

Rt Hon Philip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

20th September 2018

Dear Chancellor

The energy industry shares the Government's ambition toward a thriving and investible energy sector, where we continue to decarbonise our economy and where innovation and competition keeps costs down and improves services for consumers.

This year the Government passed the Domestic Gas and Electricity (Tariff Cap) Act to introduce a cap for customers on standard variable tariffs. We would like to ensure the impacts of the cap are closely monitored to ensure it has no unintended consequences that would negatively impact competition or the investability of the sector, and that efficient companies are able to trade and cover costs.

The regressive nature of successive governments using the electricity bill to fund social policy programmes needs to be addressed, ending the system whereby all customers, including those in or at risk of fuel poverty, pay for social and environmental programmes, such as the Energy Company Obligation (ECO) and Contracts for Difference (CfD), regardless of their ability to pay. 80% of the cost of an average energy bill are outside energy suppliers' direct control and in the last year wholesale energy prices have risen by 30%. To counteract rising cost pressures, and further uncertainty caused by Brexit, we are outlining a number of measures that could be undertaken by Government to reduce customers' bills, while supporting the decarbonisation of the economy.

Energy UK is calling on the Government to:

- **Develop a National Energy Efficiency Programme** – a centrally-funded national scheme to improve the quality of our housing stock, which will reduce bills and support the most vulnerable customers who are often in the draughtiest houses;
- **Provide policy clarity on the future of carbon pricing to bring forward investment in low carbon generation**, including the UK's future participation in the EU Emissions Trading Scheme (EU ETS) and the level of Carbon Price Floor rates at least until 2021-22;
- **Support least-cost low carbon generation** by introducing a revenue stabilisation CfD to allow a route to market for the least-cost renewable energy sources, including onshore wind and solar;
- **Facilitate further decarbonisation** – by supporting the development of the electric vehicle (EV) charging infrastructure across the UK and by committing to fund large-scale trials on the decarbonisation of heat; and
- **Zero-rate VAT on energy bills and energy efficiency products as the UK leaves the EU** – taking nearly £60 off every customer's bill and reducing the overall costs of home energy efficiency products.

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Additionally, we support the Treasury's Breathing Space Scheme to guarantee customers in debt the extra support they need and ask that the differences between energy and other sectors are acknowledged when the policy is developed.

Energy UK and our members consider that taking these actions will keep bills down for customers, allow us to decarbonise and meet our climate change targets, while also ensuring the UK remains an attractive market to invest in.

If you or your officials would like any further information related to our submission, then please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'L Slade', written in a cursive style.

Lawrence Slade
Chief Executive, Energy UK

Energy UK 2018 Budget Submission

Energy industry's contribution to UK economy

The UK energy industry is a primary contributor to the UK economy. Last year the energy sector created £32bn in economic value, while contributing a total of £6bn in tax. The sector has continued to evolve through Electricity Market Reform (EMR), transforming from a fossil fuel-based system towards a competitive, sustainable and efficient energy system.

In 2017, 53% of power generation came from low carbon sources, illustrating the progress made from 2008 when low carbon sources generated 20% of our power. This transition away from fossil fuels has enabled the UK to experience full days of power without coal generation for the first time since the industrial revolution. This has led to benefits not only within the energy sector but nationally as reduction in fossil fuels improves air quality benefiting national health.

The energy industry supports 682,000 jobs; 138,000 directly and another 544,000 indirectly throughout the UK, employing one in 51 people across the UK. The energy sector continues to invest significantly in its workforce with approximately 2,500 apprentices in place across approximately 100 employers. We expect a further 1,500 apprentices to be recruited over the next 2-3 years.

Keeping costs down for customers

National Energy Efficiency Programme

Progress on energy efficiency has stalled and we are beginning to lose many of the improvements in energy efficiency that were made in the past decade. There has been a 53% drop (from £6.8bn to £3.2bn) in annual investment in energy efficiency and 80% reduction in improvement measures between 2012 and 2015 (from 1.74m to 340,000). A further decline is projected to 2020 and beyond without policy change and investment.¹

Energy UK considers energy efficiency to be a key part of the solution in helping both household and business customers reduce their energy consumption, keep their energy bill down, improving health, and the comfort of their homes and premises. It is also central to achieving the Government's 2030 fuel poverty and 2050 carbon reduction targets.

