CRA Insights:
Energy

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October 2015

Will Trafford Power's financing problems impact the 2015 capacity market auction?

Background

According to *Utility Week*, Trafford Power, a new 1.9 GW gas-fired CCGT, has so far failed to find financial backing despite having a 15-year capacity contract. Such delay in securing financing may mean that, in the best of cases, the commissioning of the plant will be delayed by at least a year. In the worst of cases, the project could be cancelled altogether.

Trafford Power was the only new, large-scale CCGT power plant to secure a capacity contract during last year's capacity market auction. Given that the capacity auction cleared at just £19.40/kW-year, having a new large-scale power plant secure a contract when many existing plant did not was a surprise to many. CRA's analysis at the time indicated that a combination of low capital costs and bullish energy revenue expectations were necessary for a new plant to secure a contract at such a low clearing price (see **Britain's First Capacity Market Auction Results** and **Great Britain's first capacity market auction: a primer for European policymakers?**).

At the very least, commissioning delays and risk of cancellation means that non-completion penalties will receive further scrutiny and monitoring to assess whether such penalties are appropriately designed to avoid unnecessary market distortions. But, in the short-run, the financing delays may have a direct impact on forthcoming capacity market auctions.

Impact on the capacity market

CRA's analysis suggests that under current energy spreads, many existing plant remain unprofitable at last year's capacity price (see **The 2015 GB Capacity Market Auction: drivers and strategies**). Many may choose to shut down to cut the losses, while others may choose to play the waiting game for a recovery in capacity and energy prices. The news about Trafford Power provides some indication that for those who wait, a positive payoff may come quicker than might have previously been anticipated.

In the first instance, a one-year delay in the commissioning of such a large scale plant may immediately create a capacity shortage for the 2018/2019 delivery year. This will likely exert upward pressure on the T-1 auction due to take place in 2017 for delivery starting in 2018. This may be good news for all existing plant that failed to secure a contract during last year's T-4 auction and are still eligible to participate in the T-1 auction.

And, secondly, if the current market fails to support the financing of new large scale capacity at £19.40/kW-year (with a 15-year capacity contract), then this can be taken as an indication that capacity prices may need to rise. On the other hand, it must be recognised that the large scale of potential new distributed generation may be feasible at lower capacity prices, exerting downward pressure on the market. Last year's auction resulted in around 1 GW of contracts for new distributed generation capacity. The pre-qualification results for this year's auction reveal that there are 7.9 GW of de-rated distributed generation in the pipeline (3.5 GW of new build). Around 65% of the proposed distributed generation plant in last year's auction secured a contract. If this success rate is replicated in this year's auction, the business model and bidding strategies of these resources will be a driving force of the auction results.

For generators defining their 2015 auction bidding strategy, success will depend on their ability to assess the multi-year effects of these complex market dynamics.

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