

The UK energy reset: exporting the ‘Rudd model’

19 November 2015

Summary

Yesterday was a big day in European energy with simultaneous announcements in Brussels and London coinciding the German energy ministry’s annual monitoring report on the Energiewende (the German energy transition). This note looks at the UK’s emerging ‘Rudd Model’ and its potential to provide an alternative to an Energiewende which may have lost its some of its lustre as a model for fellow members of the Energy Union.

Yesterday was a big day in European energy policy: in Brussels Vice President Maroš Šefčovič presented the inaugural State of the Energy Union report; in London Energy and Climate Secretary of State, Amber Rudd, set out what had been trailed as a “reset” of UK energy policy; and in Berlin the energy ministry - published its annual monitoring report on the Energiewende (the German energy transition). The Energy Union update contained little that was unexpected, but demonstrated the political momentum that the Energy Union policy now has. Rudd’s overtly pro-European speech was a recalibration rather than abandonment of the policy paradigm the UK has followed over the past several years. And in Berlin the German government concluded the Energiewende is making “good progress”. In a week which has seen Europe stepping towards Energy Union, yesterday’s coincidence of timing suggest that within that Union there are now distinct and divergent policy models for how member states should generate and supply electricity. This note looks at the UK’s emerging ‘Rudd Model’ and its potential to provide an alternative to an Energiewende which may have lost its some of its lustre as a model for fellow members of the Energy Union.

The ‘Rudd Model’

Of yesterday’s events, Amber Rudd’s speech was by far the most significant. The ‘Rudd Model’ set out in the speech is pro-market and tough on subsidies. It sees the UK exiting unabated coal-powered generation, onshore wind and solar are expected to stand on their own feet without subsidy, while the offshore wind industry is on notice that it needs to sharply cut its costs. Shale gas is lauded. Gas and nuclear are seen as UK energy mix mainstays. With the UK’s capacity margin down to a sliver, energy security and attracting new investment features prominently. Decarbonisation and meeting the UK’s carbon budgets are restated as key policy goals, but the ‘Rudd Model’ is clear that the UK’s aim is to be “a compelling example to the rest of the world of how to cut carbon while controlling costs”.

Media reports of the speech focused, as was no doubt intended, on the plan for the UK to regulate and exit unabated coal-fired generation by 2025 and to restrict its use from 2023. Rudd’s proposal will bring a regulatory certainty to an exit from coal that her department’s forecasters expected would in any case arrive during the next decade due to a combination of coal being

priced out of the market by gas and plant closures from the EU's Industrial Emissions Directive. It is a landmark policy decision, making the UK the first major economy to set an end date for the use of the most polluting of fossil fuels.

The exit from coal will though add to the UK's energy security challenge. In 2014 coal-fired power generation supplied around 30% of the country's electricity (Figure 1). Only two weeks ago National Grid - the UK system operator - was forced to request industry reduce its power consumption in the face of generation capacity shortages. Rudd's hope will be that taking coal out of the energy mix will significantly improve the prospects for new investment in gas-fired generation which Rudd described as "imperative". The ambition is well grounded. Coal pricing out gas has been a significant feature of the market in recent years with the result that little has been invested in new gas-fired stations. The worry, however, will be that UK energy policy in recent years has had a record of never quite resulting in the intended outcomes.

The exit from coal won Rudd plaudits from the green NGOs, but they were unenthusiastic about another key element of the speech: a declaration that she intends to be "tough on subsidies to keep bills as low as possible." Following cuts after the election to support for onshore wind and solar pv, this came as little surprise. However, she struck a particularly tough note on insisting further rounds of support for offshore wind will be conditional on the industry delivering significant cost reductions. Rudd also flagged the intention to make intermittent generators (like renewables) "responsible" for their impact on the grid.

