Energy Element / June 2016

CATALYST ENERGY SOLUTIONS

Power and gas prices rise across the board

Sharp gains in commodity markets continued to support power and gas prices in May, with seasonal power contracts averaging their highest levels since December last year.

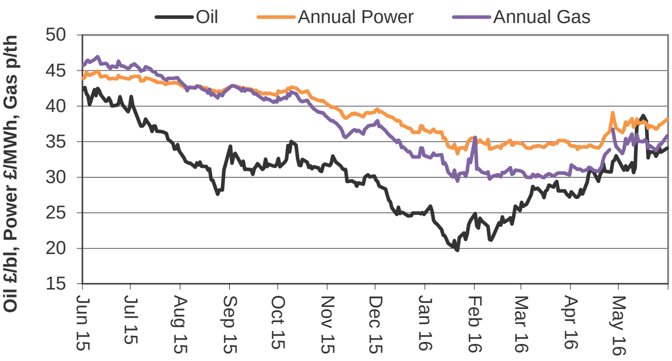
Seasonal gas prices gained 6.3% on average, as higher oil prices fed through to the GB gas market. Winter 16 gas increased by 6.9% to average 36.1p/th, while summer 17 gas experienced the largest increase, up 8.5% to 33.4p/th. Despite the recent gains, growth may be limited due to the strong gas supply outlook for Europe. In the shorter term, day-ahead gas moved 3.6% higher to average 30.3p/th. It has been reported that gas-for-power demand in May was at a four-year high. Gas-fired generation has dominated the UK energy mix in recent months, increasing demand for gas and consequently supporting prices.

Seasonal power contracts also climbed in May, following their gas counterparts higher. Winter 16 power lifted 5.4% to average a six-month high of £40.2/MWh, while summer 17 power rose 7.0% to £34.6/MWh. Day-ahead power also followed its gas counterpart, rising 1.0% to average £34.2/MWh.

Oil prices reach a seven-month high

Brent crude oil surged 10.4% to average $47.5/bl in May, and hit a seven-month high of $50.1/bl on 26 May. Throughout the month, prices were supported by a number of supply disruptions. Among these were wildfires in Canada, militant threats against oil facilities in Nigeria, political unrest in Libya and economic difficulties in Venezuela. In addition, the International Energy Agency believes the oil market is beginning to rebalance, as decreasing non-OPEC output reduces the global surplus.

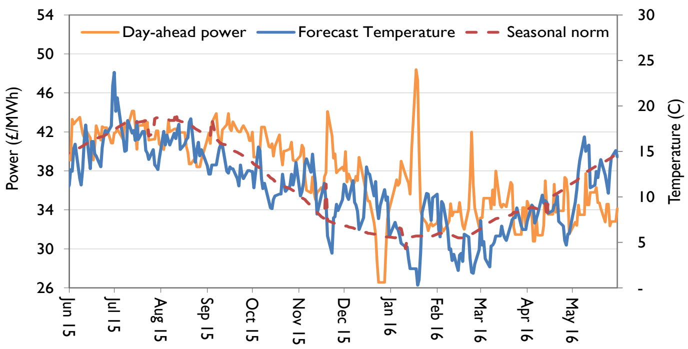
Crude oil and annual wholesale gas and power prices



API 2 coal grew 7.3% to average $46.9/t, and reached an eight-month high of $49.6/t at the month's end. A combination of supply cuts from major coal producing countries, namely the US and Indonesia, and rise in Asian demand for imported coal supported prices.

EU ETS carbon jumped 5.4% to average €6.0/t, but prices remained 20.1% lower than last year's level (€7.5/t). Prices are expected to steadily rise in the run up to the Market Stability Reserve in 2019. Further reforms to the carbon market for post-2020 are now also being discussed, with France, Germany and three major Nordic Utilities (Fortum, Statkraft and Vattenfal) expressing support to increase prices.

Spot power prices and temperatures



The month ahead: OPEC's 169th meeting

OPEC held their 169th meeting in Vienna on 2 June, and this was their first meeting since the failed supply freeze talks in April. Once again, the meeting ended without an output policy. Without an output cap, certain nations, namely Iran, could increase production levels and prevent any significant further gains in oil prices. However, there was a general consensus that the market is beginning to rebalance.

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.

