CSI NEWS

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Renewable Power: Panacea or Mirage?

With great fanfare the government recently announced the awarding of major new licences to developers of offshore wind farms in UK waters. The headlines suggested that they could provide over 20% of the UK's power needs once installed. The small print did mention that these projects might need the odd £100 billion and that money was a bit tight at the moment and that nothing much would be completed for another four or five years! At the time of record gas and power use in those frozen two weeks at the end of December and the beginning of January, the 5% of our generation capacity that was theoretically available from wind supplied just 0.1% of demand. It is an unfortunate fact of life that the high barometric pressure that led to the very cold weather also means still air!

So what is the reality?
What is quite clear is that the UK has the urgent need to develop new power sources: much of the older coal fired generation capacity is supposed to come off-line within the next three to five years and only Sizewell B of the nuclear plants has a long term future. But with the current low price on carbon and the uncertainties of the post-2012 regulatory regime, new gas-fired capacity is all that is really in the planning stage for the moment. Low natural gas prices and record proven reserves make the economics of CCGTs look increasingly attractive and sustainable in the long-term to those investors in the power market who are short of capital and worried about regulatory uncertainty. Political hiccups in the Ukraine make one cautious but various alternate pipeline options are being developed and at the end of the day Russia needs the cash from gas sales as much as Western Europe needs the gas [*see page 2 for an analysis of the Ukraine ~ Ed*]. Fortunately alternate supplies of LNG are also coming on stream which will diversify supply further and shale gas looks increasingly attractive. However, because of the intermittency of wind power, we will need the gas or some other fossil fuel generation as a back-up anyway!

So what's the problem?
In a word - money! Add to the cost of wind development the need to rebuild and extend the high voltage grid, the addition of smart meters to households and the cost of building 6-8 new nuclear power plants and you are talking about very large sums of money - let's say up to £200 billion. In round figures that is about £10,000 per household or £1000 per house per annum for the next decade! It is all very well to expect the industry to develop these new power sources to meet their regulatory supply obligations and for the general public to harvest all the opportunities for gains in energy efficiency and the reduction of carbon emissions, but today the reality is that the money is not there and the returns are too uncertain. Making unloved utility companies more profitable so they can generate the cash is not a popular cause. To put the amount in context, £20 billion per annum compares with the UK defence budget of around £35 billion per annum, so a tax-payer solution looks unlikely too.

What might happen to square the circle?
We need to get through the election because this is in the "too difficult" category, but it is clear to all politicians that continuing as before is not an option. We will begin to see the incentives for renewable energy being selectively increased - and to some extent we have seen that beginning. The new Infrastructure Planning Commission may begin to get more actively engaged. There will be great pressure on the utilities themselves to raise prices to boost their cash resources, but borrowing needs may push up interest rates. But don't expect to see any reduction in retail gas and electricity prices anytime soon if we really do want clean energy in the future!

Edward Libbey, etl@cliveandstokes.com

Once again, welcome to the latest edition of our occasional newsletter, CSI News. The day I write this welcome note sees the publication by Ofgem of their doubts "*over whether the current energy arrangements will deliver secure and sustainable energy supplies*" and the possible options to find the £200 billion needed to keep Britain supplied with power. All food for thought and one that we've already considered.

You will already have seen above the piece by one of our energy specialists, Dr Edward Libbey on the question of how renewable power fits in with that investment, but we also include an analysis of the Ukraine for the UK and European energy needs by another of our energy specialists Andrew Lees. We also have a rather controversial article by our Board and finance specialist John Collier on the question of the efficacy of non-executive directors. All extremely interesting and all reflecting the depth of knowledge and experience of our consultants.

As always we would be delighted to hear your comments and views.

Gavin Hyde-Blake, ghb@cliveandstokes.com

This and our previous editions are all available from on our website at www.cliveandstokes.com/downloads.

NEDs: the shallow gene pool?

For many years independent non-executive directors (NEDs) have played an important role on the boards of the UK's listed companies. They took centre stage after the Higgs Report was published and implemented in 2003/04 and were at the core of the UK's response to the demise of Enron and the crisis in corporate governance in the early 2000s.

Are our current NEDs past their prime?

