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Brexit and the UK biomass burn

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The UK has long been Europe's leading wood pellet importer, driven by UK utility Drax's appetite for biomass. But last week the UK voted to leave the EU, throwing up clouds of uncertainty for the market, raising questions around the implications for commodities, policy and trade.

North America accounts for the lion's share of long-term contract deliveries to the UK, but a strong dollar against the euro had left Europe — especially Portugal and the Baltic states — supplying most of the UK's marginal and spot demand in recent months. Luckily for those European producers, post-referendum jitters dragged down the euro as well as sterling against the dollar, so it looks likely that the status quo will continue for the time being in terms of price competitiveness.

But will the UK continue as the driving force behind biomass demand for power generation in Europe? As a young and subsidised industry, that depends on government policy. The commitments made to renewable energy as part of the UK's standing EU obligations cannot be rolled back until a UK exit is complete, at least two years down the line. But just how the UK meets those commitments is open to debate. Even the most ardent 'leave' campaigners have accepted that a Brexit will cost money in the short term. Inflation-linked strike prices granted to biomass projects a couple of years ago could look like a tempting area for the government to make savings, particularly since UK power prices have fallen since those strike prices were set.

A total of three UK projects are set up for contract for difference (CFD) subsidies: Drax's full conversion of its 645MW unit 1, Czech energy firm EPH's 420MW Lynemouth coal-to-biomass conversion and UK firm MGT Power's 299MW Teeside CHP.

MGT has secured its expected wood pellet demand from US biomass producer Enviva in a sterling-denominated contract, avoiding currency risk. But the project is well behind schedule and a start date has been proposed that is beyond the deadline put forward by government-owned Low Carbon Contracts, which manages the CFD contracts. So far Low Carbon Contracts has allowed extensions to the project's timeline, but a government looking to balance the books could encourage it to be stricter with deadlines in the future.
But Lynemouth is on track, and gained EU state-aid approval in December. A contract for over half its expected 1.4mn t/yr demand has been secured with Enviva — 20pc denominated in sterling, with the remainder in dollars. But, as a Czech company, how keen will EPH be to continue to invest in a market untethered by EU regulations?

Meanwhile Drax is still waiting for the outcome of an EU state aid investigation into the CFD it was granted for its unit 1 conversion back in April 2014. With the UK set to be bound by EU law for at least the next two years, it is likely that the results of that investigation will determine whether or not Drax is permitted to receive the CFD subsidy, whether Brexit proceeds or not. But the uncertainty thrown up by the referendum and its outcome, in the UK and in Brussels, is unlikely to have sped up the decision.

The three projects together would add almost 3mn t/yr of UK industrial wood pellet demand by 2020. Without them, UK generation demand is more likely to stagnate at approximately 6.8mn t/yr currently used by Drax in its two full unit conversions and 85pc biomass co-firing in unit 1.

But even that well outweighs the emerging demand in other European countries. The biggest new potential source of European demand is the Netherlands, where SDE+ subsidies are expected to support up to 3.5mn t/yr of wood pellet demand for power generation, raising the country's current generation needs from zero. But, as in the UK, those projects are dependent on government policy and subsidies – which have not all been granted yet.

Even if none of the UK projects in the works were to come online, as long as the existing demand could be maintained — barring retrospective cuts to existing subsidies, or new policies that made biomass burn in the UK simply unaffordable — the UK market will remain the centre of industrial biomass demand in Europe for the foreseeable future.

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