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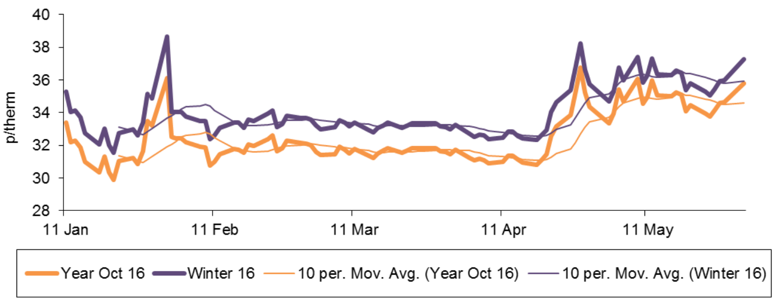
Annual gas prices

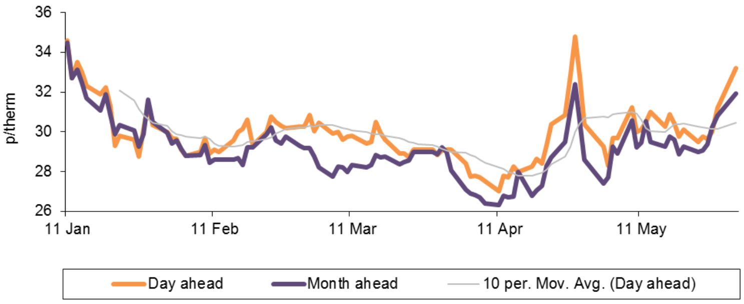


All seasonal gas prices increased in May, as higher oil prices fed into the GB gas market.

The annual October 16 gas contract gained 7.7% to average a five-month high of 34.7p/th. Winter 16 gas climbed 6.9% to average 36.1p/th, while summer 17 gas experienced the largest increase, up 8.5% to 33.4p/th.

Despite the recent gains, further growth may be limited by Europe's comfortable gas supply outlook.

Spot gas prices

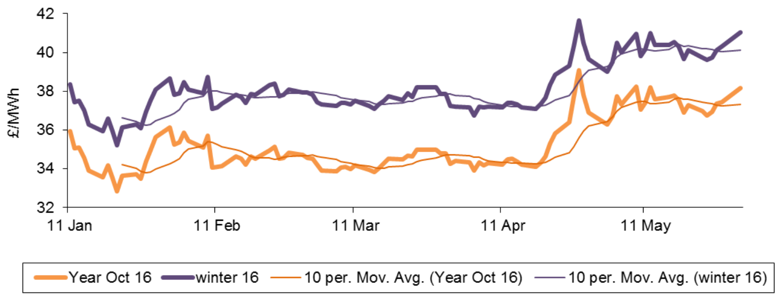


Spot gas prices also rose in May, with day-ahead gas lifting 3.6% to average 30.3p/th,

Gas-for-power demand was at a four-year high during May, compared to the same month in previous years. Gas-fired generation provided 47% of GB's energy mix during the month, while coal only produced 4%, as cheaper gas prices have made it the dominant fuel. Increased demand for power generation has helped support gas prices recently.

The month-ahead gained 9.6% to average 29.6p/th.

Annual power prices

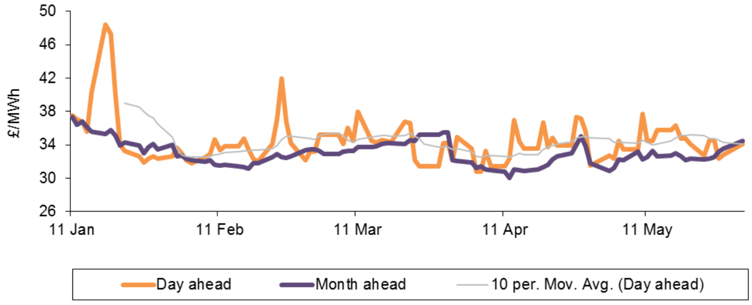


The annual October 16 baseload power contract improved 6.1% to average £37.4/MWh following both gas and commodity markets higher.

Winter 16 power rose 5.4% to average £40.2/MWh, while summer 17 increased 7.0% to £34.6/MWh.

In addition, a number of coal-fired power stations have closed in recent months. Rugeley power station will be the latest in the series, and is scheduled to close at the end of June. These closures will tighten capacity margins for next winter, and could push up power prices.

Spot power prices



Spot power prices also rose, with day-ahead power climbing 1.0% to average £34.2/MWh.

