



Consultation response: OFGEM Project Discovery

IoD response to *Project Discovery: Options for delivering secure and sustainable energy supplies*

About the IoD

Founded by Royal Charter in 1903, the IoD is an independent, non-party political organisation of 45,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92 per cent of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70 per cent, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

IoD response

We are pleased to have the opportunity to respond to this consultation document, which we think is helpful and constructive. We do not propose to answer all the consultation questions in detail, as we believe there are others better placed than us to do so, but we would like to make a few high level comments.

Prospects for the next decade

We agree with OFGEM's analysis of the risks to energy supplies over the next decade. In particular, we would point out the risk of more than one of the scenarios that were stress-tested occurring at the same time e.g. a Russia-Ukraine dispute occurring in the middle of a cold winter when there is little wind blowing.

We agree that there is a serious risk of power cuts in the middle of this decade. While prudent management may reduce the effects of power cuts, they would undoubtedly have a serious impact on business, and should therefore be avoided if at all possible, or at least minimised.

The goals of energy security and reducing emissions should be complementary. Reduction in the use of fossil fuels and an increased share of generation from renewable sources should improve security of supply by reducing dependence on gas imports.

The proliferation of support mechanisms and policy instruments to encourage renewable energy, and indecision about the role of nuclear power, has sent mixed signals to investors. While it may be right to question the ability of current market arrangements to deliver the required levels of new infrastructure, it is not surprising that energy companies have been reluctant to commit themselves to hugely expensive projects. In addition to market risks, there have been significant political

and regulatory risks, with a stable long-term policy framework that gives clear and consistent guidance about the future energy generation mix conspicuously lacking. In this environment, calls for windfall taxes on the profits of energy companies have also been extremely unhelpful.

The resulting regulatory and policy uncertainty has not encouraged private investment in new capacity. Left to itself, the market would be likely to shift the future generating mix towards a combination of cheap gas-fired generation and heavily-subsidised wind power. But, improvements in the global LNG market notwithstanding, this would represent a highly volatile and insecure energy mix.

It is clear that carrying on as we are is not an option, and so we fully support OFGEM's efforts to improve the energy policy framework.

The view of IoD members

The IoD undertook an extensive survey of around 1,000 members on energy issues in November 2009, and included energy within a general member survey in February 2010, of almost 1,800 members. The key findings are set out below:

February 2010

- Ensuring the security of energy supplies is seen by IoD members as the *fourth most important issue* that a new government should address in the first 100 days after the election;
- Beyond the priorities of the first 100 days and over the course of the full parliament, IoD members felt that ensuring the security of energy supplies was the *most important issue* (although only marginally so) that needs to be addressed;
- 85 per cent of IoD members think that new nuclear power stations should be built in the UK.

November 2009

- Around half of IoD members do not agree that current policy will be effective in reducing carbon emissions, almost twice as many as those who agree;
- Doubts are greater still in the case of energy security with more than 60 per cent disagreeing with the assertion that current energy policy will succeed in avoiding power cuts, compared with only 15 per cent agreeing.
- When asked to determine the most important of the Government's three energy priorities – reducing emissions, security of supply, and low cost supply – 53 per cent said that security of supply was the most important; 22 per cent said all three were equally important; 18 per cent said that reducing emissions was the most important and only 6 per cent said that low cost supply was the most important;
- The four most important areas to invest in new power generation plants, according to IoD members, are nuclear (71 per cent), wave and tidal (59 per cent), offshore wind (56 per cent), and solar (49 per cent);
- The three largest barriers to IoD members improving the energy-efficiency of their companies are the payback period for energy-saving equipment (38 per cent), the

large upfront investment cost (30 per cent) and inconsistent/unclear government policies (25 per cent);

- The three most important drivers for improved energy efficiency were seen by IoD members as rising energy costs (65 per cent), positive corporate social responsibility (47 per cent), and changes in technology and the availability of new products (39 per cent);
- The two most important internal changes that IoD members felt their organisations needed to make to improve energy efficiency were to encourage behavioural changes (66 per cent) and invest in new equipment (41 per cent);
- IoD members felt that the three aspects of climate change and government responses to it that would have the worst impact on their businesses were an increase in the cost of doing business from higher taxes (67 per cent), an increase in government regulation (65 per cent) and an increase in the cost of doing business from higher energy costs (65 per cent).

These results lead to several conclusions:

1. IoD members think that one of the most important challenges of the next few years is to ensure the security of energy supplies.
2. IoD members do not believe that current policy will achieve this security.
3. Building new nuclear power stations is seen as the most important way to improve energy security, although there is also strong support for renewables.
4. Rising energy costs will lead to businesses improving their energy efficiency through internal behavioural changes, but an improved financing system that helped businesses to overcome the large upfront costs of investment in energy efficiency measures would be useful. NB: The IoD has not yet surveyed its members on the most recent schemes, such as feed-in tariffs, that have been introduced.

What to do

It is pretty clear that there is no one magic bullet that will solve the UK's future energy problems. Security does lie, to some extent, in diversity of energy sources.

Equally, it is not clear which low-carbon technologies will ultimately win out. CCS for coal may look promising, but it is not yet proven to be commercially viable. Renewables are generally still comparatively expensive, although fossil fuel price increases could change that equation. The point is not to claim that the IoD has expertise in each type of power generation, but to make clear that there is a great deal of uncertainty about what an ideal future energy mix for the UK will look like in 10 years' time.

With this in mind, the IoD believes that the options set out by OFSTED that include a far greater degree of central direction are risky. If the "wrong" technologies are chosen, the economic costs could be very large.

It is clear that the Renewables Obligation does need to be replaced, particularly with respect to nuclear power. It would be better to set a carbon price, and allow the market to determine the mix of low-carbon investments, including nuclear. This is closer to the “Targeted reforms” option.

A framework with a stable carbon price and significant market freedom beyond that does, however, run up against the problem of the intermittency of renewables such as wind, and hence the need for significant back-up storage and generating capacity. We are not clear about the best way to achieve reliable back-up storage and generation, although note that it is a central concern, and an increasing concern if gas and wind make up a larger share of the UK’s energy mix in future.

A further issue is that of time. As the *Project Discovery* consultation document made clear, key decisions will need to be made in the next 2-3 years. Given that investment is likely to be delayed until a stable policy framework emerges, this urgency must surely rule out options such as the “Central energy buyer”, which will take up to 3 years to implement.

It is also important to keep pushing to open up Europe’s energy markets, as the juxtaposition of the UK’s liberalised markets with the highly regulated position in the rest of Europe hinders the UK’s energy security objectives. A more effective EU energy grid would not only improve the security of gas supplies, but would also increase the viability of, for example, wind resources across the continent.

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