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Senior Energy Lawyers Networking Luncheon 5th May 2005

Cripps Sears & Partners 4th bi-annual Networking Luncheon for Senior lawyers with an interest in the Energy sector was held on *Thursday 5th May 2005* at The City of London Club.

The luncheon was attended by representatives of UK and US law firms and multi-national energy companies.

***Note:** The Chatham House Rule applies at our lunches. Accordingly this note seeks to summarise the points made during our conversation without attributing them to individual attendees. The note is not exhaustive and does not necessarily reflect the views of Cripps Sears & Partners. Apologies for any omissions or unintentional inaccuracies.*

1. Nuclear new build: is this an inevitable consequence of the UK's Kyoto obligations and future energy mix/security of supply concerns?

The last new build nuclear plant was Sizewell B in the late 1970's. Short of covering the country with wind farms there is no alternative to nuclear. The planning life cycle means that there will not be any new build within the present government's electoral term. The next government will then have to endorse it in order for it to continue. This requires a degree of continuity that is by no means guaranteed. The public does not favour any technology; environmentalists argue nuclear is too expensive and hence will drain resources from other sources. This is a huge political issue.

Apparently there is a discussion about carrying out these projects on a PPP basis because issues such as insurance are such big stumbling blocks.

Someone made the point that there is a bountiful supply of gas and why should we invest in building new nuclear power stations when LNG may provide the answer? There is a lot of it and there is a global market as there is also for oil. On the other hand, the security of supply issue says we do not want to rely on gas from the Middle East and Russia, hence nuclear is a safer option. Furthermore, there is apparently a new nuclear technology 'EPR' (European Pressurised Water Reactor), which provides a safer and more productive answer. Europe is embracing this technology; the Finns are building nuclear power stations, as are the French. As a great deal of our power is coming from overseas we are already getting a significant proportion of our electricity from nuclear sources – does this weaken the anti-nuclear argument?

Others made the point that the discussion of nuclear vs. renewables is a false one. We should be looking at all sources: nuclear, wind, hydro, waste etc. Nuclear is definitely back on the agenda as part of this package. However under the current liability regime it will take a significant change in the financial and political structure to persuade (even under a PPP participative programme) funders and sponsors that it has sufficient upsides.

2. Election Day – What are the likely implications for the Energy industry? What would be the cornerstone of your manifesto?

The size of the majority is the key. The Labour government has had enough problems with the huge majority it currently enjoys. At this stage attendees offered various predictions regarding the size of the electoral majority ranging from 60-90; to some who expected the majority to be over 100. It was widely felt that an effective opposition would make a real and positive difference to the political landscape. Tony Blair's ability

to retain power has been remarkable although in the face of rather impotent opposition.

Energy has not really been on the agenda for the election – reliability or security of supply has not been an issue such as it was in the US.

Attendees agreed that the government was increasingly likely to become participative in the energy industry. If the government wants to, as it seems to, create new infrastructure, a public private partnership initiative will be necessary and there is quite some momentum to encourage new investment. It will be interesting to see how things work under Gordon Brown, particularly with the up and coming G8 conference where he may encourage increasing international commitment to the Kyoto Protocol.

In the face of very large geo-political issues, it is difficult to predict how important the international agenda will be, and who our friends and enemies will be. Russia and the Middle East continue to be dominant powers particularly in oil and gas.

3. Likely trends: further vertical integration and increased M&A activity within the energy market?

Currently the smaller firms are 'doing better' than the majors. Horizontal consolidation seems more likely than vertical integration. Others felt they were more likely to see a diversification across the utility industry and one attendee cited RWE as an example of an organisation likely to divest themselves of various non-core parts.

There has not been much recent M&A activity as sellers are not in ready supply whilst product prices remain good. Buyers are concerned that we are currently at the top of the market. On the other hand the Chinese, Japanese and Indians are looking at acquisitions, examples being Oil India ONGC, and Reliant on the power side. Those and other Asian entities are 'cherry-picking' around the world, looking for an ensured rate of return from network or regulated industries – they are looking for a safe rather

than a sexy rate of return. These companies are 'awash with cash' and are looking for safe places to put it. This is not indicative of a trend of vertical consolidation, just one of opportunism.

There is a possibility that the oil majors are going to get more involved in power distribution – Shell and Exxon both have power distribution businesses. Some are building power stations for oil and gas rather than coal as this allows them to control the distribution chain.

There was some speculation as to who might be a target in the market. The name 'BG' was mentioned and cited as an example of a very successful organisation that maybe too small to sustain its current development levels. As a result it is regarded as an organisation that would be very attractive to many others (although possibly a little pricey currently).

4. Do we need to import gas in the UK or is it out there but under exploited until the price is right?

The overriding opinion was yes. But where from? Norway may be the next point of call although that will only postpone the supply problem for 10-15 years. Russia and Algeria are examples of other places we may look to.

The best method of transportation is by ship. However there are a number of planning law restrictions in relation to the construction of LNG terminals. The 'NIMBY' argument is strongly against the construction of such terminals although there has been some progress at Grain and Milford Haven. If we are careful where we locate these terminals then they may provide a viable solution for the future. However, due to these planning constraints this is not a speedy process and, accordingly whilst finance may not be an issue, local governments may be.

The Wytch Farm development is located offshore at Poole Harbour. The local authority was up in arms when it was proposed. However, a BP-led consortium has made it happen. The LA has actually found that visitors to the area have increased dramatically as a result because of the number of people wanting to see a 'real oil rig' up-close. So it is very hard to tell what effect such developments will have on the local environment.

Is there additional gas to be found in the North Sea?

If the price of oil is high this will bring gas from Norway quicker and further exploration in the UK North Sea. There is no problem with supply - gas will get here via pipelines if the price is right. The bigger issue is the oil price - as it continues to remain high it will bring gas to the country. Furthermore the globalisation of the LNG market will ensure a steady supply.

Many thanks to all those who attended. The next luncheon will be held on the 10th November 2005.

All those interested in attending should email Vicki Chung at vchung@crippssears.com

Best regards,

***Andrew Somerville
Cripps Sears & Partners***