The contract followed its gas counterpart higher, while a reduction in wind generation compared to the previous month also supported the contract.

The month-ahead contract grew 2.3% to average £32.6/MWh during May.

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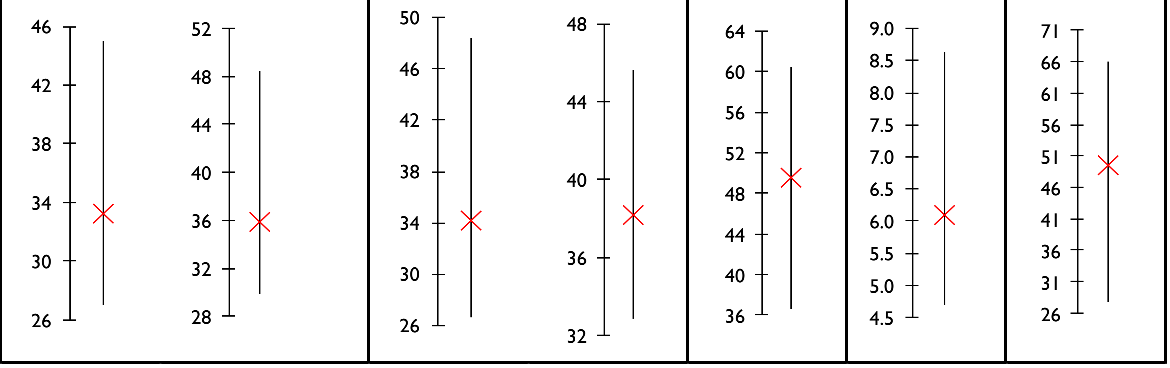
Key market indicators: 31/05/2016

		Gas (p/th)		Electricity (£/MWh)		Coal	Carbon	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	($/bl)
This month	31 May 16	33.20	35.81	34.15	38.15	49.60	6.10	49.60
Last month	29 Apr 16	30.40	34.34	31.50	36.90	46.80	6.29	48.36
Last year	29 May 15	43.20	47.19	41.00	44.65	57.25	7.30	63.21
Year-on-year % change		(23%)	(24%)	(17%)	(15%)	(13%)	(16%)	(22%)
Year high		45.00	48.38	48.40	45.65	60.50	8.64	66.01
Year low		27.00	29.88	26.56	32.84	36.55	4.69	27.83

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.

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Brexit campaigns battle over best outcome for energy sector

The two sides of the debate on the UK's future EU membership have clashed over how the energy sector will be impacted by this month's vote.

Ministerial division

Energy and climate change secretary Amber Rudd had suggested earlier this year that a vote to leave the EU could see energy bills for UK consumers rise by £500mn/ year overall. But this claim has been disputed by Andrea Leadsom, Rudd's colleague at the Department of Energy and Climate Change, who is campaigning for the UK to leave the EU.

In a speech on 17 May, Leadsom said that "absolutely none" of the UK's work towards addressing the energy trilemma would be jeopardised by a vote for Brexit. The UK's environmental commitments were, she explained, enshrined in domestic legislation, while electricity would continue to flow through interconnectors to and from the continent irrespective of the way people voted.

Leadsom warned that new European Commission proposals could in fact pose a threat to the UK's gas supply: the Commission's "winter package" requires member states to take on legal responsibility for each other's gas security – meaning that, if another member state faced a shortage, the UK could be required to support it by depriving domestic businesses of supply.

Uncertain outlook

Meanwhile, experts have continued to examine impact that Brexit would have on the UK's energy and environmental policies. In a briefing issued on 26 May, the influential Chatham House think tank said that remaining in the EU offered the "best balance" for the UK's interests in relation to energy policy. It argued that all of the models for Brexit would create regulatory uncertainty until a new framework of EU-UK relations was settled, and that this could take some time.

The report added: "The debate on Brexit risks being simplified to a choice between the status quo or leaving the EU altogether. Missing from the debate is the sense that in the sphere of energy, EU integration is moving in a direction that could benefit the UK, and is being actively shaped by UK policy.

Energy has not played a leading role in the debate over Brexit, perhaps reflecting a sense that a vote to leave the EU need not (directly at least) have major implications. However, the potential for subsequent political upheaval at Westminster has not passed without note, and could in the long term prove more consequential for the sector.

