ICOS SUBMISSION ON THE

ENERGY GREEN PAPER:

TOWARDS A SUSTAINABLE ENERGY

FUTURE FOR IRELAND

December 1st 2006

1. Introduction

ICOS and its agri-food processing and marketing members support the Green Paper and Government goals of:

- Ensuring safe and secure energy supplies
- Promoting a sustainable energy future and
- Delivering economically efficient prices to Irish consumers

In particular, ICOS is concerned at the reduction in the Irish food sector's international competitiveness due to the higher energy prices operating in the Irish market compared with UK and other EU countries.

Industrial electricity costs in Ireland are well above that of our competitors in the EU and about 30% above the UK. In addition, the basis of charging for gas for milk processing is resulting in charges which are excessive and unjustified.

These higher costs are only partly due to Ireland's high dependency on imported fossil fuels. The CER basis for granting gas and electricity increases is flawed and it is leading to higher prices than are justified. The other significant factors affecting Irish energy costs are the higher cost structures that exist in Ireland in electricity and gas provision and the lack of adequate price competition in Irish energy supply.

In this submission, ICOS and its members outline their concerns, and the key issues and problems that should be addressed. The position paper concludes with proposed solutions to a number of the specific problems.

2. Milk Production, Processing and Marketing

International competitiveness of Irish milk production, processing and marketing is being seriously impacted on by higher energy costs applying in Ireland compared with its international competitors. The extent of the impact is very significant given the need for energy in feed production and harvesting, milking and cooling on farms together with the high energy needs in milk collection, processing (post intake pasteurisation and treatment, processing including drying and chill and other storage) and national and international distribution.

As a result, the higher fuel prices in Ireland have a greater impact on the milk sector that most other sectors in the economy.

Milk processors estimate that the lack of competitive pricing of electricity and gas in Ireland relative to the UK is seriously increasing the cost of milk collection, processing and marketing, at a time of extreme pressure due to CAP reform support reductions and general cost inflation affecting the factors of production throughout the chain.

ICOS strongly recommends that the key energy issues and problems outlined in the following section need to be urgently addressed, to ensure that the milk sector's competitiveness is not permanently and seriously undermined.

3. Key Energy Issues and Problems

3.1 Structure and Competition Issues

Irish energy costs are well above the EU average, and are estimated to be 30% above the UK for industrial users. A key driver giving rise to these higher energy costs are structural deficiencies and a lack of real price competition in the Irish energy market.

Key structural concerns include

- The ESB dominance in generation and supply of electricity
- Higher electricity generation costs due to labour costs and other inefficiencies compared with international competition
- Ownership of the electricity grid
- Insufficient interconnection capacity, funding of interconnector costs, and the basis for charging users for fixed capacities.

ICOS recommends that significant structural changes are required to ensure that increased price competitiveness is achieved in the generation and supply of electricity and gas. ICOS welcomes the plans to increase interconnector capacities, North-South and East West, provided their funding is not a burden on the productive sector of the economy.

3.2 Uncompetitive Electricity Prices and Lack of Price Competition

There is a general lack of efficiency and price competition in the generation and the supply of electricity for the following reasons:

- **The electricity price increases granted in September, 2006, are unacceptable**, because international gas and oil prices declined significantly since mid-2006
- **The CER permitted the ESB to recover €150m** from 2006 purchasing costs, pushing up the PES price further
- **The CER has not put in place mechanisms, agreeable to energy users, for flexible supply contracts** that allow users to opt for monthly pricing as an alternative to the fixed price option. Monthly contracts would allow users to benefit from lower prices if they take on the associated risk.
- **Irish electricity prices are the second highest in the EU and some 30% above the UK,** partly due to the September price increases
- The 2005 Deloitte Review of the Electricity Sector in Ireland was commissioned by the Minister for Communications, Marine, and Natural Resources. **It concludes that higher electricity costs in Ireland amount to around €100million per year,** due to the poor availability of ESB facilities and the higher than average non fuel costs, especially labour, compared with electricity generation operating to international benchmarks
- **There is inadequate competition on prices because independent providers base their quotes on the ESB PES price, which is artificially inflated** as outlined above. While independent providers do not need to recover the equivalent of the €150m included by the CER in the PES, due to a lack of price competition, the CER decision to grant significant and unjustified price increases has acted as an inflated benchmark price for independent providers.
- **The CER removed the obligation on PES to quote industrial users.**

3.3 Gas Price Competition is Inhibited

Gas price decisions by the CER and Bord Gais unfairly inflate the price and inhibit price competition, for the following reasons:

- **The September, 2006, decision on gas price increases is unacceptable**, because international gas prices have declined significantly since mid-2006
- **The CER bases gas prices on the Futures Market, which is flawed**, because there is inadequate liquidity in the Futures Market. This means that the CER is basing the gas prices on a market price, which is well above the likely market prices. While there is scope for a correcting mechanism that can be applied the following year, the flawed CER basis still undermines the least cost supply of gas. The correcting mechanism is intended to take account of the difference between the CER determined gas price and the actual Bord Gais and independent gas purchase prices during the year. The flawed CER basis for granting gas price increases reduces price competition; because, firstly the Regulator's decision allows Bord Gais and independent gas suppliers to base their prices to users on an inflated price and, secondly, it thereby reduces the incentive for Bord Gais and independent gas providers to organise and manage their gas purchasing to minimise their gas purchase prices during the year.
- **The CER and Bord Gais decisions to require milk processors to pay fixed capacity charges for their full year requirements based on their peak capacity needs is unacceptable**, **because it is loading the milk sector with unjustified higher costs for the following reasons**:

