of targets by 20% will cost our sector (in the UK) in the region of £24 million pa.

4.E2. Which mechanism (outlined above), or alternative approach, would you most support and why?

The issue is already being addressed via the EU ETS and this is the route that should continue to be used.

4.E3. What impact would the proposals have on your carbon trading arrangements?

None. The proposal is a fixed additional tax on energy which will vector into increased business costs on top of the market price for EU ETS allowances. EU policies will drive up he cost of carbon anyway so the CPS proposals are not required.

4.F1. Should the Government target a certain carbon price a) for 2020 and b) for 2030? If so, at what level?

No.

The EU ETS is designed to reduce carbon at the lowest cost across the EU. It should be allowed to operate. Any changes to the cost of the ETS, s a matter to be dealt with at European level and in the context of a global agreement. The issue should not be addressed unilaterally in the UK at the cost of making UK energy intensive industry uncompetitive.

4.F2. What is the most appropriate carbon price for the UK to meet its emissions reduction targets in the power generation sector? How would this be affected by changes in the structure of the electricity market?

Carbon prices should be set by the EU ETS with rules set at European level.

4.F3. When would be the most appropriate time for introducing a carbon price support mechanism and what would be the most effective level?

If the proposals go ahead, there will be a windfall profit for existing low carbon generators where the investment decisions have already been made. This should be addressed.

If the Government insists on instigating this new tax, then it should only be brought in when required to underpin the wholesale price of the new low carbon generation. If investment certainty is required then the promise of higher wholesale prices should be sufficient – the higher prices only need to start once the newly installed equipment starts to operate. At the earliest around 2017, though new nuclear would not come on line before 2020. If this assurance on price really is the critical matter required to trigger the investment, then the tax could be introduced at zero in 2013 and increased as required at a later date. Any other approach would simply lead to windfall profits for incumbent operators.

5.B1. What impact would you expect the carbon price support mechanism to have on investment in low-carbon electricity generation?

It could be argued that the proposals is targeting the wrong problem and will not work. CPS guarantees higher better returns once new plant is operational, when the real issue is a lack of capital available to take the risk of the construction phase before any income stream is realised.

Once the risk of construction is out of the way the revenue stream is fairly guaranteed anyway. With a long term increase for electricity expected there can be little risk once the revenue stream starts. This may be better achieved and more clearly targeted if the Government acted as a guarantor for large capital investment – similar to the role envisaged for the US Government to support the revival of its nuclear power generation sector.

5.B2. What other impacts would you expect carbon price support to have on investment decisions in the electricity market?

No comment.

5.B3. How should the carbon price support be structured to support investment in electricity generation while limiting impacts on the wholesale electricity markets?

We draw attention to the overlap between the CPS tax and "contract for difference" proposed in the DECC consultation on energy market reform and we will return to this issue when we respond to the DECC consultation. However we note the overlaps between the two policies and question the need for both.

5.C1. Can you provide an assessment of the impact of the proposals on your generation portfolio and overall profitability?

No detailed comment as this response is on behalf of the sector. However we have already noted increased costs to run the existing CHP in the region of £1.6 million pa for each £1 increase on the cost of carbon imposed by the CPS with no CHP exemption. Clearly this makes additional investment unlikely and even questions the viability of existing plant

5.C2. What would be the implications of supporting the carbon price for existing electricity generators and how should the Government take this into account?

There would be a windfall tax for existing incumbents producing low carbon electricity and this should be prevented as it is not required. There may also be an impact on other generators who have not modelled the impact of the CPS tax on their ability to sell their electricity and this would be unfair.

Our reply to question 4.C2 has already drawn attention to the impact on CHP and the likely impact on future operation and investment. We reiterate out concern that by applying the tax to the heat element of the CHP operation the economics of operation are fundamentally changed with a potential overall increase in carbon emissions.

5.D1. How do you currently manage fluctuations in the wholesale electricity price?

For purchased electricity, a mixture of long term contracts, hedge deals and spot market purchases are used – the strategy varies from company to company. While good deals can delay the impact of higher prices, eventually contracts expire and renegotiations incur higher costs.

5.D2. What difference will supporting the carbon price make to your business?

The current proposals for the Carbon Price Floor (CPS) must be viewed in the context of an increasing cumulative impact on the energy costs of energy intensive industries caused by all energy and climate change related policies. This cumulative impact is simply unaffordable. EU energy costs are already high in comparison to global competitors and these proposals are designed to increase UK costs in relation to competitors elsewhere in the EU. This makes the long term future of Energy Intensive Industries (EII) in the UK unsustainable.

5.D3. As an electricity generator or supplier, how much of the cost of the carbon price would you pass onto consumers?

History suggest the utility companies will pass through costs and indeed EU ETS Phase I indicates they will also make windfall profits should the opportunity arise. The confidential nature of the utility company contacts for their input fuels means there in little transparency in their price setting.

5.D4. As a business, how much of the cost of energy bills do you pass onto customers?

There are no contracts in the paper sector where increases in the cost of energy are automatically passed on to customers. The increased costs of production are factored into general negotiations, thus the time lag between the imposition of additional costs and their partial recovery can be onerous. Indeed the closure of 40 UK paper mills since 2001 and the loss of production capacity in Europe indicates how low the profit margins for paper manufacture have been.

5.D5. How might your company or sector be affected and would there be any impact on profit margins?

It is unlikely it would be possible to fully pass through increase electricity costs to customers. As such a capital intensive industry (a modern large paper mill costs in the region of £400,000,000 to build) then it often makes sense to continue to produce in a poor economic climate in the expectation of future profits. However such scenarios result in no investment to keep a mill competitive and result in eventual permanent shut down. Once a site closes it is very unusual for it to reopen and the paper machines are normally striped out and sold to developing nations for reinstallation. The final issue leading to closure is often reported as an energy price increase that cannot be passed through the supply chain.

Our analysis indicates that the additional costs imposed on UK sites by the CPS are in the region of £3 million pa for each £1 increase in the underlying pr ice of carbon.

On its own CPS has the potential to treble the taxation levied on electricity. To this cost must be added the impact of EU ETS, ROCs and FITs. We have clearly explained in our analysis of sector profitability that this is an unsustainable burden and will inevitably harm the industry.

5.D6. Do you have any comments on the assessment of the Impact Assessment?

At a number of points references are made to not undermining the competitiveness of UK industry and reference is made the Impact Assessment. The assessment is superficial and incomplete in its analysis of the impact on Energy Intensive Industries. Assertions are not justified by evidence presented. It should be refreshed with urgency.

We are frankly astonished to see (Impact Assessment pg 3) a statement that the proposals will have no significant impact on competition. We have already clearly demonstrated that the competitive position of the UK paper sector will be severely damaged by these proposals. Thus we simply cannot understand how this statement can be made.

These proposals lock the UK into a high price for wholesale electricity and increase the cost of industrial generation from gas by a new tax. The industry is already regulated through the EU ETS trading scheme, alongside competitors throughout the rest of the EU. EU ETS is designed to reduce the emissions of carbon at the lowest cost anywhere in the EU. Participants pay the marginal cost of this abatement. This new UK only policy deliberately prevents UK installation from benefiting from lower compliance costs – additional costs not placed on competitors. Hence the competitive impact is obvious.

On its own the additional costs from CPS are significant, yet the new taxation must be viewed as part of the cumulative impact on costs of all energy and climate related policies. This cumulative impact is critical and huge and damaging to industry. On these grounds alone the case for a Carbon Price Floor in not made and should therefore be reconsidered.

We are of course pleased to provide additional information should it be necessary.

Yours sincerely

David Workman
Director General