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Market reference prices

CfD workshop

21 August 2013

Market reference price

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- The reference price is a proxy for electricity prices during the term of the CfD

- Different types of generation have different characteristics

- One of the key variations is whether a technology is baseload such as nuclear or intermittent such as wind – this affects the level of certainty a plant has over its output

- As such, there are different incentives on operating the plant and selling electricity, and it is appropriate to tailor the reference price to reflect these

Baseload reference price

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- For baseload technologies, there will be a single market reference price which applies for each season
- This will be set by reference to season ahead prices traded on specified indices over a sample period prior to the season for which the reference price is being calculated
- The price will be formulated by volume-weighting the trades to give a price for the day, and then averaging daily prices across the sample period
- Weightings will also be applied to the daily volumes traded for each price source, to reflect reliability
- Yet to be determined:
  - the length of the sample period
  - the initial choice of price sources
- See Annex 1 of the Explanatory Notes for a full explanation and worked example of the formula

Intermittent reference price

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- The market reference price for intermittent plant will be calculated on an hourly basis throughout the difference payment period
- GB day ahead hourly price to be used
- Fallback provisions if market coupling algorithm not introduced in this way:
  - If APX / N2Ex are quoting the same day ahead hourly price, this price will be used
  - If not, the day ahead hourly prices from both exchanges will be volume-weighted to give an average price which will be used as the reference price
- See Annex 2 of the Explanatory Notes for an explanation of the intermittent market reference price and a worked example

Triggers for reviewing the market reference price post Agreement Date

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- The Overview Document sets out the intention to introduce a mechanism to adjust the market reference price after the CfD Agreement Date
- This is to ensure that the market reference price remains an appropriate measure of electricity prices over the term of the CfD
- As such, we propose that certain events would trigger a review of the market reference price:
  - Volumes / weight of the market changes
  - Market conditions allow a year-ahead price for baseload
  - Market splitting makes the reference price inappropriate
  - New regulations make the reference price inappropriate
- We are considering whether periodic reviews are also appropriate
- This is not yet reflected in contract drafting

Mechanism for reviewing the market reference price post Agreement Date

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- The approach taken would depend on the trigger event:
  - Some would lead to a formulaic adjustment
    - E.g. changes to market volumes
  - Others would require a detailed principles-based change
    - E.g. if market splitting occurs
- In either case the CfD Counterparty would follow the instructions set out in the contract
- There would be an opportunity for generators to make representations for consideration by the CfD Counterparty
- The dispute resolution process would apply to all of these provisions

Questions

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Initial market reference price:

- What should the fallback for the intermittent market reference price be in case of technical failure of the day ahead auctions?
- How long should the reference price sample period be?

Amendments to the market reference price (post agreement):

- How often should reference prices be reviewed?
- Should the reference price sample period change over time?
- What objective measurement can we make of the robustness of a price source against manipulation?
- How much volume must be traded on a platform for it to be considered for inclusion?
- What market conditions need to be in place to facilitate a move to a year-ahead reference price for baseload technologies?
- For non-formulaic adjustments, what principles should apply to adjusting the market reference price?

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Strike price adjustment

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- The strike price will be adjusted for inflation on an annual basis
- This will update prices from the “base year” that they were set in
- Indexation will be to CPI
- The full value of the CPI change will be passed through to the strike price

Questions

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- We'd welcome written feedback on the formula after the event