

Position on the Carbon Price Floor

10 February 2017

Introduction

Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs with many of our members providing long-term employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

This paper summarises Energy UK views on the Carbon Price Floor (CPF) in anticipation of an announcement from HM Treasury about the future levels of the Carbon Price Support (CPS) rate as part of the Budget in March 2017.

Key messages

- All generating companies prefer and support strengthening the EU Emissions Trading System (EUETS) to provide an effective carbon price signal across the EU, but it is recognised that the effect of proposed changes to the EUETS on the carbon price is uncertain and is unlikely to work through until after 2020.
- Consequently, Energy UK members see the CPF as a transitional instrument which should be phased out at some point, but have not come to an agreed view on the appropriate conditions to trigger that, although for many there is a strong link with securing an appropriate EUETS carbon price. All generating companies agree that certainty and predictability around the level of CPS rates remain critical factors going forward.
- Any review of the CPF and associated CPS rates should take account of the full energy policy context because of complex interactions with the Levy Control Framework, interconnectors, proposed phase-out of coal-fired stations, promotion of new-build gas-fired generation, etc.

- It would be appropriate to re-visit the original objectives of the CPF (to support investment in low-carbon technologies and to help to meet national carbon targets) to check if they are still applicable e.g. coal to gas fuel switching is expected to be irrelevant after 2025 although the CPS tax could potentially (if maintained at the current or an increased level) provide an important contribution to the run-down of coal-fired generation ahead of 2025. It is also recognised that the CPF in itself will not be sufficient to warrant taking the investment decision for all low-carbon technologies and that other instruments will still be required.
- It is important to take competitiveness into account. Issues include the effects on electricity costs for domestic consumers and all but the largest energy-intensive business/industrial users¹, the role of interconnectors and the difference in the price of electricity between GB and mainland Europe (although the CPS tax is not the only factor contributing to that), the longer term prospects for new-build gas-fired generation and the role of energy carriers other than electricity in the transition to a low-carbon economy.
- Greater visibility of the future of the CPF/CPS rates and improved governance could help to bolster investor confidence in the mechanism. Some companies take the view that the credibility of the CPF has been eroded and that it is insufficiently robust politically to underpin investment decisions, though a number also consider that removing it in the near term would damage investor confidence, given that the announced rates have already been taken into account in decision-making.
- Energy UK has no agreed view as to whether the level of CPS rates should remain fixed at the current level of £18 per tonne or rise or fall into the 2020s. The range of views held by generating companies stems from the uncertainty around projected EUETS prices and their susceptibility to the effects of other policy instruments addressing support for low-carbon technologies and energy efficiency, and the effect of the COP21 climate conference outcomes on the EU's future level of ambition for de-carbonisation.
- Energy UK welcomes the Chancellor's recommitment to the CPS cap out to 2021, provided at the Autumn Statement 2016. It is important that this position is maintained.
- Energy UK would welcome clarity about the long term direction for CPS but recognises that it may be difficult to provide this while the UK's membership of the EU ETS post-Brexit remains uncertain. While this is being established, it is important that there is continuing visibility about the approach to the CPF, including the cap on CPS, four years ahead consistent with the period of the T-4 Capacity Market auction. The Chancellor should set out the approach to the CPF for 2021/22 in the March 2017 Budget and for 2022/23 in the 2018 Budget in Autumn 2017.

Background

The Carbon Price Floor (CPF) was introduced on 1 April 2013 and comprises the price of CO₂ from the EU Emissions Trading System (EUETS) and the Carbon Price Support (CPS) rate per tonne CO₂ (tCO₂), which is the UK-only additional element. It taxes fossil fuels used to generate electricity via CPS rates set under the Climate Change Levy (but does not apply in Northern Ireland). To date, CPS rates have been set for April 2014 to March 2015, April 2015 to March 2016 and from April 2016 through to 2019-20. Although the original trajectory of CPF was set to

¹ The Government has now put mechanisms in place for the time being to compensate the most energy-intensive industrial consumers to some extent.

reach £30 per tCO₂ by 2020 (in 2009 prices), in Budget 2014 the Government announced that the CPS rate would be capped at a maximum of £18 (nominal) from 2016-17 until 2019-20. This effectively froze the CPS rates for each of the taxable commodities across this period at around 2015-16 levels. The CPS cap was extended to 2021 in Budget 2016.

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