Today, household bills are £490 lower than they would have been without energy efficiency improvements made since 2004 – despite an increase in the number of household appliances². Further action on energy efficiency in our homes through the development of a National Energy Efficiency Programme could see UK households achieve a further saving of around £270 per year.³ Not only would such work help to reduce customers' bills, it would contribute to the UK meeting its climate change targets and deliver numerous health and social benefits.

At least 10,000 deaths per year that are attributed to living in cold homes are preventable through energy efficiency measures.⁴ Acting on energy efficiency will deliver substantial benefits for those households living in fuel poverty. It has been estimated that cold homes in

¹ Home Energy Efficiency 2010 – 2020 Report, Association for the Conservation of Energy, March 2016

² <http://www.ukerc.ac.uk/publications/unlocking-britains-first-fuel-energy-savings-in-uk-housing.html>

³ <http://www.ukerc.ac.uk/publications/unlocking-britains-first-fuel-energy-savings-in-uk-housing.html>

⁴ <https://www.e3g.org/news/media-room/uk-has-sixth-highest-rate-of-excess-winter-deaths-in-europe>

England result in an estimated £1.36 billion cost to the NHS per annum and contributes to “excess winter deaths” which occur every year in the UK.⁵

The Energy Efficiency Infrastructure Group (EEIG), of which Energy UK is a member, estimates that to improve the energy efficiency of the UK’s housing stock an investment of £5.2bn is required each year up to 2035. Of this the Government would need to provide £1.7bn through general taxation. According to the Cambridge Economics/Verco 2014 paper, this funding would see a net benefit of £8.61 billion per year in lower energy bills and increased employment peaking at 108,000 net jobs a year.⁶

Energy UK would like the Government to commit to, and provide funding for, a National Energy Efficiency Programme to support customers in bringing down their bills, contribute to economic growth and help to tackle climate change. Such a commitment would put England on equal footing with Scotland and Wales who have already established national energy efficiency programmes, outside, and in addition to, the Energy Company Obligation (ECO). **At the same time, the Government should put forward its proposals for an Industrial Energy Efficiency Programme which it committed to do in the Clean Growth Strategy.**

To support a National Energy Efficiency Programme, we would like the **Government to use Green Finance via the further roll out and availability of Green Mortgages.** Such a measure would avoid customers having to fund the total capital costs of energy efficiency measures upfront. Green mortgages are typically offered at a (small) discount to a normal mortgage because they are linked to investment which improves the Energy Performance Certificate (EPC) rating of a home and this will reduce ongoing energy bills.

Energy UK also supports a move towards variable stamp duty based on a property’s EPC rating – with stamp duty lower for A, B and C banded properties. As such we would expect the market to value homes differently creating the premium for homes with a better EPC rating. This premium helps to encourage owners to invest ahead of a potential sale to get the most value in the market and minimise the buyer’s stamp duty tax.

HMT should coordinate efforts with the Ministry for Housing, Communities and Local Government in the anticipated 2019 Housing Standards Review to ensure that incentives and taxation surrounding new-build and renovated properties are aligned with increased energy efficiency requirements, as well as with efforts to incorporate targeted low carbon heating and transport readiness measures into the building stock.

Funding for Renewable Heat Incentive and large-scale trials for low carbon heat

Heating homes represents a major part of customers’ bills and is recognised in the Clean Growth Strategy as the most challenging policy area in decarbonisation. Over 80% of households still dependent on gas boilers for heating and hot water, and there is a lack of clear direction in terms of technical solutions. The next three to five years will therefore be a crucial time for developing and supporting supply chains across low carbon heating solutions.

