CATALYST ENERGY SOLUTIONS

Energy Element / April 2012

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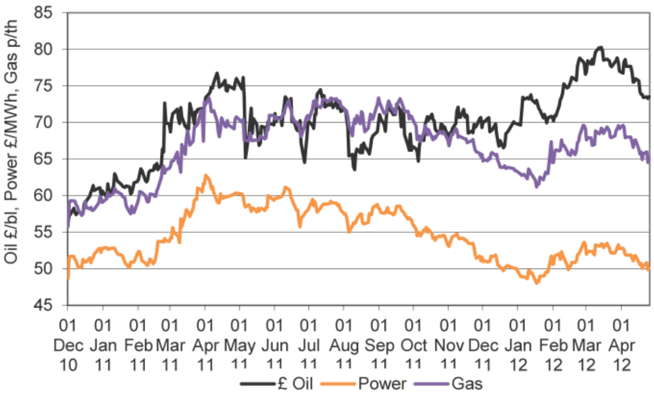
Prices pushed down on falling oil and coal

In April the wholesale energy market retreated from recent highs seen in March as international coal and oil prices have fallen dramatically. Seasonal prices were on a downward trend last month as political tensions with Iran subsided as negotiations surrounding the country's nuclear ambitions took place. There was further pressure owing to gloomy economic news from China, the Eurozone and the US.

Crude oil and annual wholesale gas and power prices



Month-on-month Brent crude oil fell 3% to $121/bl in April and hit a two-month low of $118.3/bl on 20 April. Coal prices saw a significant fall as unconventional gas displaced US coal stocks on international markets causing annual API coal to fall to a 16-month low of $110.4/t on 25 April.

Short-term prices driven by falling commodity prices and colder weather

Short-term prices were less affected by falling commodity prices than the longer-term market as a result of colder weather, the Elgin gas field leak and low wind speeds. On average the day-ahead gas price was up 2% during April, compared to March, at 60.0p/th. The contract reached 61.3p/th on 3 April but fell back to 58.0p/th by the end of the month. The drivers of the day-ahead gas price were the Elgin field leak and colder weather.

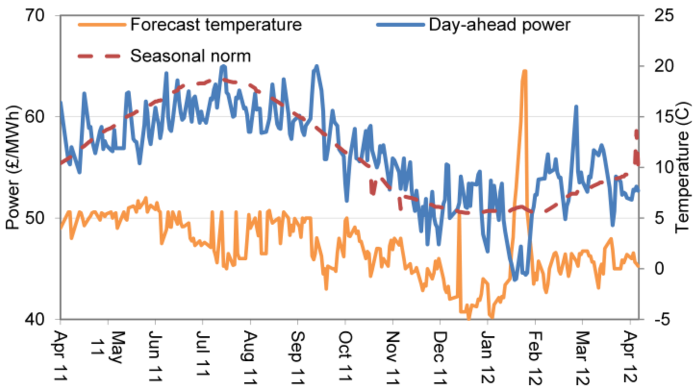
In April the average day-ahead power price was up 1% month-on-month to £45.0/MWh. The contract peaked at £48.0/MWh on 3 April as it was driven up by its gas counterpart, but it fell down to £44.5/MWh on 25 April as wind speeds increased substantially.

Short-term prices could reduce ahead of summer

We believe current wholesale energy prices are likely to reduce over the near term as demand falls ahead of expected warmer summer weather and cheap coal prices should help to provide inexpensive baseload power. This might be accompanied by a continued fall in oil prices if economic uncertainty continues.

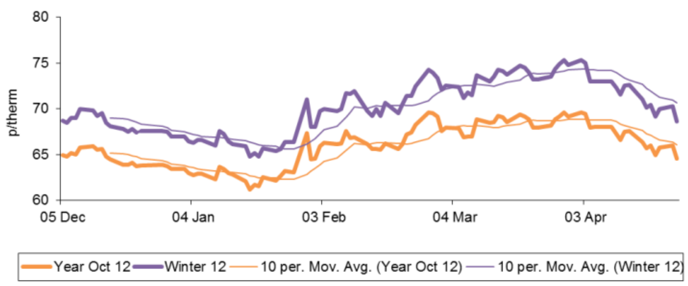
But prices will remain volatile as the EU continues to compete with high Asian demand for LNG and wildcard events such as the Elgin gas field leak could cause supply disruptions with little notice.

Spot power prices and temperatures



Catalyst Commercial Services' independent approach enables clients to manage their exposure to energy price risk, while at the same time benefiting from a first class service from a range of major and independent suppliers. Catalyst Commercial Services' procurement solutions make it simple, so contact a member of the team to discuss requirements.

