THE YEAR IN ENERGY 2018

MORE ACTION OR MORE RHETORIC?

COMMUNICATIONS | STRATEGY | INSIGHT

Last year saw a number of energy breakthroughs. Beyond the political upheaval it was the year offshore wind really came of age and the beginnings of yet another green Conservative rebirth. Energy certainly became more politically salient. This sets up 2018 to be a year of accelerated evolution. Welcome to WA's new report taking a look at what to expect from energy this year.

Recent years have been an exciting and interesting time for the energy sector in the UK. As we start 2018, the sector looks quite different to just five years ago.

Despite ongoing policy problems, competition in the retail sector has been transformed by new entrants, and we sit on the cusp of further change brought by smarter systems and tech innovation.

The UK's energy sector is now more pluralist, far less reliant on investment from the large vertically integrated incumbents. Five years ago, shale gas was coming to dominate the supply side debate, but the industry has not delivered on its promise. Nor has shale managed to maintain the strong political support that would see it through setbacks, delays and controversies: in stark contrast to nuclear which has done just that.

Meanwhile, offshore wind is the undoubted star of the sector: an example of what concerted industry action, major investment, and government support can do to bring a developing technology to maturity.

But while there are many reasons to be cheerful, nothing is ever easy in the energy sector. 2018 sees continuing political risk and reputational challenges. Cost-pressures, government indecision, concerns about retail prices, a shortage of ministerial bandwidth due to Brexit, and ever high levels of public scrutiny will all serve to test businesses and investors.

In each section of this report we present a key takeaway; something for businesses and investors operating in the sector to consider as you plan your communications and public affairs activity. If you would like to discuss the issues facing your organisation, please don't hesitate to get in touch on 020 7222 9500.

I hope you find the report useful and interesting, and I wish you a successful and prosperous year.

Dominic Church | Managing Director

REPORT OVERVIEW AND CONTENTS

THIS REPORT SETS OUT OUR THOUGHTS AND ANALYSIS ON THE KEY THEMES TO EXPECT IN THE YEAR AHEAD. WHAT SHOULD YOU BE WATCHING OUT FOR?

- Brexit negotiations will be dominant: Euratom may be the key flashpoint, but we expect most issues to be resolved only in principle during negotiations and subject to detailed work during a transition period.
- A strong emphasis from the Conservatives on the environment and low-carbon.
- A quiet battle behind the scenes to start to shape Labour's energy policy in earnest.
- Clarity from government on the next CFD auction, and hopefully a better sense of the future outlook for the wider renewables sector.
- Whether government makes any significant progress towards tackling the neglected issues of energy efficiency and decarbonising heat.
- A nuclear sector deal and a renewed push to articulate the role of nuclear in the future.
- A new public row over fracking, this time with less than whole-hearted support from the government and Conservative leadership.
- Detailed work on electric vehicle policy, and filling in of the gaps on smart systems and wider innovation policies.
- A final battle over the introduction and nature of the energy price cap.

BREXIT LOOMS LARGE

2018 is the crunch year for Brexit. If all goes to plan, negotiations will be concluded in October – just nine months' time – allowing for the exit deal to be approved ahead of March 2019. Of course a likely transition period gives further time to work through detail. But key decisions will be made in the months to come and many integral questions for the energy sector remain unanswered.

WILL BRITAIN REMAIN A MEMBER OF THE INTERNAL ENERGY MARKET?

It's relatively unlikely: doing so would go against the Government's clear desire to rid Britain of adherence to European agencies, courts and rules. Some form of EU-UK agreement will be required, and like so much else, we anticipate few final decisions this year; rather a commitment on generalities and a transitional period of remaining in the market while detail is hammered out.

