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Briefing note December 2012

Government Publishes new UK Gas Generation Strategy

The Government has published a Strategy[1] setting out the role for gas generation in the coming years. Gas is seen as an essential element of the gradual decarbonisation strategy for UK electricity generation, in particular as a useful lower carbon alternative to the generation flexibility offered by coal.

Based on the currently established carbon budgets and a diversified electricity mix, the Government suggests that up to 26 GW of new gas generation capacity might be needed by 2030 (with up to 9GW required this decade) to avoid a looming energy gap. The Government states that this significant increase from the 10-20GW estimate produced at the time of the Carbon Plan in 2011 results partly from increased electricity demand due to a higher extent of population and transport electricity demand, and greater levels of retirement of existing capacity. However, the Government has previously proposed to review its fourth carbon budget to ensure that UK carbon reductions do not exceed those in the EU (a policy it again confirms). Assuming that the fourth carbon budget might increase at such time, the Government suggests that nearer 40GW of new gas generation capacity may in fact be needed by 2030.

The Government believes that current over-capacity and uncertainty over the ongoing outlook for gas is a deterrent to future investment. Further measures are needed to address investment barriers. On the financial side, a number of measures are already in place or being considered to improve this including the review of electricity "cash-out" arrangements and the proposed Capacity Market among other Electricity Market Reform measures.[2] In an attempt to provide further comfort to investors on the future profitability of gas generation, the Government has decided to set a cap on the Levy Control Framework up to 2020 of £7.6 billion per year (real 2012 prices) in 2020-21 (the framework controls the total amount of financial support provided to low carbon and renewable generators through levies on consumers).

The Energy Bill will also include powers to enable the Government to address problems with lack of liquidity in the wholesale electricity markets and reduce barriers to entry associated with the power purchase agreement market. Particular barriers have been identified for the "combined heat and power" sector due to the need to procure both long term power purchase agreements and heat supply contracts to obtain funding. The Government has announced that CHP projects will qualify for Green Investment Bank funding as a result.

Measures to combat other barriers to gas have already been announced including increased flexibility to use the "Section 36" consenting processes for changes to plant, and a consultation on changes to the Planning Act 2008 consenting process for major infrastructure projects to make the framework more of a "one-stop shop" for consenting.

The Government is also considering whether additional measures are required to encourage storage of gas and will publish conclusions in Spring 2013.

Shale Gas

The Strategy notes the significant potential for shale gas in the UK and the possible benefits for the economy. The Strategy notes that shale production would need to be subject to a robust regulatory framework to ensure production does not cause unacceptable safety and environmental impacts. The Department of Energy and Climate Change is, however, continuing to assess the environmental implications and will conduct a full consultation on this assessment before any decisions are made

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[1] Gas Generation Strategy – Department of Energy and Climate Change

[2] See our client briefing: Energy Bill : A milestone but still more work to do

on new licensing. Interestingly, the Strategy suggests that the Government does not believe climate change impacts of shale gas production will be significant.

The Government will now set up an "Office for Unconventional Gas and Oil" to co-ordinate a streamlined regulatory process. The Government will also discuss the most suitable approach to licensing with potential licence holders with a view to finalising its thoughts by mid-2013. The Strategy also notes the ongoing work to create a tailored tax regime for shale gas exploitation; a report will be given at Budget 2013.

Carbon Capture and Storage (CCS)

The Strategy welcomes the interim findings of the CCS Association's Cost Reduction Task Force that CCS is capable of being cost-competitive with other low carbon generation by the early 2020s. In particular, it is thought that sharing of pipeline infrastructure will be crucial.

The Government has confirmed that it will maintain its requirement for new gas generation plant over 300 MWe to be "carbon capture ready" to avoid locking in high carbon intensity generation for the future.

The Government is now considering whether further investment in supporting CCS infrastructure is required beyond the CCS commercialisation programme and whether any other measures are needed to combat barriers to investment.

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