

Rail Delivery Group

Response to:

**DECC Consultation on Implementing an exemption for
Energy Intensive Industries from the indirect costs of the
Renewables Obligation and Feed-in Tariff Schemes**

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Rail Delivery Group Response: Implementing an exemption for Energy Intensive Industries from the indirect costs of the Renewables Obligation and Feed-in Tariff Schemes

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Introduction: The Rail Delivery Group (RDG) was established in May 2011. It brings together Network Rail and passenger and freight train operating companies to lead and enable improvements in the railway. The purpose of the RDG is to enable Network Rail and passenger and freight train operating companies to succeed by delivering better services for their customers. Ultimately this benefits taxpayers and the economy.

In the context of energy, RDG's member companies combine to consume approximately 3.3 TWh of electricity per year (over 1% of national consumption), under the largest single electricity contract in the UK (between Network Rail and EDF). RDG also facilitates a joint electricity procurement scheme for the majority of passenger Train Operating Companies (the EC4T Scheme Council), and represents their collective interests as large electricity consumers.

RDG welcomes the opportunity to respond to this consultation. The consultation document asks:

- 1. Do you agree with the main benefit to EIs of implementing the exemption through changes to the RO and FIT legislation being greater certainty as well as more accurate and faster support, compared with compensation? Please provide evidence and a quantification of the impact.*
- 2. For non-exempt businesses, to what extent do you think the estimated increase in electricity bills will affect competitiveness and decisions regarding output, employment and investment? Please provide evidence and a quantification of the impact.*

RDG's response addresses these two points together. More detailed quantified analysis for Q2 can be found in the Annex. As business electricity consumers, it is not appropriate for RDG to address the other consultation questions.

Policy Objectives and Charging

Fundamentally, RDG believes that cost protection for EIs (whether by compensation or exemption) constitutes a policy mechanism to provide financial support for selected industries, rather than a support mechanism for renewable generation (or any other energy policy objectives). Cost protection for EIs is primarily to maintain the competitiveness of domestic industry and associated economic benefits.

Additional costs on electricity bills should be limited to the direct support of energy policy objectives, in relation to the generation, transmission, supply or consumption of energy. Cost protection for EIs does not address energy policy objectives, other than mitigating the threat of carbon leakage which is an international policy issue rather than domestic. The consultation document acknowledges that there is some risk of 'rebound effect' or decreased investment in energy efficiency by EIs – domestically the cost protection of EIs may in fact work against energy policy objectives.

In the view of RDG, these are compelling reasons why the costs of exemption should not be shifted to non-exempt electricity bill payers, and should remain funded by taxation under a compensation regime. From a policy standpoint, RDG urges DECC to review the appropriateness of how this proposed policy change is being targeted.

Suggested Benefits to EILs of Exemption vs Compensation

RDG does not agree that 'increased certainty' for EILs is a strong argument to move from compensation to exemption. It is concerning that increased certainty is presented as a key reason for moving to exemption, yet paragraph 77 of the Impact Assessment states this has not been quantified, and therefore the benefits to EILs are speculative.

RDG believes that the 'uncertainty' of retrospectively using historical consumption data under a compensation arrangement is a minor issue. EILs should already be rigorous in measuring and forecasting their electricity consumption, and should therefore predict with a strong degree of certainty the value of the compensation in a given year to aid sensible financial planning for all aspects of business operations.

There is also a paradox in the proposals whereby any potential increased certainty for EILs from exemption is at the expense of decreased cost certainty for non-exempt electricity consumers, who are faced with another unknown variable in the electricity bill (discussed further in the next section).

The suggested risk posed by 'fluctuating departmental budgets' under a compensatory arrangement could be addressed by ringfencing or other measures to protect funding long term. In any case, this is likely a secondary consideration to the uncertainty of the consistency of energy policy in the long term, which recent experience has shown can be subject to significant changes at short notice, whether or not legislation is required.

Finally, it can be seen that any administrative benefits to EILs are minimal given that there is an ongoing cost associated with both compensatory and exemption mechanisms.

It is important that the consideration of any proposed changes are proportionate, and it must be recognised that EILs are already being afforded significant benefits from compensation. RDG disagrees with the proposed gold-plating of the cost protection mechanism on the basis of unquantified and overstated benefits to EILs where there are tangible costs and risks to other parties.

Costs for Non-Exempt Businesses

The proposal to exempt EILs will increase FiT and RO costs for non-exempt consumers. The rail industry accounts for over 1% of national electricity consumption, and it is estimated that EIL exemption will cost the industry £5-£11 million per annum. Calculations are outlined in detail in the Annex, and RDG advises that DECC reconsider the cost figures used in its own Impact Assessment which appear inconsistent with other data contained in the Impact Assessment, and to be an underestimate. Exemption may serve to incentivise rebound effect of higher consumption by exempt EIL's, therefore increasing overall emissions and further increasing the cost to be picked up by non-exempt industries.

DECC has not quantified the impact upon output, employment and investment decisions for non-exempt businesses. This is undoubtedly a complex area to address given that this is one of many variable cost elements in the electricity bill, which in turn is one of many costs that businesses must factor into their operations. However in the simplest terms, an increasing cost to a business will have to be offset somewhere.

In the rail industry, train operators cannot adapt to rising costs by reducing output, i.e. the number of train services, nor by increasing service costs given that they are constrained by fares regulation. Train Operating Companies' margins are closely defined in franchise agreements with Government

(typically spanning a 7-10 year period), further reducing the ability to absorb unforecasted costs. Longer term, the risks of rising costs must be priced into bids for new rail franchises, which impacts net subsidy/premium payments with Government. RDG believes that the increased costs of this proposal must be taken in the context of a cumulative cost burden and forecasting uncertainty risk that is presented by renewable policy costs as a whole, which are putting increasing strain on the rail industry and other electricity consumers. Effectively, a move to exemption would incur a double penalty for non-exempt customers who are already faced with rising costs of FiT and RO.