Whatever the exact approach taken, **we expect relatively minimal disruption**. The UK has long been the driver for the market liberalisation now happening across the EU, and there are strong arguments for ongoing economic integration; continuing alignment makes sense. Moreover, there are few market participants and relatively few other stakeholders for whom a fundamentally new approach is a priority. Given the pressures on Government in other areas of Brexit negotiations where a new approach is demanded, we expect all to favour a replication of the status quo, if not the status quo itself.

Nonetheless investors, particularly those in interconnection projects, will want to ensure that BEIS fully understands the implications of market withdrawal.

IS WITHDRAWAL FROM EURATOM REALISTIC?

Britain's withdrawal from Euratom, the European civil nuclear regulator, will continue to cause anxiety throughout the year. Expect a deal on a transitional period for withdrawal, and agreement on as close as possible association for the foreseeable future.

WHAT NEXT FOR EU EMISSIONS TRADING SCHEME AND THE CARBON PRICE?

The UK government continues to be non-committal on the future of UK participation. While UK climate obligations are fundamentally driven by the Climate Change Act, green interests will be keen to ensure that a withdrawal is only acceptable if accompanied by an as-strong or stronger carbon pricing scheme in the UK. The good news for the low-carbon sector is that those Tory voices who would want Brexit to see a tearing down of carbon pricing and environmental ambition are currently weak. Low-carbon interests should be advocating for ongoing participation, or the creation of a robust UK wide trading system.

Arguably the biggest impact of Brexit on the energy sector in the year ahead will be its absorptive effect on departmental capacity. The sector has already experienced problems relating to a lack of capacity at DECC and now BEIS in recent years; departmental cuts have meant that officials have had to be more ruthless in focusing on key policies. A concern is that as we move into negotiations on the future relationship, BEIS will have less and less capacity to devote to issues that are already suffering from procrastination or a lack of focus – energy efficiency, decarbonisation of heat, solar, onshore wind, small nuclear, tidal lagoons and more.

KEY TAKEAWAYS

Businesses will need to fight harder and harder to ensure government focuses on their issues in 2018.

Meanwhile, the sector should take care to consider its positioning regarding Brexit. Investors who feel able and confident to make a positive case for the UK environment post-withdrawal will continue to receive an assured hearing in the corridors of power.

ARE THE BLUES GOING GREEN (AGAIN)?

THERE ARE SOME PROMISING SIGNS: 2018 IS THE YEAR WE WILL FIND OUT FOR SURE.

From the heady days of David Cameron hugging huskies, to the nadir of the 2013 'green crap' row and subsequent onshore wind ban, the Tory leadership's relationship to green issues has not been straightforward. But 2017 saw a pivot-point, as a combination of personal, technological and electoral factors meant that once again, the party started to embrace environmentalism.

As we start 2018, how do things look?

- Theresa May's otherwise hapless reshuffle saw Greg Clark, a pragmatic and consistent friend of low-carbon, stay in place. **The solidly pro-low-carbon** Claire Perry didn't just retain her energy and climate change responsibilities, but had an elevation in status to Cabinet level. Elsewhere, Michael Gove remains in place at Defra, and while not focused on energy issues, is increasingly strident on environmentalism.

- The Conservatives' efforts to regain electoral support amongst 'younger' people, i.e. 18-47 year olds, means that the **environment is being embraced afresh**. Having realised that environmental and related issues (like animal rights) carry sway with younger voters, the party is placing them front and centre. Hence Theresa May's major speech on protecting the national environment, and the endless retweeting of graphics on everything, from banning microbeads to phasing out coal, by Tory MPs.

- This combination of personalities and electoral strategy will act as a bulwark against those who might be pressing for a shift away from 'European' low carbon targets and environmental protection post-Brexit. Indeed, **Theresa May is eager to demonstrate seriousness on international climate change obligations**: a way of showing leadership and responsibility on the international stage as EU withdrawal progresses.

- The economics of low carbon are now looking fundamentally different. With offshore wind prices so low, a huge plank of Tory opposition to the low-carbon agenda has been kicked away. Continuing chuntering from the backbenches about green-costs can be expected, but it is far weakened in tone and influence.