  - **Gas capacity charges should be based on monthly capacity requirements**, as charging fixed capacity based on peak summer capacity needs increases the annual charges unfairly because the milk processing sector peak is several times its valley needs, due to seasonality,
  - **There should be lower unit gas capacity charges during the lower gas demand periods such as Spring/Summer/Autumn**, as there is no justification for charging for capacity a the same level as during the winter. If the Milk Processing Sector had no seasonality, i.e. had a flatter profile comparable to most other sectors, then capacity constraints across industry in general would be greater in the peak winter demand period and fixed charges would be higher. Presently with peak milk processing in the summer, when there is ample capacity, the milk sector is in effect subsidising peak capacity demand charges for other sectors.
  - **Gas charges are based on a 90% fixed capacity and 10% volume charge whereas it should be based on a 80:20 ratio**, as applies in other competing countries

- Bord Gais provides a discount for an interruptible capacity provision, which means that users may under limited conditions benefit from a 25% discount if they accept interruptions in supply. **The conditions applying to this discount inhibit gas price competition because:**
  - **In effect the 25% discount represents an excessive loading on basic gas prices** that milk processors have to pay for security of supply. The loading is excessive as the risk of interruption is very low and there has been no interruption in the past 5 years.

- **The current system does not provide an adequate advanced warning system for milk processors to plan properly to deal with interruptions,** therefore it is too risky for milk processors to contract on an interruptible basis.
- **The discount is not available to independent providers and this is a barrier to gas price competition.**

§ **It is anticompetitive of the CER, under the RTF, to limit gas buyers below 9 million Therms to purchase from Bord Gais on a quarterly basis rather than a daily basis. This restriction is undermining price competition in gas supply.**

3.4 Infrastructure Costs

Infrastructure costs being incurred by ESB and Bord Gais for grid, network and interconnector investments are being charged to current users in a manner that undermines competitiveness, for example:

§ **Electricity national grid, gas grid and interconnectors are a national infrastructure cost so they should be funded by the NDP**. This is especially important going forward given the plans to invest €7B in the electricity network from 2000 to 2009 and additional investments in gas networks, and interconnector costs.

§ **The basis of charging current users to recover capital costs over a time period that is shorter than the life of the infrastructure investment is unacceptable and the rates of return on investment being charged are too high.**

§ **It is inconsistent to charge users** for investments in the general national infrastructure and together with this to individually charge an indigenous processor **100% of the cost of a spur link**.

3.5 Combined Heat and Power

A number of milk processing plants have installed CHP plants or would consider developing plans to install CHP plants. The benefits of efficient CHP plants include 25% more cost effective energy generation compared with the conventional power station generation combined with separate heat-only boilers. The other benefits included lower CO_2 emissions. **However, CHP needs to be encouraged by the removal of barriers and the provision of incentives, for example**:

§ Processors have to pay for stand-by capacity if they need to revert to the grid, and this is a barrier to CHP energy production, which is reducing the use of existing CHP plants and militating against new plants. **Instead grid capacity should be paid for by CHP users only when they use the capacity**

§ The SEI CHP Policy Group recommendations for CHP incentives should be implemented. **These include the payment of a premium of 1 cent/KWh hour and other incentives.**

3.6 Renewable Energy

ICOS supports the intention of the Government to increase the output of renewable energy to attain the target that 15% of electricity consumption be met by renewable energy by 2010, with a further target of 30% by 2020. It is important that the White Paper provides specific targets for each sub-sector, wind, biofuel etc. To achieve these targets ICOS recommends that barriers to expansion of renewable energy need to be addressed and incentives are required as follows:

3.6.1 Wind Energy

Operators planning to expand wind energy production point out that the cost increases and the contract prices for the supply of wind-generated energy are barriers to expansion. Therefore, ICOS proposes that the following key issues should be reviewed:

- Wind generation costs have increased significantly in recent years including turbine prices, grid access costs and interests rates
- The Refit Programme feed-in tariffs are regarded as too low and need to be increased to offset the higher costs, currently applying to wind energy in general and also to take account of the specifically higher costs in developing offshore wind energy.
- Planning permission should be for a period of 10 years rather than the current 5 years to allow adequate time to deal with delays in getting permission for grid access and to put grid connections in place. Existing legislation relating to the extension of planning permission needs to be clarified to provide for extensions under consistent guidelines.

