



Amicus response to Gas Security of Supply Arrangements DTI Consultation

Amicus is the UK's second largest trade union with 1.2 million members across the private and public sectors. Our members work in a range of industries including manufacturing, financial services, print, media, construction and not for profit sectors, local government, education and the health service.

Amicus also has 25,000 members employed in the Energy sector.

Executive Summary

- a) Concerns over security of supply and a repeat of the national gas shortages experienced during the winter of 2005/6 could place thousands of UK manufacturing jobs at risk.
- b) The lack of a fully liberalised market in Europe has caused UK supplies to be restricted. Storage capacity in the UK amounts to 8 days of full capacity output which is far less than its neighbours in Europe.
- c) Even the additional capacity of two further interconnectors and the expansion of the pre-existing pipeline may not be enough to avert a repeat of energy supply driven price levels experienced in 2005/6.
- d) With North Sea supply dwindling, more investment is needed to expand exploration into hitherto unexplored regions of the UK Continental Shelf (UKCS).
- e) The LNG import capacity needs to increase to provide alternatives to Interconnector flow as well as supplement supplies at times of shortages although this must be recognised as only part of the solution.

1. Impact of lack of secure supplies

1.1. UK gas supply deficiencies have influenced the market price to such a significant level over recent years as to create an environment in manufacturing which questions the viability of sustained investment in the UK. Amicus has examined a number of high energy users and some of our findings are set out below:

Chemical Industries

- a. On average energy cost increases from 2004 to 2005 amounted to 60% of trading profit in that year. For several companies the increase was greater than trading profit, implying a move into loss unless costs could be trimmed or recouped in other ways.
- b. Cancelled and deferred investment in 2006 and 2007 amounted to just under £90m: if these results are typical of the industry they suggest over £600m of investment has been lost within industrial chemicals alone.
- c. 2% of production has already been moved abroad as a result of energy costs.

Paper Industry

- a. A survey in 2005 of 16 companies showed an average energy budget increase of 32% against the previous year had been adjusted to 42% to meet actual market prices.
- b. Extrapolated across all paper and tissue mills, the sums involved exceed the profitability of these entire sectors and seriously threaten the future of these companies.

Glass industry

- a. During the last 18 months, 16 facilities have closed with the loss of 2,500 jobs.
- b. One company ceased trading completely on basis of high energy costs.

Cement industry

- a. Lafarge cancelled a major investment project due to instability of energy prices in UK.

Manufacturing Generally

- a. A survey¹ published at the end of 2005 revealed that 93% of companies surveyed had experienced an increase in energy prices over the last 12 months with average weighted increases in gas and electricity of 47% and 34% respectively. These rates are more than double the level of increases reported in 2004.

2. The Market Place

- 2.1. The UK gas market has seen a succession of supply/demand issues leading to price spikes in both the forward and spot markets during the last three winters. The magnitude and duration of the price spikes has been increasing at each occurrence. Amicus believes that this is fundamentally due to failings in the structure of the UK market.
- 2.2. The UK market depends on pure economic signals to balance supply and demand. As demand for gas increases one would expect the price to increase, which would dampen demand and make it economic for more supplies to be delivered until a supply/demand balance is restored. There seem to be two issues with how this works in the UK: The majority of winter demand is due to space heating in the domestic

¹ Engineering Employers Federation - Dec 2005

sector and this is price inelastic; secondly, marginal supply of gas is from continental gas markets that are not liberalised and do not effectively respond to price signals to increase supply.

2.3. The UK reliance on imported gas is subject to the competition for supplies from the developing eastern European industries and the events in the early part of 2006 provided a warning of the potential instability of supplies from Russia. Amicus recognises the positive impact on the market with the coming on stream of new interconnectors this winter. However we share the concerns expressed by the previous Minister for Energy, Malcolm Wicks² that this alone was unlikely to be enough.

3. The LNG Factor

3.1. The emerging trade in LNG cargoes in the Atlantic is beginning to change the economics of gas, creating price competition between North America and Europe. Amicus accepts that LNG has a contribution to make to the gas supply issue. However, like the Mid Atlantic Oil market which preceded it, tankers shipping LNG are increasingly being diverted to ports which have the highest price. Whilst in the long term this could create a global market price or at the very least a European one, it does leave any nation which is reliant on LNG imports, a hostage to fortune of suppliers.

3.2. Amicus believes that reliance upon LNG imports as a means of addressing the shortfall in natural gas supplies may be a strategic mistake if the evidence of the Oxford Institute for Energy Studies proves correct.³ Amicus in its submission on the 2006 Energy Review stated *“Given the growing economic climate in the Far East and the development of Mid Atlantic Liquefied Natural Gas market, it is predicted that supplies of LNG will be handled by the big cartels in the same way oil supplies have in the past, with the ships diverted to the port with the best price. Consequently Britain’s rush to build new capacity to receive these shipments may be money wasted.”*

4. Expansion of UKCS Exploration

4.1. The OIES study⁴ by Jonathan Stern highlighted some of the potential security of supply issues arising from reliance upon supplies from Russia and Northern Africa. Amicus has previously called for further exploration of gas reserves which are available in the North Sea and UKCS and we repeat that call in this submission.

4.2. North Sea gas supply is diminishing, despite the discovery of gas equal to 250 million barrels of oil, in September 2006. This is, in

² TUC Congress fringe meeting September 2006

³ THE NEW SECURITY ENVIRONMENT FOR EUROPEAN GAS: WORSENING GEOPOLITICS AND INCREASING GLOBAL COMPETITION FOR LNG - Jonathan Stern - October 2006, OIES

⁴ Ibid

exploration circles, little more than a footnote. Whilst it will extend the life of the North Sea, the find will not be ready to start pumping gas until 2010.

4.3. More investment is needed in UKCS exploration as Amicus believes this still has the potential to make an economic contribution to the issues of gas supply to the UK. The growing reliance on imported gas has resulted during the last year, of the UK having a net £1,069 million cost deficit. This drain on the economy will only get worse as the volume of imports inevitably grows larger.

5. Storage Capacity

5.1. Around the UK there are six gas and four liquefied gas storage facilities from which only five deliver in excess of 1000GWh a day of supply at full capacity. After six days however the total output is reduced to 833GWh per day. Half of this reduced output will be from the Rough facility in the North Sea.

5.2. Although other European nations have considerably more storage capacity, it is disappointing to note that in the consultation document the Energy Review did not recommend the public provision of strategic storage for the UK. Amicus believes that this will have a negative impact on the incentive for further exploration and also risks reducing the incentive for private sector companies to invest in more storage or other kinds of flexibility. Amicus believes that relying on the market to make such fundamental decisions on what is needed rather than what is most profitable is foolish.

5.3. Amicus is also concerned that future investment in manufacturing in the UK could be adversely affected if steps to increase storage facilities are not planned and therefore fuel manufacturers' concerns about security of supply.

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