Expect to see more and more positivity from the Conservative government on low-carbon and the environment. It will seek to contrast its action – coal phase out, offshore wind investment, record levels of low-carbon – with Labour's ideology around nationalisation. Industry would be right to be a little sceptical about the Tories' new-found environmentalism, but should encourage it.

The key challenge for businesses in the sector again relates to government bandwidth and ambition. If you are outside of the offshore wind sector, Tory positivity is all well and good but might not pay the bills.

KEY TAKEAWAY

It will be important to find ways to encourage BEIS & Downing Street to learn from the economic success of offshore wind, and the populism of tough environmental action, and to convert that into further action: on energy efficiency, onshore wind, decarbonised heat, tidal and more.

PREPARE FOR LABOUR?

2018 should be the year that businesses engage seriously with Labour party energy policy-making. It is perfectly likely that there will be no new election for another four years. But when an election comes Labour are likely to be in a strong position. The promise of nationalisations and intervention, so far just a high-impact but low-probability event, will become much more real. So there are four years to shape Labour thinking on energy.

Risks are particularly high for the nuclear, retail and distribution industries. Jeremy Corbyn is the first Labour leader since John Smith to be anti-nuclear. While others in the party may have managed to keep the party's 2017 manifesto neutral on the subject, it is hard to see Corbyn signing off on new builds. Without significant work now to shape Labour's thinking on new nuclear, it is not hard to see how disruptive the next general election could be to investment plans. Meanwhile retail and distribution industries will face threats of nationalisation. While perhaps unlikely to be carried out, both face the prospect of major intervention.

The time to build relationships and engage constructively in Labour policy making circles is now. While Labour has not announced a specific Energy Shadow Minister, Dr Alan Whitehead MP remains the leading energy intellectual within the party.

KEY TAKEAWAY

The time to build relationships and engage constructively in Labour policy making circles is now. Especially on the retail sector, consumer prices and fracking.

MEETING CARBON TARGETS: CHALLENGES REMAIN

THE NEWFOUND POSITIVITY OF THE GOVERNMENT ON ENVIRONMENTAL ISSUES MIRRORS THE GOOD NEWS COMING OUT OF 2017.

Last year saw the first day with no coal-fired power since the industrial revolution, and low carbon sources delivering more power than fossil fuels for the first time ever. The offshore wind industry came of age in dramatic style, smashing expectations with CFD strike prices as low as £57.50/MWh. The cost reductions, and industry confidence that further savings are perfectly achievable, point to the future possibility of subsidy free offshore wind.

But it wasn't all positive news. **For investors and businesses operating in other parts of the sector – onshore wind, solar, tidal, wave, nuclear, energy efficiency, low-carbon heat – last year was characterised by indecision and a lack of ambition**.

We can expect a little more from Government in the months ahead on the following:

- Clarity over the nature and available funding for the 2019 CFD auction.
- New proposals on the domestic energy efficiency market.
- Evidence for renewable & low carbon heat scenarios.

At present however, the promised collection of publications, consultations and scenarios feels a little inadequate to the scale of the task ahead.

RE-ENERGISING RENEWABLES

Outside of offshore wind, renewable and low-carbon industries need to engage effectively with government to secure their future. The success of offshore wind has paradoxically created some difficulties for other technologies, particularly those that are less mature. While not impossible, it looks harder and harder to persuade government to provide support at the kind of prices needed to get first-of-a-kind projects up and running. BEIS's procrastination on tidal lagoons – awaiting decision a year after Charles Hendry's review recommended pushing ahead with a project – is indicative of that. The Dieter Helm review of energy costs has been somewhat side-lined by Ministers, but its existence points to ongoing concern about subsidy costs and a determination to extract value for money.

KEY TAKEAWAY

In 2018 project developers and investors need to relentlessly focus on a convincing value-proposition that can overcome any short term concerns about price.

