FT European Gas Conference

23 October 2014 - Sam Laidlaw, CEO

Thank you Ed. It is a pleasure to be back here at the FT European Gas Conference, although it is also with great sadness following the tragic death just a few days ago of a great friend, Christophe de Margerie. He was a very original and gifted person, a strong spokesman for the oil and gas industry and he will be sorely missed by many of us. Our thoughts are with his wife, Bernadette, and his family.

This conference is an event which continues to provide valuable insights into the latest developments in our industry and global energy markets. It has been a key event in my calendar since I became Chief Executive of Centrica a little over eight years ago. So I am pleased to have this opportunity to share with you some of the perspectives I've gained over those years, especially on how we can create sustainable and affordable energy policies.

Your timing is, as ever, impeccable. We meet here as wholesale energy costs register a significant downward shift. It is a development which has taken some observers by surprise and it reminds us that market forces are unpredictable, with implications for many of the assumptions that underlie energy policy across Europe.

Crude oil - on both main measures, Brent and WTI - is now trading below 90 dollars barrel, touching levels last seen in the immediate aftermath of the global financial crisis in 2009.

Wholesale gas prices too have fallen this year, with gas for delivery in Winter 2015 trading at little more than 60 pence a therm. Other components of the typical household energy bill continue to rise in cost – especially network charges, environmental levies and the price of carbon. But it is undoubtedly the case that lower oil and gas prices are good for consumers and will also benefit European economies by reducing input costs for industry and business.

There's much debate about whether the fall in oil and gas prices is a temporary correction or a long term trend. One key factor behind the move has been the slowdown in economic growth in developing markets this year, particularly Asia. That has also meant slower demand growth. Spot prices for gas in the Asian region have come off sharply. But that trend can soon reverse when economic growth revives.

Gas prices in Europe have fallen too, driven by soft demand, high levels of storage and warm weather. This comes in spite of external shocks, in particular Russia's intervention in Ukraine. In Western Europe we are less dependent on this gas transit route than we used to be. Nevertheless, geopolitical shocks still have the capacity to reverse the downward trend in energy prices and to do so with little warning. So we cannot be complacent on that score.

However, there are some longer term factors behind the recent fall in oil and gas prices. Shale gas is the most obvious example. With the US moving rapidly towards energy self-sufficiency and the first North American shale exports scheduled to begin late next year, the dynamics of the global energy market are changing. New supplies are coming on stream around the world and new LNG projects are delivering them to market. So supply is increasing as demand growth slows.

The other long term factor underpinning the fall in wholesale energy costs is increased energy efficiency. We still have a long way go in improving our use of energy. But there has been progress. UK gas consumption has been declining by around 4 per cent a year and continues on a downward path.

So questions remain about whether lower wholesale energy costs are a blip or something more structural. What is clear though is that some of the assumptions we have made in Europe about sharply increasing fossil fuel prices need to be revisited. That in turn prompts the question of whether policymakers should reconsider some of the choices they have made about energy.

Let's take power generation as an example. In a properly functioning market you would expect to see lower input costs from falling fossil fuel prices reflected in lower output prices from power stations. This has indeed been happening and, in its most recent forecast, the UK's Department of Energy and Climate Change revised down its estimate of power prices over the rest of this decade by as much as 20 per cent.

But energy consumers will be puzzled to learn that they are unlikely to enjoy the benefit of those lower power prices. That's because of the choices made by successive UK Governments about which renewable and low carbon technologies to prioritise and how to incentivise them.

Take the Contracts for Difference on offer to developers of renewable energy projects. I am not questioning the need to develop alternative sources of power or to cut the carbon emissions from our electricity. But a UK offshore wind project coming on stream in 2018 will be guaranteed a strike price of £140 per Megawatt hour. That compares to an estimated market reference price for power in 2018 of just over £50 per Megawatt hour.

By the end of this decade, under current plans, consumers will be spending £7.6 billion a year through the levy control framework, much of it to support wind turbines that have not come down in cost. It is only natural for UK bill payers to question why they are being faced with the prospect of subsidising power prices which are well above the market rate. They will also ask whether this is a cost-effective and sustainable way of reducing carbon emissions.

Affordability must be the watchword if we are to achieve an energy policy which is both green and sustainable, because without popular support it will fail. But we are in danger of falling short on all counts.

This year the UK is launching a capacity auction to provide back-up generation for intermittent renewable sources. The expectation was that this would incentivise the building of new gas-fired power stations. But look through the pre-qualification lists published a few weeks ago and it is clear that old, dirty coal stations will be paid extra to stay online for longer. The cost of this will be levied on customers' bills, alongside the cost of the carbon price floor, which is designed to encourage switching AWAY from coal. There's an inherent paradox here.