John Collier would like to hear your views at jc@cliveandstokes.com

But there has been a lot of criticism of their effectiveness in the last 18 months. There were highly experienced NEDs sitting on the boards of all the financial institutions that failed or got into difficulties, but they did not or could not stop the events that led to the crash.

There is no simple explanation, but some concerns are emerging about the lack of up-to-date experience of many NEDs and the breadth and depth of the pool of talent from which most of them are drawn. We may change the Combined Code and introduce new board committees (the Risk Committee being the latest addition) but the people who sit on our listed company boards and committees are much the same as before. There is a perception that (perhaps) too many NEDs are retired executives rather than current executives from other businesses, applying their knowledge and experience in different environments. Put another way: are many of our current NEDs past their prime?

The reasons for this shallow "gene pool" of talent may lie with Nomination Committees, who can be very prescriptive and for example, always insist on prior board experience in the NED candidates they review. This creates a vicious circle - you need to be or have been a NED to get another NED appointment!

The fault might lie with head hunters who are not creative enough - although they work to a client brief and ultimately get paid for doing what they are asked to do. It might also lie with companies themselves who do not encourage their senior executives, perhaps leading major divisions just below main board level, to look for and take on outside NED roles. The experience for the individual, the ceding company and the receiving company could be hugely valuable.

The same problem - a shallow gene pool of talent - could also be said to apply to board chairmen too. Many if not most chairmen are former CEOs and have their main careers behind them. There is perhaps a case of for a different model, with highly experienced but younger executives taking on a small portfolio of chairmen appointments. One problem might be that the financial rewards for a chairman are usually considerably less than for a successful CEO.

Do you believe that there are issues to be addressed here and that the reasons suggested have some merit? We would like to hear from you.

John Collier, jc@cliveandstokes.com

Ukraine & Europe's energy security

The Ukraine is of fundamental importance to the UK and EU energy future. It is of strategic importance as its geographic location makes it the most practical route to transit oil and natural gas from Russia and the Caspian Sea to European markets. It hosts four international gas pipelines, and 80% of Russia's gas exports to Europe pass through Ukrainian territory. Additionally, around 16% of Russia's oil exports to Europe transit through Ukraine.

This importance of Ukraine as one of the world's top transit countries has been brought into sharp focus in recent years as the gas disputes between Russia and Ukraine have escalated, with the ensuing impact on European consumers. The cycle of Ukrainian indebtedness provoking reductions in Russian supplies, in turn leading to unauthorized diversion of the volumes in transit to European countries has become depressingly familiar with the EU coming to the view that neither Russia nor Ukraine can be regarded as reliable guarantors of energy security.

How, therefore should Europe and the West view the recent gas agreement between Ukraine and Russia, brokered by Prime Ministers Vladimir Putin and Yulia Timoshenko? How also should the EU view the crushing defeat of the pro - western incumbent President, Victor Yushchenko, who barely mustered 5% of the vote at the 17th January polls?

Regarding the gas supply agreement, Russia, in reality, offered only one major concession in opting to waive penalties for non observance of the 2009 agreement and the new price regime benefitted both sides equally. More critically, the likelihood of a default in payments on the Ukrainian side is still high as is the potential for Russia seeking to exert pressure on Ukraine via carefully planned political manoeuvres. In short, it is premature to see this as a major step towards Europe's energy security.

Yushchenko's downfall would seem to be largely of his own making. His divide and rule policy has led to political deadlock whilst the constitutional amendments introduced after the Orange revolution of 2004/5 were ill conceived and have only served to curtail the powers of the presidency, leading to political instability, of which the electorate has grown weary. The economy has been hard hit by the recession, contracting by 16% and it is for this, more than for his antagonistic attitude towards Russia, that he has been rightly judged at the ballot box.

Paradoxically, though, Yushchenko's abysmal showing in the polls is an indicator of how far Ukraine has come. There is a genuinely free media, the parliament is not a mere rubber stamp for the executive power and the recent elections have been seen to be clean. This all adds to a growing consensus that Ukraine's future belongs in Europe, although not necessarily in NATO or the EU. Furthermore, contrary to popular misconception, neither Yulia Timoshenko nor her rival for the presidency in the second round runoff (Feb 7), Victor Yanukovych, are staunchly pro-Russian. More correctly, they are pro-Ukrainian and backed by financial groups with a vested interest in greater integration with Europe.

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