PROSPECT ADVISORY

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WHOLESALE ENERGY PRICES: MAY 2016 – JULY 2016: PART II: ELECTRICITY

In this series of articles, Dominic Whittome covers wholesale energy prices between May and July.

Firming prices for coal, the buoyant gas market and some concern over the timing of infrastructure projects after Brexit helped base-load power prices surge a further 15% over the period. The notional spark spread (undiscounted for carbon prices) increased 21% to £13.50/MWh.

Any future rises in base-load power prices may underplay the final PPA contract price rises for industrial users as the gap between base and peak load prices widens. Elexon's maximum System Reserve Price is slated to increase to an unprecedented £5,000 MWh (£5/kWh) within two years. The main jump (to £3/kWh) was instigated last year. Although Cash Out prices will seldom reach such levels, forthwith Ofgem will allow such prices to happen. This shows how the balancing market will value peak-plant and storage-flex capacity in future. Further, the decision (made before the Brexit result) by National Grid to stick to half-hourly trading windows after all and not adopt a European-style 15 minute regime will, if anything, maintain the pressure on peak prices, with Elexon left to keep the system balanced over the existing, longer balancing period.

Brexit could conceivably affect the outcome of the proposed 3,200 MW reactor at Hinckley Point, whatever that may be, as this may depend on the new administration in Whitehall, given the political capital invested and still required by this project. Most of the focus has been on the £20bn + construction cost, underwritten by the taxpayer under a Treasury loan guarantee. There has been less focus on the Contract for Difference subsidy - a totally separate form of project support. This potential cost is underwritten by end users, reflected in their electricity bills.

Assuming a Forward Year Baseload price of £45/MWh and the CFD 's Strike price (£92.50 MWh at the time of signing + accumulated price indexation to the present day) of £100/MWh i.e. both in today's money, then the value of this subsidy can be calculated 3,200 MW x £55/MWh x 24 x 365 x 35 = £ 54 bn. This estimate is a speculative one. It will only fall if power prices increase rise relative to the inflation-indexation of the Strike Price. This £54 billion figure represents the cost of the subsidy only. The electricity volume itself still has to be purchased by consumers in the normal way.

The estimate calculated should be close to the mark, provided our CFD contract assumptions are correct and Baseload power prices not rise substantial in real terms. It is worth noting that it is Peakload rather than Baseload generation which is generally recognised as the commodity that the system has in short supply. If new-build nuclear projects planned for Wylfa, Sellafield and Bradwell command similar subsidy terms, then combined support cost for all four new nuclear power plants could surpass £200 bn. One effect of Brexit therefore could be to bring these financial considerations into the spotlight. Possibly rekindle the debate over the future of coal and gas generation, if the imminent Westminster government uses the Leave vote as a moment to revisit energy policy.

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