

10 September 2001

Project Scoping Note – Energy Policy

I am grateful for the opportunity to comment on the Project Scoping Note published in June. United Utilities is a significant player in the energy market. As well as providing electricity distribution services in the North west of England, we also have a growing Green Energy business which has interests in a number of renewable generation technologies. We are therefore able to comment both as an established infrastructure provider, and as a developer anxious to contribute further to the introduction of more sustainable forms of generation.

We recognise the difficult issues raised in your scoping note, and support the need for a project to establish clear guidelines for the future of energy policy. We also think it is appropriate to look ahead for almost fifty years in order to identify the longer term challenges that will have to be faced. This also has the advantage of extending the review period beyond the life of most of the existing infrastructure for energy production and distribution. The main purpose must however be to provide a framework within which policy over the next five to ten years can be established.

In this regard we feel that the scoping note has identified the key questions to be addressed. These can be seen as falling into three sections:

- accessibility
- sustainability
- affordability

Accessibility would cover not only the security of adequate sources of energy to meet anticipated demand, but also the means of delivery. A reliable supply probably requires diversity of source and will also be dependent on a resilient means of distribution. It is important that this aspect of security of supply is not overlooked. It will be necessary to take account of likely changes in the volumes and types of generation plant on the transportation infrastructure for gas and electricity. Changes in the design characteristics of networks can take many years to implement, and need to be supported by a consistent regulatory framework offering continuing incentives to invest.

Sustainability will need to reflect growing concerns over the impact on the wider environment of continuing reliance on carbon based fuels. Over the next fifty years we should be making significant strides towards stabilisation of the levels of emissions of greenhouse gases. In particular we note the Royal Commission on Environmental Pollution recommended that, by 2050, carbon dioxide emissions should be reduced by 60%. There is a clear role for improvements in the efficiency of energy usage to reduce the underlying demand for all forms of energy, but changes must also occur on the supply side. It is clearly not possible now to predict all the technological developments that will occur over that period. However, we need to create a framework which will encourage innovation and help to support emerging technologies, until they have reached the stage where they can compete effectively with established sources of energy.

Under **affordability**, we would expect there to be consideration of the speed with which changes in the energy market can be achieved without causing price shocks that would have unacceptable social consequences. It will also be important to identify what are the true total costs to society of using energy derived from different sources and establishing who should bear those costs. By recognising the full cost of energy use, it will be easier to create appropriate incentives for the careful use of energy resources.

Approach to the project

A significant part of the project will therefore need to be devoted to assembling background information on future scenarios, so that the areas where government intervention may be needed can be more clearly identified. We hope that this will allow a broad vision of the future development of energy markets to be described. This should include as much quantification as possible, including interim milestones, which will be of more use in trying to set targets for the shorter term. The detailed development of policy can then focus on the means to achieve those milestones. In this regard, we believe it will also be important to devote time to the consideration of the policy instruments available to government. In the recent past there has been increasing emphasis on the role of markets to secure broader policy goals. However, we are mindful of the impact that recent events in California have had on public opinion on energy related issues around the world. It is therefore necessary to review objectively what has happened in the western USA, to see what lessons there are for energy policy makers in other countries. It is easy to assert that similar conditions could not exist here, but much harder to be sure that this will continue to be the case for many years into the future.

The role of markets

More generally we see value in a piece of work to explore the limitations of markets to deal with energy policy matters. We agree that market solutions should be used wherever possible, but we believe that there are limits to the role of markets, particularly where significant externalities exist. This will be the case when the production of a product causes environmental damage and is especially challenging where the effects spread beyond national boundaries. We are also aware that markets do not normally deal with social issues. It may be possible to use market mechanisms to identify a new 'equilibrium position' but no account will be taken of the potential social costs of the change that results. If environmental and social issues are to be tackled within the remit of an energy policy review, it will be important to recognise the limitations of markets in solving problems.

Management of policy

We also believe that there should be a review of the administrative framework, which will support the delivery of policy goals. The existing structure, which separates economic regulation from other aspects of government policy has secured substantial benefits in terms of price reductions for customers. However it is becoming increasingly clear that tensions will arise when the policy objectives go beyond price. We can already see elements of this in the Utilities Act requirements for guidance on social and environmental issues. We see more scope for potential conflict as the public interest in quality and security of supply leads to calls for enhanced investment programmes that are difficult to reconcile with a continuing drive for lower prices. The companies that will ultimately deliver the policy objectives need to receive unambiguous guidance on the direction the market is moving. This will be assisted by improved clarity of the broader regulatory framework, including the links between the sector regulator and the wide range of government departments with an interest in the energy sector.

I hope that you find these comments helpful. We intend to follow closely the work of the Performance and Innovation Unit over the coming months and will be pleased to contribute further to your project as discussion points emerge.

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Head of Electricity Regulation