

energy transactions

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Major Stimulus for Investment into New UK Gas-Fired Power Stations

Government announcement of new initiatives, along with new gas strategy, will increase opportunities for investors in the UK power sector.

On 5 December, the UK Government's Department of Energy and Climate Change released its new strategy for gas-fired power generation.¹ The strategy involves the development of 26GW of new gas-fired power capacity due to the decommissioning of old coal and nuclear plants. The UK government envisages more than 30 new gas-fired power stations.

The new gas strategy is intended to work in conjunction with a major shakeup of the electricity market in the UK (which is presently going through the legislative stages in the UK Parliament). A cornerstone of the new electricity market in the UK will be new two-way Contracts for Difference (CfDs), which will stabilize revenues for investors in low carbon power generation, including gas-fired power. This means that, if the market price for electricity falls below what is needed to reward an investment, an additional payment will be made to the generator. However, if the market price is higher than the strike price, the generator will pay the difference. It is expected that the CfDs will be with a single counterparty owned by the UK Government. The CfDs mechanism will result in investors being effectively shielded from the current low spark spread in the UK.

Another important feature of the electricity market reform is the establishment of a new capacity market, which will provide generators with an additional revenue stream for being available to generate, even if not called upon to do so.² This is intended to backstop other renewables, particularly wind. These capacity contracts will be first auctioned in 2014, with a start date of winter 2018–2019. The new capacity market is expected to be similar to the capacity markets in New England and PJM Interconnection in the United States.

It is expected that the combination of these new initiatives, combined with the new gas strategy (which will give the go-ahead for significant shale gas development in the UK), will give rise to attractive opportunities for international investors seeking to enter the UK energy sector.

Contacts

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1. View the "Gas Generation Survey" at <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/oil-gas/7165-gas-generation-strategy.pdf>.

2. View the "Electricity Market Reform: policy overview" at <http://www.decc.gov.uk/assets/decc/11/meeting-energy-demand/energy-markets/7090-electricity-market-reform-policy-overview-.pdf>.

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