EFFICIENCY AND HEAT

For the energy efficiency and heat sectors, the challenge is more one of focus. The Government has announced it wants all homes to be energy efficient – up to a Band C standard – by 2035. That's a huge challenge, but there remains little sense that the Government is adequately focused on considering how to meet it. The primary focus of rhetoric to date has been on green mortgages. But even if they were given a major, concerted push from government it is hard to see that they will deliver the kind of transformative investment in retrofitting that is required. The same could easily be said for the decarbonisation of heat: BEIS's recognition of the problem is not accompanied by action adequate to the scale of the challenge.

On both heat and efficiency, action is lagging way behind what is required to hit carbon targets, not to mention create better homes and take a lead in key growth industries.

KEY TAKEAWAY

The challenge for retrofitting, energy efficiency and heat interests in 2018 is to build irresistible pressure for action to close the gap, and avoid sleep-walking further towards failure.

THE SURPRISE OF 2018?

It's not always easy to know what's coming next, in the energy sector or in the politics that impacts it. Here are four possible surprises that could shake things up in 2018.

NEW TORY LEADERSHIP

We don't predict a new PM or an election in 2018, but never say never. Businesses exposed to political risk should ensure they have friends and allies in all wings of the Tory party (and Labour), in order to be well prepared for whatever comes.

NETWORK OPERATORS IN THE LINE OF FIRE

Gas and electricity network operators have experienced slowly growing levels of scrutiny in recent years, owing largely to Citizens' Advice Bureau's campaigning on the issue. As Labour continues its rhetoric of nationalisation, the Tories look for more areas where capitalism isn't working, and as Ofgem starts to consult on the next price control period for the networks, could we see opposition to network profits break through to the mainstream? With the price cap maybe taking some heat out of the retail market debate, network profits could be the major flashpoint on costs in 2018.

SUBSIDY FREE SOLAR

The solar industry has had a rocky ride, suffering more than most from stop-start decisions on subsidies and deployment. Last year could be the year it delivers a major breakthrough in subsidy free projects. Such an achievement would create a stir and force developers reliant on subsidy to reflect even harder on their value-proposition.

HINKLEY POINT COLLAPSES

Most expect Hinkley Point to plod slowly onwards. But a 'black swan' event forcing the project's collapse is by no means impossible: a further technological problem at any of the wildly delayed projects using the same EPR reactor, or a scandal involving Chinese espionage. Everyone in the generation sector, particularly other nuclear developers, should have this on their risk-register and be planning what it would mean for them, positive or negative.

WHAT DOES 2018 HOLD FOR NUCLEAR?

The nuclear industry can start the year with a spring in its step. Sure, there has been no great breakthrough in progress at Hinkley Point, and progress on small modular reactors and advanced nuclear has been far slower than hoped for.

But **the nuclear industry has maintained strong governmental support in the face of repeated questioning about its future**. It ended 2017 with a renewed statement of support from government that new nuclear "remains key" to its 2050 ambitions, a commitment to a new national policy statement to enable further new nuclear sites to be developed, and £56m R&D funding for advanced nuclear. The sense of progress has been helped by industry developments, with the regulatory approval of Hitachi's reactor design for use at Wylfa, and the news that the well regarded South Korean firm KEPCO is expected to acquire NuGen.

More than with most technologies, the unique safety and regulatory requirements of nuclear means that the strong support of and close cooperation with government is a fundamental pre-requisite for progress. The industry should therefore be pleased at its current outlook, particularly given the pattern of delays and financial difficulties in recent years.

But the industry continues to face a broader reputational challenge. The traditional case for nuclear has relied heavily, if not entirely, on arguments of cost, scale and the need for baseload. But technological and policy progress elsewhere is gnawing away at these foundations. Developments in offshore wind scale and cost, and ever faster shifts towards smarter grid balancing. Healthy competition in renewables is making the non-competitive negotiations of the nuclear industry look distinctly unhealthy.