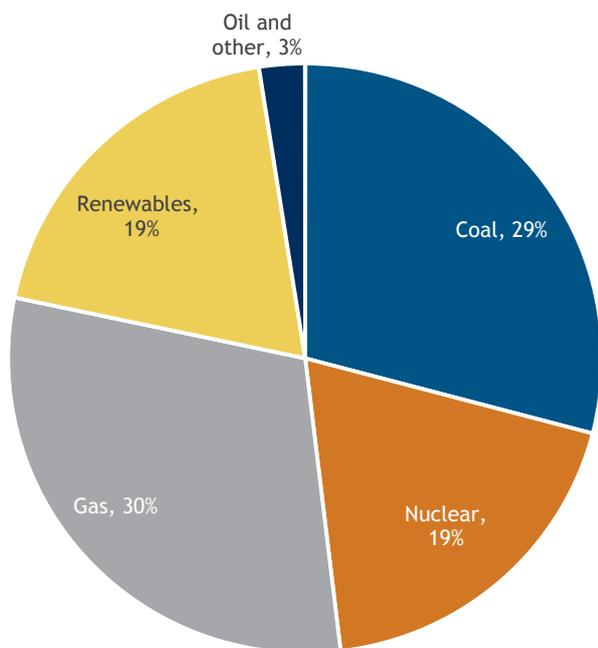


Figure 1: UK electricity generation mix 2014
Source: DECC

What is clear is that the renewables industry faces a cooler climate under Rudd than it enjoyed under the patronage of her predecessors Ed Miliband, Chris Huhne and Ed Davey. Unlike her predecessors she made no mention of the benefits of the 'green economy' or 'green jobs', and the list of proposed targets for R&D spending included nuclear, CCS and energy storage but excluded mention of any renewable energy. In the 'Rudd Model' renewables will have a place when they can compete on cost, but will not be part of a big industrial vision. The 'Rudd Model' looks relaxed about the UK being an importer and installer of kit made elsewhere, rather than a manufacturer of renewable technologies. Nevertheless, the UK's obligation to meet its EU target of 15% of energy from renewables by 2020 - and it is one of only three member states which missed its 2013 interim target - should at least put a floor under demand for renewables in the UK. Meeting the renewable targets in heat and transport is likely to require more subsidy in those sectors, even as the UK curtails subsidies for renewable electricity.

This changing approach to renewables and the assertion that "energy security is the first priority for this government" were interpreted by many as a rolling back of the government's commitment to climate action. This is unfair. While renewables policy has indeed moved on, the government's commitment to cutting emissions was confirmed as was the intention to meet the terms and targets of the UK's fourth and fifth carbon budgets.

With a clear nod in the direction of one of her Conservative predecessors as energy minister, Nigel (now Lord) Lawson, whose 1982 speech pushed UK energy policy firmly towards market liberalisation, the 'Rudd Model' aspires to getting "government out the way as much as possible, by 2025". Her speech was littered with references to the market and competition marking a shift in the recent UK paradigm. The UK led Europe in privatisation in the 1980s and then in the 1990s and early 2000s market liberalisation in the energy sector. But more recently intervention by the state in the market - most substantially through the Energy Market Reform Act (EMR) - has played a much greater role.

In the 'Rudd Model' the view is firmly that the interventionism of the EMR is a transitional necessity not a desirable end state. The reality, as demonstrated by the Conservative government's 35 year contract with EdF for the building of the Hinckley nuclear plant, is that the transition is going to be lengthy. And with growing concerns about the UK capacity margin and the challenge of renewable intermittency the 'Rudd Model' is in practice going to involve further interventions through capacity mechanisms and other steps. Rudd's demand is that "subsidy should be temporary, not part of the permanent business model". The reality for the near future at least, is that it will continue to be an important part of the UK energy business model.

An alternative model for Energy Union?

As Amber Rudd was finishing her speech Berlin released its report on the Energiewende concluding that it is making “good progress”. Progress on deploying renewables is rated as 5 out of 5. With a third of the country’s electricity sourced from renewables, it is well on the way to the 2020 target of 35%. However, the Energiewende’s progress on decarbonisation is less impressive. To meet Germany’s 2020 target it will need to triple the pace of decarbonisation over the next five years. This difference in performance reflects that to date the Energiewende has been as much a technology policy to specifically promote renewables as it has been a policy to cut emissions. This is the first of a number of differences with the ‘Rudd Model’ where renewables are a means of decarbonisation and only when they are cost effective. In the Energiewende renewables are an end in themselves. This is by no means the only difference (Figure 3). Where Germany is committed to phasing out nuclear, the UK is looking to expand. Where Germany has put coal-fired power plants on life support, the UK has committed to close them. In the ‘Rudd Model’ shale gas is a valuable resource and gas is flagged as a key part of the energy mix, in Germany there is reluctance about shale and silence about gas in the energy mix. The cost of the Energiewende is widely seen as a price worth paying, in the ‘Rudd Model’ keeping bills as low as possible is a priority.