3.6.2 Biofuels and Biomass

The targets for increased biofuels production are also welcomed. Achieving the targets may prove difficult and increase incentives are likely to be required. ICOS proposes:

- An increase in the volume of biofuel that is covered by the Biofuel Excise Relief Scheme and the confirmation of relief over a longer period
- Capital grant aid for investment in biofuel processing facilities should be provided where deemed necessary to increase capacity
- The grant aid provided under the CAP supports for growing energy crops needs to be increased significantly from its current level of €45 per hectare to encourage the production these crops and offset the loss of other CAP/EU supports
- Funding measures for biomass including capital grant support for boilers and for processors
- Funding measures for the establishment of new biomass crops
- Funding for investment in R/D for production and processing of biofuels

3.7 CO_2 Emissions: National Allocation Plan

The Irish milk processing sector is facing a period of significant change due to the increased liberalisation of markets and reduced EU supports. As a result, there is a strong need that the number of processing plants should be reduced in future, as the sector consolidates processing in a smaller number of plants processing increased volumes per plant. This strategy is consistent with the Government Commissioned Prospectus Report – March 2003 and the ICOS Dairy Strategy – April 2000.

In this respect, it is essential that processors are allowed to retain 75% of the annual allocations for installations that close up to a maximum of 25,000 allowances per annum, as proposed the NAP2 in July 2006. This provision is especially important in the Irish milk processing sector given the need for consolidation of processing. ICOS is strongly opposed to the Commission's views on the NAP2 and in particular the proposals that annual allocations should be reduced and that the 75% retention provision should be removed. ICOS requests the Government to ensure that the 75% retention and the proposed allocations are maintained, as otherwise it will militate against consolidation in the milk processing sector.

4. ICOS Energy Position

4.1 **There is a pressing need to remove obstacles to the more price competitive generation and supply of energy in Ireland, through increased efficiency, increased new entrant generation and supply, and the more competitive transmission and supply of electricity and gas.**

4.2 **There is a very strong case that Government taxes on electricity, gas and other industrial and farmer fuel inputs should be reduced**, to ensure that Irish fuel costs are not higher than our international competitors.

4.3 There is compelling evidence that the CER should significantly reduce his September 2006 price recommendations because they allow electricity and gas providers to charge unjustified price increases that do not reflect the current international market prices of oil and gas. **The CER must ensure that the review in 2006 and future price decisions deliver more competitive prices by:**

- **Taking account of the most competitive international gas and oil prices**
- **The use of best practice internationally efficient energy generation and supply** instead of the higher cost structures in Ireland, identified in the Deloitte Review
- **The exclusion of any recovery** arising from generators or providers buying poorly in the international fuel supply market.
- **The introduction of an alternative system of flexible monthly electricity supply contracts**, agreeable to energy users, that allows users to lower electricity prices where they take on the associated risk.

4.4 The Bord Gais tariff system is flawed and should be corrected to reduce gas charges by:

- **Basing fixed capacity charges on actual monthly capacity requirements for milk processors**
- **Applying lower fixed charges during the Spring/Summer/Autumn months** when gas demand is lower
- **Reducing the ratio of fixed capacity and volume** by changing it from 90:10 to 80:20
- **Allowing milk processors to purchase gas on a daily basis** if they wish instead of quarterly, where such limits apply
- **Introducing an acceptable system of advance warnings of interruptions,** based on discussions with users, so that it is feasible for users to avail of the interruption discount
- **Allowing independents to benefit from the 25% interruptible discount**
- **Allowing all users buying from Bord Gais to buy on a monthly or prompt basis if they wish, similar to what is permitted for independent suppliers**

4.5 CHP needs to be encouraged by the removal of barriers and the provision of incentives as follows:

- CHP processors should not have to pay for standby grid capacity access, instead **capacity should be paid for on a use basis**
- The CHP SEI Policy Group recommendations for increased support for CHP plants should be implemented including **the payment of a premium of 1cent/KWH hour**

4.6 On Renewable Energy ICOS recommends that:

- **The Green Paper targets should be set out on a sub-sector basis for wind, biofuel, etc**
- **Wind energy Refit feed-in tariffs need to be increased to offset increasing costs and higher costs of off shore wind generation**
- **Wind planning permission should be granted for 10 years and legislation relating to extensions needs to be clarified**
- **The Government should continue to support biofuel production** in terms of excise relief, capital grants for biofuel and other facilities and increased grants for growing energy crops

4.7 CO_2 Emissions: National Allocation Plan

- **ICOS strongly proposes that 75% of annual allocations for plants which close is maintained to encourage consolidation.**
- **NAP2 increases for the milk sector should be maintained.**

4.8 The current approach by the CER to introduce competition into the energy supply sector is not succeeding. Therefore the following actions need to be taken to increase price competition:

- **The cost of electricity and gas interconnections should be funded by the NDP**, as it is a national infrastructure cost, similar to the road infrastructure
- **The CER approval for Gas Transport Charges to Bord Gais for interconnector costs needs to be reduced** to reflect a lower return on capital and a longer recovery period representing the full life of the investment
- **Models need to be developed on the operation of the SEM**, by the CER in conjunction with users, to ensure that it will lead to lower electricity prices
- **Removal of all barriers to increased price competition** to ensure that Ireland's energy prices decline to match international competitors.

ICOS
December 1st, 2006