So how do we get to a sustainable energy policy? Above all we must be straight with the public and honest about the costs. There is no magic silver bullet. In the real world there are trade-offs that have to be made between decarbonisation, security of supply and affordability – the energy "trilemma" of our time.

It's a tough puzzle to solve. But essentially I remain optimistic. There IS a practical and achievable way to meet our long term carbon reduction targets without placing unnecessary costs on households and businesses. At Centrica we set out our thinking on these issues in the "Energy Choices for the UK" report which we published earlier this year.

There are three simple principles we should follow. Firstly, we should take the most cost-effective, lowest-regret options. This keeps choices open for the future and builds confidence that investment won't be wasted.

Secondly, we must set very simple carbon reduction targets. The UK's Carbon Budgets provide a useful guide towards our long-term goal of cutting emissions by 80% by 2050. Let's not clutter up the roadmap with a lot of intermediate targets that simply add unnecessary cost to the system.

Thirdly, we must support those most affected by the cost of energy, whether they are vulnerable households or energy intensive industries. Government schemes funded through energy bills are paid for by all customers, including those on low incomes. Funding these in alternative ways, through general taxation, would help to avoid socially regressive outcomes and be more transparent for the consumer.

What will this mean for the UK's energy mix?

Well, it means recognising that some forms of renewable electricity are just very expensive. Offshore wind, as I set out earlier, requires three times the current wholesale price. We do need renewable electricity, but renewable heating could be more cost-effective, and so should be prioritised too.

We must make energy efficiency a priority. I know I have made this point many times before. But if there is any legacy I hope to leave as Chief Executive of Centrica from my contribution to the energy debate, it is a wider appreciation of the difference that energy efficiency can make.

There has been progress. Over the past 6 years, British Gas alone has insulated more than 3 million homes and fitted more than half a million energy efficient boilers. Despite this, large swathes of our housing stock still need urgent improvement. But some measures pay back better than others. Solid wall insulation has a role to play in limited circumstances. But dealing with the remaining loft and cavity wall opportunities is more cost effective, and there are much bigger opportunities for energy efficiency gains in the business sector.

Perhaps the most important aspect of energy efficiency is the help that we can give people to take control of their energy use. It is in this area - where new technology is transforming the landscape - that I believe the biggest savings can be made, with beneficial consequences for customers and suppliers alike. As we have seen with the advent of the smartphone, technology can shift human behaviour.

With old-fashioned meters and a monthly direct debit payment, it can often feel that you pay the same amount of money each month, regardless of how much you boil the kettle or how often you leave the heating on. For many customers, there is a real disconnect between what they use and what they pay. Without reconnecting the two, how can we expect customers to trust that their bills are accurate? But if they can see that their behaviour and consumption directly affects the amount of money they pay, then I believe we can really begin to rebuild trust in our industry.

British Gas has installed more than one million residential smart meters in the UK, giving customers more control over what they spend, as well as enabling flexible time-of-use tariffs. And innovative products like our Hive smart thermostat, which lets you control your heating through your mobile phone, are changing the way we use energy.

Being able to see on your phone (wherever you are) how much you have spent and how much energy you are using changes the game. It can help people to cut their bills. It can help people understand how to use less. And it can even mean we need to build fewer power stations.

Our own trials of time-of-use tariffs, for example, show that household peak demand could be reduced by some 9.7%. Scaling this up could avoid Britain needing to build more than 2 Gigawatts of generation capacity. That's three new power stations we won't have to build and pay for.

During my time at Centrica I've witnessed some seismic changes in the world of gas, if you'll forgive a rather bad geophysical pun. The shale revolution in North America and the full scale development of LNG as an effective means of transportation have both been transformational on the supply side. As a business, we have invested some £14 billion in securing new sources of energy for our customers. Equally transformational, I believe, over the next ten years will be the impact of technology and innovation on the demand side.

Energy policy too has undergone a massive shift of emphasis over the past decade. It has now become the principle means by which Governments in the developed world seek to tackle the effects of climate change. Unfortunately, policymakers are seldom better equipped than anybody else at predicting markets or new technologies. Interventions often add complexity, with unintended cost to the customer.

So my parting observation today is that, if energy policy is to fulfil this role, it must be sustainable, and not just in the environmental sense. Policy that chops and changes, or tries to pick technologies, doesn't deliver investment. Policy for the short-term cannot deliver long-term goals. Policy that doesn't have public support - support ultimately from those who will pay for it - isn't sustainable. The challenge for Governments is to have an honest conversation about our precious environment and to set a framework that has broad support. Then let the markets and innovation deliver. Thank you.