Energy UK is calling on Government to give clarity on funding, or other mechanisms, for encouraging uptake of low carbon heat installations post-2021. The Government

⁵ Age UK cited in Policy Exchange (2015) ‘Warmer Homes - Improving fuel poverty and energy efficiency policy in the UK’.
⁶ <http://www.energybillrevolution.org/wp-content/uploads/2014/10/Building-the-Future-The-Economic-and-Fiscal-impacts-of-making-homes-energy-efficient.pdf>

should initiate and drive forward large-scale trials, incorporating a wide range of technologies and business models, so as to develop a comprehensive evidence base for technological options, economically sound support mechanisms and consumer acceptance.

Support for the HMT Breathing Space Scheme

Energy UK supports the implementation of the Breathing Space Scheme to give those in serious debt the right to legal protections from their creditors for up to six weeks, in order to receive debt advice and enter into a sustainable debt solution.

If the energy sector is to be part of this scheme, the differences between energy and others industry's must be acknowledged when the policy is developed. In particular:

- *Ongoing usage*: a customer's use of energy does not stop during a breathing space period and they will still be charged for the energy they use. This means that a customer's debt may still grow during the 'breathing space period.
- *Ability to Pay*: It is also important for HMT to recognise that energy is regulated differently to other types of credit. In 2010 Ofgem introduced a series of Ability to Pay Principles for suppliers to abide by when assisting customers who have an energy debt and deciding on the amount of repayment. These provide the regulatory framework for energy debt. The principles state that any repayment arrangement a supplier sets up with a customer must be reasonable and consider the customer's individual circumstances in order to ensure they are able to pay off the amount, (regardless of what amount will be). Adherence with the Ability to Pay Principles are taken into account by Ofgem when assessing a supplier's compliance with supply licence conditions.
- *Prepayment*: Prepayment meters (PPM), including smart meters operating in prepayment mode, are used where the customer cannot pay their balance in one payment and/or may have refused or failed to comply with other suitable repayment options. With regards to the breathing space proposal, consideration will have to be given as to how this is compatible with PPM's. PPMs that are not Smart operable cannot receive messages or information from suppliers unless a customer tops up and therefore will not automatically stop deducting debt payments from the customer. This will require the supplier sending a message to the vendor where the customer usually tops up the PPM instructing the vendor not to deduct any debt repayment. This can only happen if the supplier is aware that the customer has entered a breathing space period. Therefore, there is the risk that debt repayments may still be taken from the customer if the supplier is not made aware that they have entered a breathing space period before the next time they top up.

Energy UK is calling on the Government to implement Breathing Space Scheme in a way that protects customers but recognises the differences between energy and other forms of credit, in particular the limitations of the existing prepayment infrastructure.

Zero-rated VAT on energy bills and energy efficiency products after Brexit

The UK energy industry maintains its support for remaining in the EU Internal Energy Market (IEM). As the Energy Minister, Claire Perry MP acknowledges, membership of the IEM and cooperation with EU Member States provides reduced costs on customer bills.

Upon leaving the European Union on 30 March 2019, however (outside of any implementation arrangement), UK consumers should benefit from government zero-rating household energy supply for VAT purposes, something that is not currently permitted. Norway, a member of the IEM, zero-rates its domestic energy bills, which shows that it is possible to both be a member of the IEM and zero-rate energy bills.

The Government could take 5% off consumers' energy bills by zero-rating VAT on energy bills which would reduce the average standard variable tariff⁷ by nearly £60⁸ reducing energy bills for every consumer in the UK. This would go some way in adding to the efforts and strategies currently employed to reduce fuel poverty. If accompanied by a National Energy Efficiency Programme, it would also help the most vulnerable customers to afford their energy bill.

Energy UK would also like to see the Government zero-rate VAT on all energy efficiency measures and installations. We consider this to have the potential to provide greater incentive for households to invest in upgrading their properties. This would reduce the cost on services and energy efficiency products delivered and installed, outside of ECO by 20% helping to create a market for energy efficiency.

Delivering further decarbonisation

Benefitting from least-cost renewables

It is a transformative time for the renewables sector and technical strides have been made in both emerging and established technologies, driving cost reductions and efficiencies.