Annual gas prices

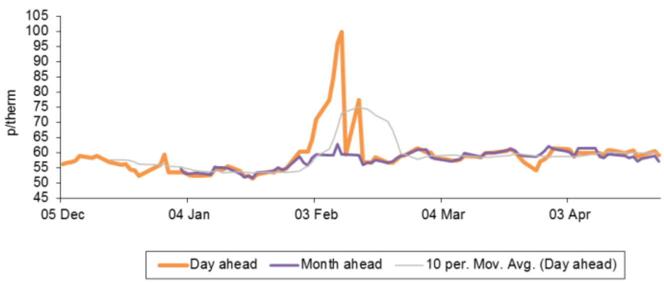


Annual gas prices saw downward movement over the month following falling oil prices.

Annual October 2012 gas prices fell to 64.6p/th on 24 April.

The winter 2012 contract dropped to a three-month low of 68.7p/th on 24 April.

Spot gas prices

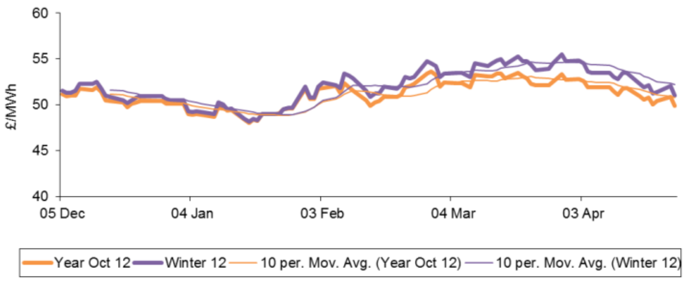


Spot gas prices saw a slight increase over April after the Elgin field gas leak and colder weather.

Day-ahead gas prices peaked at 61.3p/th on 3 April.

Month-ahead gas prices peaked at 61.5p/th on 9 April.

Annual power prices

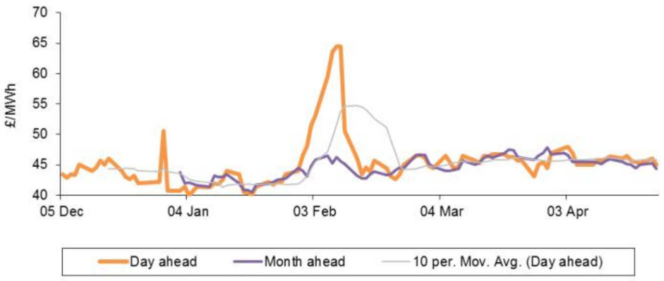


Annual electricity prices also saw notable falls following their gas counterparts.

Annual October 2012 power prices dropped to £49.9/MWh on 24 April—a four-month low.

The winter 2012 electricity contract dropped to £51.0/MWh on 24 April.

Spot power prices



Spot electricity prices were also driven upwards slightly by low temperatures and the rise in gas prices.

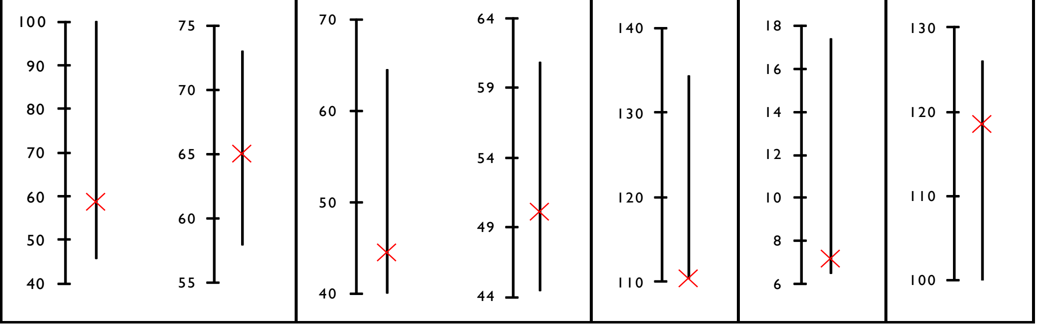
Day-ahead electricity prices peaked at £48.0/MWh on 3 April.

Month-ahead power prices peaked at £47.0/MWh on 2 April, but fell to £44.5/MWh on 19 April.

Key market indicators: 25/04/2012

		Gas (p/th)		Electricity (£/MWh)		Coal	Carbon 2012	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	($/bl)
April	25 Apr 12	58.65	65.03	44.50	50.10	110.35	7.18	118.48
March	26 Mar 12	54.25	68.18	43.10	52.15	113.00	6.90	124.70
Last year	26 Apr 11	59.50	70.28	50.60	59.88	131.25	16.87	123.56
Year-on-year % change		(1%)	(7%)	(12%)	(16%)	(16%)	(57%)	(4%)
Year high		100.00	73.00	64.50	60.83	134.25	17.35	125.97
Year low		45.50	57.88	40.00	44.38	111.75	6.45	99.79

This table shows the price at the end of this month compared with prices from the previous month and year. The graphs show the position of this month's prices with a red X and the range of prices over the year is represented by the black line.