RDG refutes the statement that “[an] increase for non-exempt consumers should be considered in the context of the action the Government has taken and continues to take to increase competitiveness in the electricity supply sector and to reduce overall consumer bills”. Recent experience for electricity consumers has been to the contrary, where costs of Government led schemes have incurred higher than expected costs. Examples in the past year include the systematic overspend of the Feed-in Tariff and Renewables Obligation Scheme, and the late introduction of the 2017/18 capacity market which will bring forward costs to consumers. Recent changes to the FiT and RO have only served to curb the overspend, rather than lower costs to the required expenditure levels as outlined by the Levy Control Framework. The prospect of another increase to electricity bills at short notice, driven by Government Policy, provides yet more challenges to consumers. Forecasting uncertainty and rising costs pose a challenge for businesses’ financial planning, particularly in the rail industry where electricity costs are significant.

RDG has highlighted in numerous consultations the perverse incentives and competitive disadvantages posed to the rail industry by rising renewable policy costs, given that electrified rail is already a low carbon form of transport whose primary competition is with road. RDG believes that it is particularly inappropriate for the rail industry to be providing a cross-subsidy to heavy industry, which is the situation as proposed by this consultation.

Summary

- RDG has highlighted a number of reasons why cost protection for EILs should continue to be met through compensation, and disagrees that exemption provides a suitable or beneficial alternative.
- Given that the Government has taken the decision to subsidise certain industries, RDG strongly believes EIL cost protection from RO and FiT should remain a taxpayer expense, and that it is inappropriate for this burden to be met through electricity bills. Electricity bills should not be used as a levy for non-energy policy objectives.
- The benefits to EILs of moving from compensation to exemption have not been quantified, nor have the impacts upon non-exempt consumers, therefore the NPV values contained in Table 9 of the Impact Assessment are incomplete.
- RDG does not believe that the suggested benefits to EILs constitute a compelling case to move from a compensation arrangement, whereas there are clear consequences for non-exempt electricity consumers that are already burdened by rising renewable policy support.
- RDG asks that DECC revises its cost assumptions, as outlined in the Annex. The revised costs should be considered in conjunction with the discussions above in recognition of the negative impacts of this proposal to the rail industry and other consumers, which strengthen the case for cost protection continuing to be met by compensation.

Annex – Quantified Impacts of the Proposals

RDG Analysis of Cost Impacts

Table 6 of the DECC impact assessment (I.A.) estimates the annual impact of exemption as follows:

£m	Exemption Option 1 (20% threshold)
Low estimate	240
Best estimate	390
High estimate	600

However, using only information derived from the consultation document, RDG believes that there is reason to believe these estimates should be higher. The methodology is outlined below.

I.A. Table 4 projects average electricity sales of 281 TWh, prior to exemption, between 2017/18 and 2026/27. Table 1 provides low, best and high estimates for electricity that will be exempt: 12, 19 and 26 TWh respectively. In percentage terms, this equates to 4.27%, 6.76% and 9.25% of total electricity which is exempt, based on a total annual electricity consumption of 281 TWh.

I.A. Table 2 projects average annual costs of RO and FiT of £8.0bn from 2017/18 - 2026/27. The estimate of the annual costs of exemption can therefore be derived using the percentage of consumption that will be exempt:

Low scenario: £8,000m * 4.27% = £342.1m

Best scenario: £8,000m * 6.76% = £541.6m

High scenario: £8,000m * 9.25% = £741.1m

RDG notes that the extreme bounds of the high/low scenarios are conservative, given uncertainty over the costs of RO and FiT, and total electricity consumption over this time period. However, the 'best estimate' scenario is still considerably higher than the figures quoted in I.A. Table 6 using this methodology.

Quantified cost impacts on the rail industry

Annually, the rail industry consumes approximately 3.3TWh of electricity for traction purposes. This figure is forecast to increase by 2026/27 as committed electrification projects on the rail network are completed. The precise impact on consumption is uncertain, but 3.9 TWh would be a reasonable assumption for annual average consumption from 2017-27.

RDG represents the collective interests of passenger and freight operators, and Network Rail with regards to energy issues. The costs outlined below are for all users of the rail network; passenger train operating companies account for nearly 95% of the consumption.

To estimate the cost impacts on the rail industry, the estimated annual cost of exemption needs to be converted to a unit cost (£ /MWh): dividing by average annual non-exempt consumption. For the purposes of Figure 1 below, non-exempt consumption is assumed to be 281 TWh (as per I.A. Table 4) minus 12, 19 and 26 TWh for low, best and high scenarios respectively.

Source	Scenario	Average Annual Cost of Exemption	Average Annual Non-exempt Consumption	£ /MWh cost of exemption	Total Annual Cost to Rail Industry (at 3.9 TWh consumption per annum)
DECC I.A. Costs	low	£240m	269 TWh	£0.89/MWh	£3.5m
	best	£390m	262 TWh	£1.49/MWh	£5.8m
	high	£600m	255 TWh	£2.35/MWh	£9.2m
RDG analysis	low	£342m	269 TWh	£1.27/MWh	£5.0m
	best	£542m	262 TWh	£2.07/MWh	£8.1m
	high	£741m	255 TWh	£2.91/MWh	£11.3m

Figure 1 – Estimated costs of EII exemption to the rail industry.

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