THE UK'S CROSS CUTTING NET ZERO STRATEGY – FUEL SUPPLY AND HYDROGEN

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In the third sector article of our Net Zero series, our team looks at what the UK's Net Zero Strategy ("the Strategy") means for industry stakeholders in the fuel supply and Hydrogen sector.

WHAT DOES THE NET ZERO STRATEGY MEAN FOR YOUR SECTOR?

The key commitments set out in the Net Zero Strategy (the "Strategy") for fuel supply and hydrogen offer little that is new. As set out in our introductory article, half of these commitments came out of the Hydrogen Strategy (published August 2021). Our full analysis of the UK Hydrogen Strategy is available here.

Some progress has been made toward the goals set out in the Hydrogen Strategy (and repeated in the Strategy):

- The Hydrogen BECCS Innovation Programme: Phase 1 competition was launched in January 2022, after a stakeholder workshop in November 2021, and is open for applications until 4 March 2022. It forms part of the BEIS £1bn Net Zero Innovation Portfolio, which aims to accelerate the commercialisation of innovative clean energy technologies and processes through the 2020s and 2030s; and
- The Hydrogen Skills and Standards for Heat programme was published in December 2021. Its stated aim is to "*define the required criteria to safely repurpose existing natural gas equipment for hydrogen and to train a workforce of competent hydrogen gas installers*". The programme forms part of the Net Zero Innovation Portfolio.

Turning to the new, only the commitment analysed further below stands out, and even that will need further clarity to give market participants certainty.

Key commitment: *Work with stakeholders to address barriers to electrification of oil and gas production by Q4 2022 and continue to drive down routine flaring and venting*.

The North Sea Transition Deal (published March 2021) highlighted the need to decarbonise upstream oil and gas activities in the UK. It stated that its focus was "*on actions the government and industry can take to reduce emissions from the UKCS oil and gas production, for example, electrification of offshore production installations and adherence to new standards on flaring and venting*".

The Strategy's commitment here focusses on emissions beyond power generation, where "*flaring and venting account for most remaining upstream emissions*" and it endorses "*industry's commitment in the NSTD to accelerate reductions beyond the World Bank's 'Zero Routine Flaring by 2030' initiative*". It goes on to refer to new OGA guidance which "*sets out the expectation that all facilities should have zero routine flaring and venting by 2030 or sooner*". Finally, it refers to the Methane Action Plan which aims for "*continuous emissions reductions with specific methane emissions reduction targets*" and sets "*the expectation that assets will have individual action plans by 2022*".

The Strategy promises additional work by government and regulators, to include "*improved measurement, reporting and verification*" and collection of "*robust industry data which will enable effective implementation of their strategy*". While the Strategy also states that the "*OGA's tracking of overall emissions reductions and benchmarking of flaring and venting data will also improve performance across industry*", it is unclear how it will do so. While mechanisms already exist to drive down emissions, there is no clarity on the proposed changes and how these will strengthen existing incentives.

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WHAT ARE THE RISKS AND OPPORTUNITIES?

The opportunities for stakeholders abound in 2022. Now is the time for industry participants to make their voices heard and to shape the practical strategies that will help government achieve its stated goals. The Strategy does not make new proposals, but "endorses" steps already taken by industry, and promises further discussions.

First movers will therefore have an advantage as UK oil and gas regulation tends to follow the market, rather than the other way around. There are strong examples of UK oil and gas companies which have undertaken specific initiatives to reduce emissions. However, wholesale implementation of effective technologies (such as plant electrification) is dependent on multiple important factors including geography and asset mix, which can make certain initiatives less desirable and impractical.

WHAT DOES THIS MEAN FOR:

- **Lenders to projects?**

Lenders will continue to apply their usual environmental and social requirements to oil and gas projects. It is unlikely that lenders will place obligations on companies to electrify oil and gas production specifically, however, as part of their ongoing commitment to support decarbonisation in the market, lenders may look to provide financing to companies (those that can afford it) to electrify production.

Lenders already place obligations on oil and gas companies to adhere to existing standards on flaring and venting which are monitored and which, in some cases, do result in improved operational reliability for oil and gas companies. It will certainly be more beneficial to the market that major UK banks and financial institutions remain primary participants in financing projects, as they already apply robust frameworks for ensuring compliance with environmental standards by oil and gas companies.

- **Investors/shareholders in projects (including borrowers)?**

With investors in the oil and gas industry pushing for more transparency and demonstrable data on emissions reduction, borrowers are looking for practical initiatives which lead to further decarbonisation of production. It has been shown that taking steps to reducing emissions can have a positive effect on returns. Improving operational reliability has been shown to reduce nonroutine flaring whilst switching power sources from on-site diesel generation to electricity can pay for itself over time.

Borrowers and project sponsors will need to think carefully about how aggressively they want to pursue any net-zero emissions targets. Whilst the key commitment refers to working with stakeholders in the industry to address barriers to electrification of production and to continue to drive down routine flaring and venting, it is not clear how government will look to support these commitments in a way which makes them both practically and economically viable for sponsors and borrowers to commit to.

- **Project developers?**

New projects adopting new technologies are on the rise, particularly those which boost productivity. The level of investment in electrification of production and improving infrastructure and equipment may push project developers to expand their offerings in new, lower-emissions targeted technology. However, given the complexity of oil and gas projects and the fact that no two projects are the same, expanding on current offerings is not straightforward.

Adopting new practices and improving on development time currently comes at a cost. There may be enormous benefits to those project developers focussed on this area which bring forth innovative (and cost effective) ways to provide the advantages that these new technologies bring.

WHAT DOES THIS MEAN IF YOU'RE NOT IN THE UK?

> **"The new key commitment set out in the Strategy is unlikely to bring more focus from international participants to the UK market."**

Participants across the globe in the oil and gas market will continue to focus on new technologies (including electrification of production), reducing emissions and improving operational efficiency for those oil and gas producers who can make incremental changes toward decarbonisation. First movers in the UK market will attract interest from international investors in these areas, which could spur on other producers in the market. For now, current trends are likely to continue and until such time as regulation is imposed in the UK market aimed specifically at electrification, or farther reaching obligations are imposed on producers with regard to flaring and venting, the new key commitment set out in the Strategy is unlikely to bring more focus from international participants to the UK market.

HOW WILL PROGRESS BE MEASURED OR DEMONSTRATED?

There is an obvious measure of success in tracking consultations, stakeholder engagement events and open letters throughout 2022 to determine what discussions have taken place with government. A bit harder to measure will be the outcome of that engagement – will we see new policy commitments or implementation of incentive mechanisms or measures?

Whatever the way forward, it is likely that public consultations will be required, giving stakeholders enough time to understand issues and proposals, and to formulate their own responses.

Once the way forward is confirmed, the government will go through implementation stages, which may involve changes to primary and secondary legislation, and to industry codes. While this phase is also likely to be time consuming, we will see concrete progress more easily and businesses can then adapt their structures and investment decisions with tangible reform in sight.

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