Commodities

Carbon: EU Emissions Trading Scheme carbon is quoted as over-the-counter (OTC) latest opening prices. All carbon prices are in euros per tonne (€/EUA).

Coal: Coal is quoted as OTC latest opening prices. All coal prices are in US dollars per tonne ($/t).

Electricity: UK power base-load and peak-load are quoted as OTC latest opening prices. All UK electricity prices are in pounds per megawatt hour (£/MWh).

Gas: UK National Balancing Point (NBP) gas is quoted as OTC latest opening prices. All UK gas prices are in pence per therm (p/th).

Oil: Brent crude oil is quoted as OTC latest opening prices. All Brent crude oil prices are in US dollars per barrel ($/bl).

Language/ terms

Bearish: A bearish market shows a general decline in prices over a period of time.

Bullish: A bullish market shows a general increase in prices over a period of time.

Curve: A graph of forward prices over a future time period.

Margin: The indicated UK imbalance of a given settlement period. It is the difference between the sum of the indicated generation available, and the national demand forecast made by National Grid.

Over-the-counter (OTC): The trade of a commodity directly between two parties, often on standardised terms.

Spark/ Dark spread: The theoretical net income of a gas-/ coal-fired power plant from selling electricity having purchased the necessary fuel. The clean spark/ dark spread is this net income adjusted for the cost of carbon.

Energy regulator moves to mitigate network charging volatility

Ofgem recently set out for consultation options to help alleviate network charging volatility from gas and electricity transmission and distribution.

Network costs can be broken down into three elements: transmission network use of system charges (TNUoS); distribution use of system charges (DUoS); and balancing use of system charges (BSUoS). TNUoS charges reflect the costs recovered by the system operator (National Grid) for installing and maintaining the electricity transmission system to enable the bulk transfer of power between connection sites and to provide transmission system security. DUoS charges reflect the costs recovered from distribution network operators for the enabling the connection and use of their distribution systems. BSUoS charges reflect the costs recovered by National Grid for the services it employs to keep the electricity transmission system in balance.

When combined these network charges generally account for 15%-25% of a non-domestic customer's energy bill. The percentage varies based on contract terms.

Uncertainty reigns

Given energy transportation businesses are natural monopolies, there is no realistic means of introducing competition. Instead the energy regulator protects customers' interests by regulating the companies through period price control, which include curbs on expenditure as well incentives to be efficient and to innovate technically. The price controls set the maximum amount of revenue that energy network owners can take through charges they levy on users of their networks to cover costs and earn them a return in-line with expectations.

Options	Initial assessment
Improved information for suppliers and customers	Reduces risk to suppliers, and reduces risk premium. No additional risk for network operators and low cost. Implementation likely to be beneficial.
Restricting the frequency of intra-year charge changes	Reduces risk to suppliers with limited additional risk for network operators. Implementation likely to be beneficial.
Increasing the lag on incentive rewards/ penalties that networks recover through allowed revenues	Reduces risk to suppliers with limited additional risk for network operators. Implementation likely to be beneficial.
Increasing the lag on adjustments to allowed revenues from uncertainty mechanisms	Reduces risk to suppliers but at cost of increased risk for network operators. Consider changes on a mechanism-by-mechanism basis.
Imposing a cap and collar on changes to allowed revenues	Reduces risk to suppliers but potential material additional risk for network operators. Implementation unlikely to be beneficial.

But allowed revenues under the price controls are not fixed and vary for a number of reasons, including inflation indexation, pass-through costs, incentive schemes and adjustments. They can fluctuate widely year-to-year (sometimes in excess of 20%) and cause unexpected changes in consumers' bills.

Volatility in network charges can also act as a barrier to entry to the energy market, particularly for smaller suppliers who are less able to absorb fluctuations.

Change is nigh

Ofgem noted that network charging volatility—particularly the ability to predict charges reasonably accurately—is an important issue for energy suppliers and their customers. In a bid to reduce this price unpredictability, it is seeking views on five different options (*see table left*).

Responses will influence Ofgem's on-going price control reviews for the gas and electricity transmission networks (referred to as RIIO-T1), the gas distribution networks (RIIO-GD1), and the electricity distribution networks (RIIO-ED1).

If you wish to get involved, responses are invited by 11 June. Ofgem will publish its decision in the summer.

Ofgem

Government to “beef-up” Ofgem

The energy regulator Ofgem is to be given new powers to force energy companies to compensate customers who have been mis-sold services or over-charged under new proposals put forward by the government.