The cost reductions experienced by a number of low carbon technologies means that for some projects the required strike prices are now approaching current wholesale prices. As evidenced by the 2017 Contract for Difference (CfD) allocation round and Capacity Market auction results, the continued success of the Electricity Market Reform (EMR) framework and the closure of legacy regimes like the Feed-in Tariff provides an opportunity to homogenise policy and mitigate regulatory complexity.

However, as generators are increasingly deriving income from a variety of sources other than the wholesale market (e.g. Capacity Market and Balancing Market payments), long-term wholesale prices become increasingly uncertain. Even as the costs of low carbon technologies come down, low marginal cost, but high capex low carbon technologies are exposed to wholesale price fluctuations. Therefore, in order to compete on a level playing field, these technologies need technology-agnostic, revenue stabilisation contracts to be able to contribute to the longer term cost-effective decarbonisation of the sector.

The CfD significantly reduces this risk and, by de-risking the investment, reduces the cost of capital for a generation project. This leads to lower strike prices and levelised cost of energy which ultimately benefits the customer through lower bills. The provision of such contracts will ensure that consumers are accessing the cheapest new sources of low carbon electricity required to meet the UK's targets under the Climate Change Act (2008).

⁷ Average RMR variable tariff of the whole market for a typical dual fuel domestic customer as of 20th August 2018 is £1,107.

⁸ Average standard variable tariff of the six largest energy firms as of 28th August 2018

We recommend that the **Government support least-cost low carbon generation by introducing a revenue stabilisation Contract for Difference to allow a route to market for the least-cost renewable energy sources, including onshore wind and solar.**

EU Emissions Trading Scheme

Energy UK considers carbon pricing to play a vital role in delivering cost-effective decarbonisation.

For this reason, it is important that there is a clear policy framework in place to ensure a stable and predictable carbon price signal before and after the exit of the UK from the EU.

Energy UK's order of preference for carbon pricing post-Brexit is as follows:

- Our first preference is to stay in Phase 4 (2021 till 2030) of the EU ETS, whilst retaining influence over its future development so as to deliver a robust carbon price signal.
- Our second preference is to create a standalone UK Emissions Trading System (UK ETS) and link this immediately to the EU ETS on exit from the EU ETS – it will, however, be very challenging to have a domestic scheme in place by January 2021 given that it took 4 years to establish the first UK ETS in 2002 and we estimate it would take at least 18 months to create a linked domestic scheme.⁹
- If neither of these options are possible, then a carbon tax would be preferred to a standalone UK ETS with no linkage.

If the UK is to leave the EU ETS, it will take time to establish an alternative regime for carbon pricing. **Energy UK calls on the Government to urgently clarify its intentions with regard to future participation in the EU ETS.**

Carbon Price Support

The interaction between EU Allowance (EUA) prices and Carbon Price Support (CPS) rates creates uncertainty on what the carbon price faced by generators will be for the next few years. Effectively, the wholesale electricity market is trading on the basis that the “Total Carbon Price”, consisting of EUA price plus the indicative CPS rate, is around £33/tCO₂ for 2019-20.

The 2017 Budget indicated that CPS rates were to be maintained at the level of £18/tCO₂ for 2019-20 and £18.52/tCO₂ for 2020-21 as a continuation of the cap introduced in the 2014 Budget. However, in recent months, the price of EUAs has risen significantly and is now over twice the level at the time of the Autumn 2017 Budget (trading recently at over €20/tCO₂ versus around €7/tCO₂ in 2017)¹⁰.

This raises the question of whether the Government intends to maintain the current level of Total Carbon Price, or make adjustments to the CPS.