The industry is clearly already responding. Its proposed sector deal for nuclear, committing to 30% cuts in construction costs will help maintain support, and it is clear that the government is warming towards, if not committed to, playing a clearer role in financing new reactors. It is possible that the government will also be bold enough to move more clearly forwards on (expensive) small and advanced nuclear. But industry still faces major challenges, particularly when it comes to the crucial question of cost, that need to be tackled head on.

KEY TAKEAWAY

The industry should not ignore the reputational challenges it faces: 2018 is a year to relaunch a bold, positive case for the role of nuclear in the UK's energy future.

RETURN OF THE FRACK

It's five years since fracking dominated the headlines and distorted the energy debate, generating anger from environmentalists and enthusiasm from the Tory leadership in equal measure. The industry has not had the success it hoped for since George Osborne demanded rapid progress and fast-tracked fracking. Indeed, barely a well has been drilled. 2018 is therefore something of a make or break year for the sector.

The signs are not particularly positive. Scotland has banned the technique. Public opinion is at a record low. Embracing fracking with enthusiasm would feel out of sync with the current government's new-found environmentalist standpoint, and has almost completely slipped from Ministers' public narrative on energy. Ominously, Cuadrilla has permission to conduct tests again near Balcombe, the Sussex village which saw environmentalists and local people come together to passionately protest drilling five years ago. The communications challenge for shale developers is arguably as much a deal-breaker as the technical and economic questions about its future in the UK.

This is particularly so as the industry can no longer rely on the highest levels of government to give it strong support. Osborne was a powerful and personally enthusiastic advocate as Chancellor: there is no equivalent cheerleader for the industry in May's government. Ministers are positive but much more nuanced. A push for fracking hardly seems aligned with the government's new embrace of environmentalism.

KEY TAKEAWAY

Has industry learnt its lessons, and embraced better community engagement? Built a stronger, wider foundation of support to enable it to see out controversies? If it hasn't yet, it should start to do so now, or 2018 could be the year that investors and government lose patience in shale in the UK.

WILL POLICY KEEP UP WITH TECHNOLOGICAL INNOVATION?

From blockchain to electric vehicles, the tech revolution in energy continues apace. The energy sector has evolved significantly in recent years: in particular as smart technologies, enabling better grid management, have moved forward. Policy hasn't always kept up with the pace of change, but 2018 should start to see some pay-off from Whitehall's work in the last year.

The Faraday challenge, with £246m of funding behind it, should spurn the development of energy storage that is essential if the UK is to derive more energy from intermittent sources. Meanwhile the Industrial Strategy Challenge Fund aims to make it much easier for pioneering businesses to tap into the talent of the UK's world leading research institutions. This should help spur the development of smart grids, but also finally bring theoretically sensible ideas to practical reality, for example, the broader proliferation of district level heat generation.

Follow through from Ofgem's Smart Systems and Flexibility Plan, published last summer, will also be important. The plan represents a significant step forwards a smarter energy grid. In 2018 it will be important to keep the pressure on the government to deliver, for example finding parliamentary time to define storage as a subset of generation, and to fill in gaps such as in relation to Time of Use tariffs.

KEY TAKEAWAY

As ever, businesses operating at the forefront of technological innovation face a challenge to ensure that government and the wider industry understand and can take into account innovation. In particular Government will soon have to turn its attention to some of our basic physical infrastructure, such as transmission and distribution cables, that urgently need upgrading to enable future technological breakthroughs.

DRIVING FORWARD WITH ELECTRIC VEHICLES

Analysts predict there will be 200,000 electric vehicles (EVs) on the streets by the end of the year. Registrations of new EVs grew almost 30 per cent last year, and the trend is accelerating. But that's still a far cry from the government's ambition for 2040: for all new vehicles to be electric or hybrid. To reach that target much more needs to be done tackle financing, standards and other regulatory barriers to getting charging infrastructure in place.

