

Implications of the New Government for the UK Energy Sector

June 2017



Following the General Election on 8 June, Theresa May has formed a minority Conservative Government, which will rely in Parliament on support from the Democratic Unionist Party (DUP).

The Government's legislative agenda will be dominated by Brexit, leaving limited scope for other policy initiatives.

This note considers what the Conservative manifesto said on energy and what might happen now, against this new political backdrop.

Energy prices and bills

The Conservative manifesto had a clear focus on affordability and keeping energy bills down. This is also a priority for the DUP.

The Conservatives have said that they want the UK to have the lowest energy costs in Europe. This is a very stretching goal, given the need to replace the UK's ageing energy infrastructure and the ambitious (legally-binding) targets for decarbonisation already in place.

There will be an independent Review into the Cost of Energy, which will make recommendations on how to get the cost of energy down. This is bound to increase the spotlight on all elements of our energy bills, including wholesale costs, network costs and policy costs.

The manifesto also said that the Government would introduce *"a safeguard tariff cap...for customers on the poorest value tariffs."* The Queen's Speech on 21 June confirmed that the Government would take action to tackle *"unfair practices in the energy market and help reduce energy bills"*, although the exact measures to achieve this are still under consideration. Greg Clark wrote to Ofgem on 21 June to ask what other steps they might be able to take to achieve this objective, which might avoid legislation.

Any commitment to re-regulate retail energy prices through the introduction of a price cap would mark a sea change in attitudes and would bring to an end nearly 30 years of energy policy based on the belief that markets and competition deliver the best outcomes for consumers.

The impacts of any regulated tariff would depend heavily on its design. Any such intervention would need to be temporary to be consistent with EU law.

"The emphasis of energy policy will be on affordability and keeping bills down"

However, what we have already seen, partly in anticipation of a cap being introduced, is the narrowing of the price differential between Standard Variable Tariffs (SVTs) and the best fixed price deals from about £300pa a year ago to around £150pa in May 2017. Smaller differentials are likely to mean less incentive to switch (although the Government remains committed to making switching *"easier and more reliable"* over time). A number of the bigger suppliers have also raised concerns about the potential impact of the cap on investment and innovation in the sector.

Energy efficiency and smart meters

The Conservative manifesto said that the Government would introduce *"an industrial energy efficiency scheme to help large companies...cut their energy use and bills."* It is unclear whether this would require new legislation. If it does, this may be one of the measures that gets squeezed out through a lack of legislative space, although there is likely to be cross-party support for improving energy efficiency.

Improving business energy efficiency will be essential if the Government is to meet the fourth and fifth Carbon Budgets in a cost effective way. However, energy efficiency is an area where previous policy initiatives (like the Green Deal and Carbon Reduction Commitment) have struggled to deliver the scale of savings initially hoped for.

The Government remains committed to the roll out of smart meters by 2020, with the manifesto saying that every household and business *"will be offered"* a smart meter by the end of 2020. This careful wording reflects the fact that customers can refuse to have one fitted. But even this looser formulation will still be extremely challenging to achieve given the tight timescales the programme is working towards. This was recognised in the proposed Smart Meter Bill in the Queen's Speech, which extends by 5 years the period in which the Government can change smart meter regulations.

On fuel poverty, the manifesto referred to an “upgrading all fuel poor homes to Energy Performance Level C by 2030”, although no details have been set out.

Electric vehicles

The new Government also has an ambitious target to achieve on electric vehicles (EVs): “For Britain’s to lead the world in electric vehicle technology and use.”

The Government intends to introduce new legislation and invest £600m by 2020 to help achieve this. If EVs do take-off as expected, this will have major implications for the Britain power system in the years ahead.

Renewables

The position on renewables remains largely as under the previous Conservative Government. The new Government wants “to maintain our position as a global leader in offshore wind”. However, large-scale onshore wind is seen as not “right” for England. This does leave open the possibility of further onshore wind in Scotland. There is also explicit backing for wind projects in the remote islands of Scotland.

Implicit in the wording about focussing on “outcomes not means” is that meeting the 2020 EU Renewable Energy Target will be less important going forwards. However, the Government will continue to seek to meet its “global commitments on climate change” (i.e. those in the Paris Accord) as well as the Carbon Budgets under the 2008 Climate Change Act (although the DUP may constrain the scope for radical measures on tackling climate change). There is also a commitment to tackle air quality in urban areas.

Shale Gas

The manifesto set out ambitious plans on shale gas, seeking to repeat what has happened with the “revolution” that has taken place in the US on shale. To achieve this, the manifesto set out plans to “change planning law for shale applications”, “set up a new Shale Environmental Regulator” and change the proposed Shale Wealth Fund so local communities get a higher share of the benefits.



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However, this may not be possible now, given these reforms are bound to prove controversial, especially with Labour saying they would ban fracking.

Upstream Oil and Gas

There is continuing support for maximising economic recovery from the North Sea – something on which all the main parties agree. But there is also recognition that the North Sea will be the first major oil and gas basin to decommission fully. For the Government, this presents an opportunity to develop “a world leading decommissioning industry”.

Nuclear

One surprising omission from the Conservative manifesto was any mention at all of the role that nuclear power plays in delivering security of supply and helping decarbonise the power system. There has been no public statement setting out a change of policy from previous Government statements about the importance of nuclear. The forthcoming Emissions Reduction Plan will be an opportunity to clarify the position of the new Government on nuclear power.

Critical National Infrastructure

As confirmed in the Queen’s Speech, the Government plans to revisit what is defined as ‘Critical National Infrastructure’. It has highlighted energy infrastructure as one of the areas that will be reviewed. This is broadly in line with the statements made by the Prime Minister following the review of the Hinkley Point C decision back in summer 2016.

Brexit

On Brexit, the manifesto repeats previous statement made by the Prime Minister that the UK will be leaving the Single Market (and therefore implicitly the Internal Energy Market), but seeking a comprehensive free trade deal to secure access to the European market.

It remains to be seen whether this stance changes now in light of the new political reality. But it seems unlikely that a comprehensive new free trade deal covering all aspects of the economy (including energy) can be negotiated by March 2019. So, as highlighted by the Chancellor in his Mansion House Speech, transitional arrangements are likely to be very important in maintaining confidence that tariff-free harmonised trading of gas and electricity can continue post March 2019.

Ministers and Institutions

Greg Clark remains as Secretary of State for BEIS, which will provide a degree of continuity on the energy brief. With Nick Hurd moving to the Home Office, Clare Perry has taken over his role at BEIS at Minister of State level. Richard Harrington is Parliamentary Under-Secretary of State and Lord Prior of Brampton remains Lords Minister.