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The Challenging Decade

No one can be in any doubt that the UK energy markets face challenging times in the coming years: carbon reduction, ageing plant, a changing portfolio of generating assets and a mismatch between transport infrastructure and generating assets. For an industry that requires substantial investment (the typical figures quoted are 20-30GW of new generating capacity and £200bn of investment by 2020) are the investment signals in place or are we sending mixed messages?

The Government published in June its finalised energy National Policy Statements (NPS) confirming plans to have 8 new nuclear power plants in operation before the end of 2025. The sites deemed suitable for new power stations are all adjacent to existing nuclear sites. With around a quarter of UK generation capacity due to close by the end of the decade, the purpose of the NPS is to set out the UK's energy requirements and inform the planning process.

However, perhaps the greater challenge for the Government will be delivering energy market reforms that provide stability and encourage investment in UK energy infrastructure (no mean feat especially considering that the majority of the Big Six are in foreign ownership). There is genuine concern that banks will avoid financing nuclear projects perceiving the financial risks too great. Even Centrica's Hinkley Point project, scheduled to be built by 2018, has been delayed to an unknown date.

And its not just investment in new capacity that is required but also in the Grid infrastructure. With an increasing proportion of UK energy coming from renewable sources the Grid infrastructure needs to evolve to support this portfolio. National Grid has reported that with around one quarter of electricity coming from wind and marine sources it may require as much as a threefold increase in its balancing options which may include

- Flexible Generation
- More European Interconnectors
- Improved Storage facilities to act as sinks for wind
- Flexing usage through demand side bidding and smart grids.

2020 is constantly heralded as the crunch date but inadvertently it an attempt to stimulate investment (and support nuclear), the Government may have made things worse. The introduction of the Carbon Floor Price in 2013 (at a level and date that was not anticipated by industry participants) has brought forward the closure date for a number of older generating plants. Those assets that had opted out of the Large Combustion Plant Directive had been scheduling their generation to enable them to run until the set closure dates in 2015. However, the carbon floor price will now incentivise these units to front load their generation meaning they will now close in 2013.

The Carbon Floor Price, along with other 'carbon combating measures' may also create 'carbon leakage'. The Floor Price has already been priced into the UK Power forward curve and the CBI warned this month that it was putting the UK's energy intensive industry at a serious disadvantage. Higher energy costs along with the CRC tax on business as well as the higher taxes on oil and gas output will substantially affect UK business' competitiveness forcing some to consider taking their operations overseas.

At a time when the Government is struggling to stimulate economic growth and encourage a healthy trade position it seems that the policy makers need to now more than ever agree priorities and deliver a joined up approach. The signals need to be clear, unambiguous and avoid creating conflicting incentives. The Energy White Paper is expected later this month. In the meantime we wait and while we may not know all the answers or anticipate the impact policy may have on markets, we can manage risks. For energy users, this must now be their number one priority.

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