In the consultation, issued on 10 April, the government noted that gas and electricity businesses are already subject to a range of legislative obligations. Failure to comply with some obligations can trigger enforcement action by Ofgem, including substantial fines of up to 10% of annual turnover, which are paid to the government.

In some cases non-compliance with obligations can also lead to consumers suffering a financial loss. But the regulator currently has no powers to force companies to provide compensation to affected consumers.

The government has argued that providing Ofgem with a formal power to order compensation—a power that many other industry regulators already have—would strengthen the regulator's ability to protect the interests of consumers. It would also “increase justice and fairness in energy markets” and force energy companies to “put right the effects of their wrong-doing rather than simply pay a fine”. This power could allow Ofgem to require energy companies to compensate consumers on a pound for pound basis. It could also cover goodwill payments where the extent of the loss cannot be determined.

Responses are requested by 2 July.

Government

Green light for smart meter roll-out in 2014

The government recently confirmed the roll-out of smart meters to 30mn UK homes and businesses will start in less than three years—it said this was a “challenging but achievable” timescale.

Smart metering enables a two-way flow of data between the supplier and the customer that can deliver real-time information about energy consumption and demand for energy. The government has said understanding this data will help to slash unnecessary energy use, reduce emissions and cut consumers energy bills by putting an end to estimated billing.

Importantly the government has confirmed that energy suppliers will not be able to make any sales pitches during the smart meter installation. But they must provide energy efficiency advice as part of the visit.

The proposals, currently up for consultation, also give consumers a choice about who has access to their data. Under the plans energy suppliers will be able to access monthly energy consumption data to bill customers or to fulfil “any statutory requirement or licence obligation” without having to ask customers permission. It will be up to the consumer whether they share this information with third parties.

The government also agreed, in principle, that energy distribution network operators can have access to half-hourly energy consumption data so they can develop and maintain “efficient, co-ordinated and economical systems for the distribution of electricity and gas”. It is likely that this data will be aggregated to prevent individuals and their usage from being identified.

As part of the tranche of documents the government also confirmed its intention to publish the conclusions regarding the Smart Metering Equipment Technical Specifications (SMETS) shortly. The SMETS will define the minimum standards of equipment to be used as part of the programme.

Responses to the consultations are requested by 1 June.

Government

Growth is green, says Clegg

On 11 April the deputy prime minister Nick Clegg gave a keynote speech where he argued to dispel the myth that greening the economy would harm the UK's growth. Against a backdrop of numerous environmental problems "going green has never made so much sense" for consumers and businesses. The UK's dilemma is not choosing between going green and growth but it is about "marrying the two", he said

Liberal Democrats

Government revives carbon capture and storage competition

Over Easter the government re-launched its £1bn carbon capture and storage (CCS) competition and unveiled its first road-map for the technology. The competition aims to stimulate the industry and drive down the costs of the technology. It does this by supporting practical experience in the design, construction and operation of commercial-scale facilities by providing capital funding and long-term support. The accompanying road-map sets out further steps to develop a "world-leading CCS industry" in the UK by the 2020s. These steps include setting aside £125mn for research and development and offering a commitment to work with the industry on developing the necessary skills and supply chain.

Government

Green Deal pioneers unveiled, as non-domestic scheme delayed

More than 20 organisations, including Kingfisher, Anglian Home Improvements and Carillion, have signed up to the agreement to provide the government's flagship Green Deal energy efficiency initiative. But the government has stressed the 22 organisations were only the first tranche of providers. The Green Deal aims to encourage households and businesses to take measures to make their properties more energy efficient. It will do this by providing upfront finance for energy efficiency measures, which is repaid from energy bill savings.

Separately on 18 April a spokesperson for the government told newswire *GreenWise Business* that the Green Deal for businesses was being delayed due to the complexity of the market. The date for the launch is still to be confirmed, but it is believed it will not be far behind the domestic launch in October this year.

Government GreenWise Business

Energy UK launches as "new voice for the energy industry"

The new trade association Energy UK was officially launched on 2 April with the aim of providing a "strong voice for the energy industry". It has been established following the merger of the Association of Electricity Producers, the Energy Retail Association and the UK Business Council for Sustainable Development. The new organisation represents some 70 companies working in electricity generation, energy networks, gas and electricity supply as well as businesses providing support to the industry.

Energy UK

Barker calls for a "more ambitious" emissions reduction target

Speaking on BBC Radio 4's Today programme on 10 April, climate change minister Greg Barker called for a higher EU carbon reduction target ahead of a meeting with his EU counterparts. Barker said increasing the UK's 2020 target from a 20% reduction in emissions on 1990 levels to a 30% drop could be achieved "comfortably".

But the minister reaffirmed the UK will not do it without Europe following suit. He added there is scope for a tighter carbon emissions target but that would be "good for business".

BBC
