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WHOLESALE ENERGY PRICES: JANUARY – FEBRUARY 2017: PART II: ELECTRICITY

In this series of articles, Dominic Whittome covers recent changes to wholesale energy prices.

Electricity

Baseload prices finished the period down 7% as weak demand and firm supplies across the board of generation took hold. Storage is becoming an increasingly key feature in the market. It is thought that the perceived 'low' £22.50/kW clearing price in the last Frequency Response/capacity market auctions may be leading to a future 'Mexican stand-off' between storage investors and National Grid Transmission, with developers wary of investing in ventures offering only them quite modest returns but significant exposure to the market risk once their auction contracts expire, in 4 years or even less in some cases.

However, the Grid will broaden the range of different Frequency Response services which developers can bid for. This wider choice of contract terms could help underpin the storage market from now on. Last year's low clearing price may have been partly the result of lower-than-normal bidding by developers. Having been given their batteries by the manufacturer at a concession, some may have bid low, keen to bank any positive margin to ensure they would at least break-even.

If price sweeteners are a one-off event, for that reason too we could see storage auction prices firmer next time around, even if it is modest. So talk in some industry circles of sustained sub-£20/kW prices look wide off the mark perhaps. Looking further ahead, significant demand growth is anticipated for electricity storage across Europe according to virtually all government and industry forecasts made on the subject.

On the power generation front, the lack of investment in peak capacity will only intensify demand for load-shaping tools, batteries and demand-side response in the future. With new-build nuclear plans reported to be stalling, NuGen's 3,800MW Anglesey reactor of recent concern, the UK's generation margin could tighten further over the next 10 years.

While it is true that Whitehall secured significant capacity in its 'T4' capacity market auctions last year, centrally planned economies and markets come at a cost. On which question, the current strike price for the 3,200 MW Hinkley Point power station has passed £105/MWh on account of inflation, as agreed when the deal was struck at the outset when it stood at £92.50/MWh. Comparable CFD strike prices can be expected for the other new-build reactor due over the next ten years and a benchmark may gradually become established.

Meanwhile the spark spread is still falling, down 2% over the two month period. This low margin is a continuing disincentive for developers to build new gas-fired plants or to prolong the UK's remaining coal stations. Grid batteries and Demand Side Response may help in the future. However, storage is only good for short bursts and cannot cover for prolonged outages.

The commercial incentives to build un-subsidised plants will stay weak unless UK energy policy shows signs of change. One future key plant scheduled, the 1,500 MW gas station at Trafford, has been delayed again amid financing issues, so significant that it has even had to surrender its capacity market concession.

The bright spot perhaps has been the steady development of interconnectors, which may redress some of the imbalance as existing nuclear reactors and other plants are retired over the coming years. These include a second 1 GW cable to France and a second Norwegian 1.5 GW link interconnector to bring hydro electricity to the UK market and double-up Statnett's North Sea Link project. Landsnet's IceLink cable will bring 1.5 GW of geo-thermal electricity from Iceland and further 1 GW cables are planned to Holland and Belgium.

However, as the UK market experience with the Gas Interconnector flagged up almost a decade ago, the mere presence of a subsea pipeline is no guarantee of supply when it is needed most. Volumes will no doubt eventually arrive, although at prices which the power market will determine.

Prospect Law and Prospect Advisory provide legal and business consultancy services for clients involved in the infrastructure, energy and financial sectors.

Dominic Whittome is an economist with 25 years of commercial experience in oil & gas exploration, power generation, business development and supply & trading. Dominic has served as an analyst, contract negotiator and Head of Trading with four energy majors (Statoil, Mobil, ENI and EDF). As a consultant, Dominic has also advised government clients (including the UK Treasury, Met Office and Consumer Focus) and various private entities on a range of energy origination, strategy and trading issues.

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