

CASTLETOWN LAW

Is the Energy Transition transitioning?



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We are all familiar with the energy trilemma – the tension in balancing clean sustainable energy, at an affordable cost, with security of supply. We've known for a long time that we need to transition to a new way of generating the energy we need, but time is not on our side. We know that we need to develop new ways of balancing supply and demand, but are we moving quickly enough? We see daily evidence of the impact of climate change, but still we are reluctant to change. Is the way we think about the trilemma in 2022 different to the way we thought about it in 2021?

What's changed?

In the last 6 months the energy trilemma has been a headline issue. Carbon reduction was in the spotlight during COP26 in the autumn. Then, over the winter months, we have had to deal with the cost of living crisis, driven by a complex range of economic pressures, including stretched supply chains and COVID-19, but most recently the soaring wholesale price of gas. Those governments who have tried to tackle the energy crisis have tended to focus on short-term fiscal measures, with less focus on underlying reasons as to why we find ourselves here in the first place. Although many countries have made significant progress on decarbonising their economies in the past decade, that has often resulted in an ever increasing reliance on gas, as we move away from coal and nuclear.

Over the last month we have seen the impact of global socio-political pressures. The response to the war in Ukraine has not only shifted the spotlight to security of supply, but as sanctions start to bite, it has broadened the meaning of security from more than just keeping the lights on. In Europe in particular, there have been wide ranging commitments to replace existing and future Russian gas supplies with gas from alternative sources. (Full details in the International Energy Agency 10-point plan to seek to reduce reliance on Russian gas – <https://www.iea.org/reports/a-10-point-plan-to-reduce-the-european-unions-reliance-on-russian-natural-gas>). That, combined with a reluctance to obtain commitments from other major gas producers to increase supplies, has compounded the underlying problems relating to gas supplies and led to a corresponding spike in wholesale gas costs.

The speed of response to security of supply issues, and the associated cost of supply, is not surprising. We have seen eastern European countries stepping away from their green commitments and returning with some immediacy to coal and oil generation. We wait to see whether this will happen elsewhere. The political will of European nations to stop purchasing Russian gas is countered by economic expediency. In the UK, Boris Johnson has signalled that he is in favour of increasing the domestic supply of fossil fuels in the short-term, to reduce the UK's reliance on Russian oil and gas. In the long-term, he is looking to significantly increased investment in renewables and nuclear. In Germany, which is enormously reliant on Russian gas, it had been thought the crisis would bring about a rethink on nuclear, but that has since been ruled out in favour of even greater reliance on gas through the construction of a new LNG terminal. What is clear is that with reduced supply for gas at economically viable prices, the commitment to electrification means that more low carbon energy generation is needed now. This, of course, was always the case but the scales have now been well and truly tipped in favour of investing now for countries reliant on gas. The challenges of climate change can no longer be kicked into the long grass.

A renewed focus on the shift to low carbon generation

The war in Ukraine and the impact of the pandemic means that the shift to low carbon generation has a renewed focus and purpose beyond climate change alone. The UK Government – in common with many others in the West - has stated that increasing domestic wind and generation is now “a matter of national security”. Failure to change is having an impact on people now and not just, as many perceive with climate change, future generations. In the UK, we see the Government’s commitment to battery storage and solar strengthening, and Boris Johnson has announced that a new energy supply strategy will be published. There was no such political will or impetus before the current crisis.

We anticipate that a significant part of any budget for clean energy generation will be allocated to on and off-shore wind generation capacity. To drive change at the speed required, many governments will need to make changes to planning rules to make the development process easier – building on the relaxation of planning rules for battery energy storage introduced during COVID lockdowns as an incentive to sectoral investment.

We are beginning to see governments, developers and funders waking up to the potential for co-locating battery storage and generation assets. Co-located shorter term battery storage projects have been very successful in the latest capacity market auctions – including the InterGen 320MW Gateway battery project – one of the largest battery storage projects in Europe. Huge opportunities for these co-located projects exist across the European continent.

Similarly, we find our clients turning increasingly to a hub model, seeking to generate at the point of demand. This is often an attempt to work around the problems accessing the grid, and constraints upon it. Co-locating supply and demand requires storage – and we are seeing many opportunities for battery storage in this space. A party may look to rely on a Force Majeure clause, assuming there is one in the contract. A Force Majeure clause, if it applies to the event in question, will excuse one or both parties from performance of the contract in some way following the occurrence of certain specified events. The concept works on the basis that on the occurrence of certain events which are outside a party’s control, that party should be excused from, or entitled to suspend performance of all or part of its obligations. In addition, that party will not be liable for its failure to perform the obligations.

Barriers to entry

However, one of the biggest issues for renewables developers in the past decade has been, and remains, grid. There remain fundamental issues of access to the grid, and constraints upon it. Without investment in the grid, our collective inability to deliver the full electrification agenda without such investment remains. Battery storage has a huge role to play in security of supply, but modernising grid is critical.

Hand in hand with the upgraded grid infrastructure, we need continued supportive government policy and more renewable capacity. Storage and hydrogen are indispensable for grid integration of renewables and decarbonisation of hard to abate sectors. It is clear that to achieve our net zero targets we need longer term storage battery solutions, for periods of 4 to 8 hours, or more. Government incentives are needed urgently to support the roll-out of battery projects with greater storage capacities with a longer duration. The extension of capacity mechanisms would achieve this, as would the introduction of a cap and floor model, which we have seen successfully used for interconnectors.

We know what the problems are, and we have access to the solutions. What we now need is the political will to drive investment and change at speeds not seen to date.



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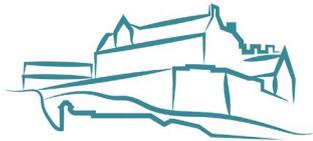


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