⁹ Energy UK: Essential components and timescales for establishing a linkable UK ETS, June 2018

¹⁰ www.eex.com/en/market-data/environmental-markets/spot-market/european-emission-allowances#!/2018/09/20

We understand that the uncertainty over the UK's continued participation in the EU ETS may not be resolved before the Autumn 2018 Budget. However, HM Treasury should provide clarity on how the CPS rate would be set if the UK leaves the EU ETS in March 2019 or on any other date. **Energy UK would like HM Treasury to clarify the position on CPS in the light of the increased EUA price and specifically to confirm that the indicative rates for 2019-20 and 2020-21 will be maintained while the UK remains in the EU ETS.**

Supporting EV infrastructure to hasten pick up and the future of fuel duty

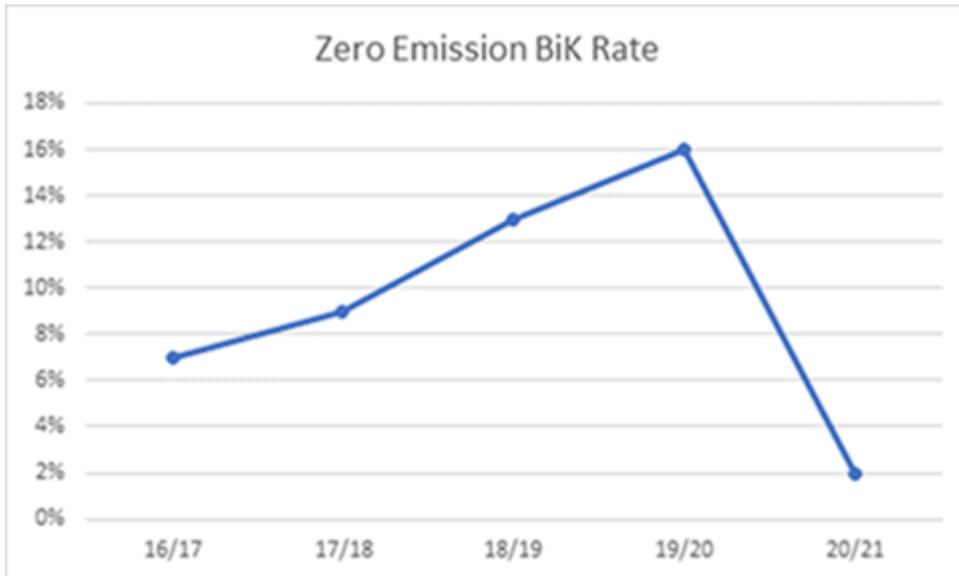
Energy UK strongly supports Government's ambitions on electric vehicle (EV) rollout, as laid out in the Road to Zero strategy, and welcomes the support that it has put in place to boost their uptake, through tax incentives and subsidy schemes.

Grants for plug-in vehicles and charge points have been crucial for the uptake of EVs and we welcome the Government's commitment to maintaining support in the short term. As recognised by the National Infrastructure Commission, public support for charge point provision has a crucial role to play¹¹. As part of this, long term certainty and visibility is vital for consumer confidence and avoiding cliff-edge effects. As such, **Energy UK urges Government to commit to continue subsidising the upfront costs of both EVs and charge points until at least 2020, and provide greater clarity on the level of support that will be available.**

EVs represent a compelling alternative to internal combustion vehicles for many fleet operators and the planned reduction in the company car tax benefit in kind (BIK) rate to two per cent from 2020/21 for battery electric vehicles (BEV) is a very positive step. Half of all new cars are procured by company fleets making the BIK rate one of the most powerful levers available to Government.

However, as illustrated in the graph below, BIK rates will increase to 16 per cent prior to 2020/21. This approach has made what will be a strong incentive to buy a company BEV, a strong disincentive in the interim. Put simply, fleet operators are delaying investment which is harming the uptake of EVs: nearly three quarters of fleet operators have stated that they are deferring the purchase of a BEV. Although it is too late to undo the entire BIK rate increase, it is possible to remove the worst cliff-edge and bring forward the two per cent BIK rate to 2019/20.

¹¹ <https://www.nic.org.uk/assessment/national-infrastructure-assessment/revolutionising-road-transport/>



EV uptake will drastically change the make-up of the vehicle fleet, resulting in reduced Government receipts from fuel duty. There is no obvious solution at present but Energy UK is clear that whichever of the various alternative models is chosen, costs must not be levied on electricity bills. Doing so would increase costs for all electricity users, regardless of whether they own an EV, and risks hitting vulnerable customers the hardest.