The key policy development in 2018 will be the passage and enactment of the legislation currently going through Parliament to enable government to regulate and ensure provision of charging points. The legislation is largely uncontentious and we anticipate few political problems, simply a long process to work through and shape the detailed nature of the regulation required. Businesses in the sector should be prepared to get stuck in.

KEY TAKEAWAY

The greater challenge for businesses in the sector may be to continue to shape positive perceptions: there is a risk that if the number of vehicles on our streets continues to grow significantly quicker than then number of accessible charging points and before the grid is sufficiently robust to cope with the extra electricity demand.

DOES THE (PRICE) CAP FIT?

Despite new entrants, enhanced competition, smarter metering and technological innovation, one thing in the energy retail market has not changed at all in the last ten years: there are still far too many customers on expensive legacy tariffs, and no one is really agreed how to deal with the problem.

Back in 2008 Gordon Brown was under pressure to introduce a windfall tax on the Big Six, amidst accusations of profiteering and concerns that the market was not working for those customers on single variable tariffs. Brown resisted such an intervention: in 2018 May is being bolder, making an intervention she hopes will tackle the issue once and for all.

May's price cap policy was developed without consultation with the Cabinet, and as a blunt and interventionist instrument it remains highly controversial among the free-marketers in her party. Industry commentators' scepticism hasn't helped.

Nevertheless, as the year starts, the government is showing no signs of backing down. Unless more suppliers make stronger moves towards a credible solution to the problem of loyal customers languishing on expensive tariffs, a cap should be in place by next winter. But there is a lot to fight for first: the enabling legislation remains in draft form, and after it is enacted Ofgem must consult before implementation. The battle is not yet over.

Industry should not underestimate No 10's determination to push on. May is hoping that the existence of the policy, manifestly a heavier handed intervention than any of the measures proposed or introduced in the last ten years, will blunt Labour attacks on the Tories for failing to protect families from profiteering energy companies.

However the price cap emerges, it will be used in a market that is changing more rapidly than in previous years. The merger of SSE and Npower's retail businesses, and Shell's acquisition of smaller supplier First Utility, are indicators of the changing fortunes of new entrants and some of the old incumbents. Meanwhile supplier innovation is kicking off in earnest, such as Ovo's 'vehicle-to-grid' package that sees the take management of a customer's EV, and draw down on and trade power from its battery at peak times before recharging off-peak. Should the price cap be successful, the start of 2019 might finally bring a more positive outlook for the sector: with more and more competition, supplier innovations, and finally a solution to the SVT problem.

KEY TAKEAWAY

Suppliers need to work hard to maintain their licence to operate: even newer market entrants with better innovation stories can't afford to neglect the basics: demonstrating value, high quality service and transparency on pricing.

HOW WA CAN HELP YOU

ASSESSING THE IMPACT ON YOUR ORGANISATION

An assessment of the immediate political and economic implications of Theresa May's new agenda:

1. The latest political developments and implications for you.
2. How to effectively position your organisation within the developing political, media and policy narrative around energy.
3. A presentation to your senior team on the government's proposals and our analysis.

SUPPORTING YOUR ENGAGEMENT STRATEGY

A deep-dive into your public affairs, PR and communications strategy to help you maximise impact and exploit new opportunities:

1. Review your strategy and stress-test your messaging in light of the manifesto.
2. Make recommendations on how to revise your strategy to ensure it effectively responds.
3. Support in engaging with ministers, government officials and political players.
4. Help you to forward-plan your political engagement against key milestones.

ABOUT WA

WA is the agency of choice for clients with complex public affairs and strategic communications challenges.
WA blends creative, strategic thinking with experience to solve public affairs and strategic communications challenges. We develop and protect clients' reputation, inform the policy debate and help clients get up to speed quickly on the external issues and stakeholders that matter.

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