



“Energy Review”: Discussion and Conclusions

Energy policy is once again high on the political agenda, with the publication of the Energy Review Consultation Document,¹ and is likely to remain so; this is true not just in the UK but also in Europe where the European Commission has published a Green Paper on Energy Policy and it was top of the agenda at the European Council Meeting on 23-24 March.² At the same time, Russia has put energy security at the top of its agenda in its capacity as president of the G8 for 2006.³

The Indepen Forum for Chief Executives held a roundtable on 14 March 2006 to discuss the many issues in the Government’s Energy Review. The roundtable included chairmen, chief executives and directors of major energy companies together with representatives from regulators and directors from financial institutions. The following is a summary of the main conclusions.

Clarifying the role of government

The meeting recognised that the consultation on the Energy Review provides an important opportunity to establish clearly (and not for the first time) the proper roles for government, for regulators and for the industry in energy policy. Clarity of roles is needed to establish the main policy drivers and clarity is needed as to who should be making the decisions necessary to ensure that the necessary investment is undertaken in both networks and in energy production including power generation and oil and gas output. Too often in the past the government had failed to make a clear distinction between the often conflicting objectives that it has set itself and has not offered the necessary leadership to the industry; this clarity is also necessary if the regulatory framework is to operate effectively and predictably. Companies need to recognise that government objectives will almost always have conflicting objectives that need to be resolved. (“Companies are *not* the Country”).

When government should intervene

The meeting emphasised the importance of the market as the main means for ensuring that the necessary energy investment takes place. At the same time it is important to guard against and where possible reduce “regulatory creep”. There has been a tendency to extend the scope of regulation and add costs for industry without full consideration of the expected benefits and if these outweigh the costs.

However it was recognised that the elected government has a key role to play first in cases where there is “market failure” and second where it is necessary to ensure the provision of “public goods”. In the case of energy, the two main policy areas where there are elements of “public goods” concern policies for dealing with “climate security” and for ensuring “supply security”. Individual consumers, in particular cannot ensure climate security or their supply security. The government through the policy framework must ensure that consumers’ needs are properly identified to enable the regulatory framework to be properly targeted. In particular, Government needs to decide the limits of the risks that it is reasonable for the market to cover and for the consumer to pay for.

¹ “Our Energy Challenge: securing clean, affordable energy for the long term” DTI 23 January 2006

²The Green Paper “A European Strategy for Sustainable, Competitive and Secure Energy” COM (2006)105 Final was published on 8 March 2006 and was discussed by the European Council at their Summit on 23-24 March. This follows the mandate given to the Commission by the Heads of Government Informal Summit at Hampton Court of September 2005.

³ Russian G8 Presidency website <http://en.g8russia.ru/agenda/>



The priority of “Climate security” as a key policy driver is accepted

The meeting recognised that the government is fully persuaded that climate change is a reality and more particularly dealing with it should be a major policy driver for energy policy as a whole; what is more there is a deep cross-party conviction of its reality. This in turn creates a reality of its own for the business community to comprehend. Policies to address that reality are needed not only in terms of new low-carbon sources of supply but also in terms of demand-side measures.

The government needs to redouble its efforts to ensure that the so far long waited for, but never realised, demand-side responses to high prices and insecurity (see below) become a reality. New measures are needed to encourage (relatively) new technology (that may come to surprise us all), in particular the myriad of transforming micro-solutions (e.g. micro-generators etc), as distinct from the familiar supply-side blockbusters like new large-scale power stations, though many thought that nuclear power stations will need to feature, it was by no means a unanimous view.

“Supply security” is once again high on the agenda

The meeting urged that the government to recognise the materially greater threat of damaging shocks in the world supplies of energy from geo-political risks, the rapid depletion of conventional oil and gas reserves, and the inadequacy of investment in future oil and gas supplies. The meeting questioned whether the government was really seeking to maximise the value of the remaining potential oil and gas reserves in the UKCS. The need for action has become particularly urgent as the need for gas imports to the UK and Europe increases. The expected increase in gas imports has added to the urgency for considering investing in “shock absorbers” like strategic stocks of natural gas (as well as oil). Such a policy is one that only government and the regulators can address in the first instance; however once a framework is in place the market can then play its part in the provision of such investment and stocks.

The meeting questioned the response from certain European governments that sought to create “national champions” as one of the principal vehicles for delivering supply security. However the meeting wondered whether it is time to reconsider the UK government’s stance of *not* supporting national champions for the UK and whether it should now encourage the formation of a UK equivalent rather than continue to allow the capital market to dictate industry structures and ownership subject to the usual constraints of competition policy.

The policy and regulatory framework must provide for appropriate long term stability

All were agreed that the government and regulators must recognise the capital intensity and hence long term nature of the energy industry. Too often there have been short term changes in policy that damaged investment incentives. Governments need to resist the temptation to intervene having established appropriate policies and incentives. Given the (inevitably) shorter term political-cycle, the meeting considered that a degree of cross-party consensus on energy policy is important if the necessary investments in infrastructure are to be encouraged.

The increasing UK dependence on imported gas (and oil) shifts the energy policy debate to the EU level

The meeting recognised that climate security and supply security are not just problems for the UK to address but need to be addressed at the EU-level and indeed on a world level. The need for clarity, long-term stability and transparency in policy making and priorities are just as important at these levels as they are for the UK.

While there has been a general view that the UK “model” of liberalisation was one that should be adopted across the EU, the meeting questioned whether that needed to be re-considered in the light



of the growing pressures to ensure supply security and therefore asked whether adaptations should be made to the “model” to address the issues of climate and supply security more clearly.

It was not always clear at the meeting the degree of understanding of the relative roles of the EU and UK government in policy decisions on energy policy; however it was recognised that regulation was increasingly an EU-level issue and this made it all the more important that Ofgem continues to play a leading role.

The importance of energy needs a concerted political will to take policy forward

Events, such as Russia's temporary interruption of gas supplies to the Ukraine in January 2006 and the shut-in of the Rough gas storage field in March 2006 for a period of months, have emphasised the vulnerabilities of the energy supply system to consumers and the need for concerted action at the UK and EU level. To implement the necessary changes to the legal and regulatory framework to ensure delivery of new investment on time and ensure that the needs for supply security and climate security are met requires a clear political will to make the necessary decisions and that those decisions are now becoming pressing.

Summary

In summary the meeting concluded:

- The need for clarity on the role of government and the role of market forces recognising that government needs to address cases of market failure and “public goods” in particular climate security and supply security
- All now recognised climate security as a key policy driver where measures are needed to include demand side as well as supply side measures
- The importance of supply security and noted the moves in certain European countries to support “national champions” and questioned whether the Government's resistance to such a policy should be reconsidered
- The capital intensity of much investment in the energy industries required a regulatory framework that emphasized long term stability
- The expected progress to the UK importing much of its gas and oil emphasised the importance of policy making at the EU level as well as the UK level
- The need for new investment in the energy system emphasised the need for the necessary political will to ensure the regulatory framework was in place to ensure that the necessary investment took place.