Within Germany the Energiewende is backed by a broad consensus. And despite its cost, borne by household consumers, opinion polls consistently report public support. Efforts by Economy and Energy Minister Sigmar Gabriel to reduce cost impacts and emissions from coal-fired power plants have faced effective opposition from a combination of a powerful renewables lobby on the one hand and powerful union and industry lobbies on the other. Where it was once seen as setting out the path to a decarbonised energy system, as a model to be

emulated by others in Europe its reputation is now more equivocal. The Energiewende looks to be a costly and its record - to date at least - on cutting carbon emissions has been limited (Figure 2).

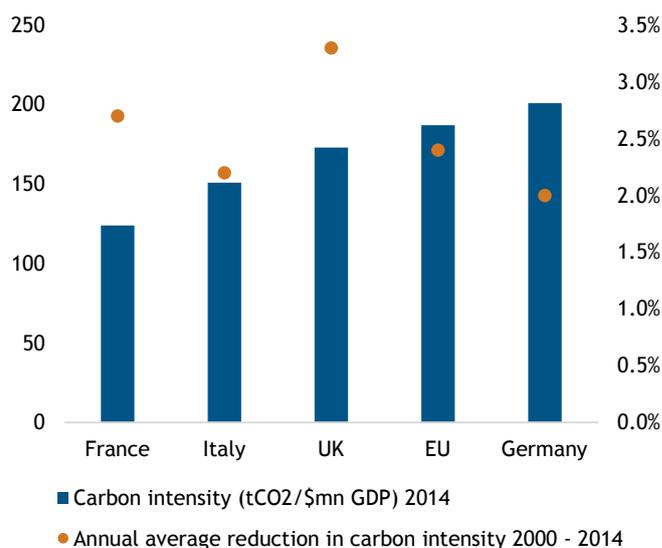


Figure 2: Germany’s mixed record on decarbonisation
Source: PWC, BP, IMF, GC calculations

The political rows over energy prices and concerns about the capacity margin flags that the UK too has issues. But Rudd’s rebooting of the UK model is offering a distinctive alternative to the Energiewende. Its focus on affordability and cost will be attractive at a time of continuing economic difficulty in Europe, the more so as hopes have been dialed down of gains from a ‘green economy’. Its attractiveness to the UK’s fellow members of the Energy Union though will ultimately be determined by whether it delivers - from new nuclear and gas plants being built, shale gas developed and carbon being cut at the lowest possible cost. This delivery is now the task for the ‘Rudd Model’.

| | The ‘Rudd Model’ | Energiewende |
|----------------------------|---|---|
| Coal | Exit unabated coal by 2025, with use restricted from 2023. | 2.7GW of oldest coal-fired power plants to be moved into a ‘security of supply’ reserve. No further plans. |
| Nuclear | Ambition to renew and expand fleet to generate 30% of electricity up from 20% today. | Phase out from nuclear due to be completed by 2022. |
| Renewables | Identified as a means to decarbonise with the emphasis on value for money. “Tough on subsidies”. | Promotion and deployment central to the Energiewende. Costs justified as developing an important future industry. |
| Gas | Key generation fuel for security of supply and less carbon intensive replacement for retiring coal fleet. | Being squeezed out of the generation market between renewables and coal. |
| Shale gas | Identified as an important resource to reduce future import dependence. | Highly contested within the coalition government with burden on producers to demonstrate safety. |
| Capacity mechanisms | Accepted as a policy tool for incentivising investment in new gas plant. | Disavowed by the government in favour of greater interconnection. |

Figure 3: The ‘Rudd Model’ and Energiewende compared
Source: DECC

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