Chatham House

Findings of energy competition investigation to be implemented

The government has confirmed that it will introduce legislation to implement the recommendations emerging from a competition investigation of the energy sector.

The investigation, being undertaken by the Competition and Markets Authority (CMA), was launched in 2014, with provisional remedies unveiled earlier this year. It followed concerns, raised by the regulator Ofgem, that competition was not functioning properly in the energy market.

As part of the Queen's Speech, delivered on 18 May, the government announced that it would, during the forthcoming parliamentary session, introduce a *Better Markets Bill*, which would allow policy-makers to "act quickly" when the CMA delivered its final verdict on the sector.

The government said that the Bill would aim to give consumers more power and choice through faster switching, "and more protection when things go wrong".

The CMA will report the final conclusions from its energy market investigation by the end of June.

Government

Businesses warm to energy switching

A new survey has shown that businesses have an increasingly positive view of the process for switching between electricity and gas suppliers.

On 25 May, energy regulator Ofgem published research, prepared by analyst BMG, on *Micro and Small Business Engagement in Energy Markets.* It was based on 1,500 telephone interviews with businesses between October-December last year.

Switching up

The report found that nearly two thirds of businesses (64%) had switched gas or electricity suppliers in the past five years. The proportion of businesses that had switched supplier in the last 12 months increased slightly – up to 25% in 2015, from 23% a year earlier.

Just under half (47%) of all businesses have explored other supplier or tariff options in the last 12 months. While cost savings remain the key factor in firms' decision to switch, other significant triggers include awareness that a contract is coming to end, and receiving a renewal notice from an existing supplier.

Just under half of businesses (48%) said they regarded comparing prices as easy, while nearly four in 10 (39%) felt the opposite way. The majority (61%) also believed that switching supplier was easy.

Supplier satisfaction

Two thirds of businesses were satisfied with their current energy suppliers' services overall. Satisfaction was highest for the supplier meeting their customers' business needs (72% satisfied), but lower for the information provided on available tariffs and options (51% satisfied).

However, around two fifths (39%) of businesses said they tended to distrust energy suppliers to be completely fair in their dealings with customers, while just over a quarter (26%) trusted them. A third of businesses said they were satisfied with the competitiveness of energy prices.

The research brought mixed news for the energy industry – increasing levels of consumer engagement are welcome but there clearly remain significant trust issues to overcome.

Ofgem

Plans to ensure power supplies brought forward a year

The government has confirmed that its key mechanism for ensuring the security of Britain's electricity supplies will be introduced a year earlier than had been planned.

The capacity market aims to help ensure the lights stay on by offering a payment to reliable sources of capacity, alongside their electricity revenues, to deliver power onto the system when it is needed. This, it is hoped, will also ensure that the government secures the investment that is needed to replace older power stations and provide back-up for more intermittent low-carbon generation sources.

Auctions for capacity market contracts have already been held to secure supplies for winters 2018-19 and 2019-20. But, earlier this year, the government set out plans to hold an auction for winter 2017-18, in light of concerns over tightening electricity margins over the next few years. While system operator National Grid has been provided with tools to help balance the system, the government believes that the capacity market would have a "less distortive impact" and would therefore be preferable. An auction, into which both power generators and demand-side response providers can bid, will be held early next year.

The government has also outlined plans to provide gas-fired generation projects with a better chance of success in the next "T-4" auction, to be held in December. The development of new gas plants is regarded as a crucial component of the UK's low-carbon transition, helping to replace coal plant as they come off the system over the next decade. However, only one new gas plant was successful in the first two capacity market auctions, as the clearing price was relatively low.

Government

Government's fracking push reaches milestone

An application to frack for shale gas has been approved in the UK for the first time since 2011.

North Yorkshire County Council announced on 27 May that it had voted to allow Third Energy to undertake fracking near the village of Kirby Misperton, despite strong local protests.

Bill savings

The government has, since last year's General Election, been eager to promote the development of a shale gas industry in the UK, after a moratorium on fracking was lifted in 2012. It has sought to ease the planning process for firms in the sector, and has taken steps towards ensuring that local communities would benefit from shale development.

However, attempts to persuade the public of shale's benefits appear not to have proved successful so far. Opinion polls, undertaken by the government, have indicated that opposition to fracking has grown stronger in recent months, with particular concerns about its impact on the environment.

National policy push

In its decision, North Yorkshire County Council said it was aware that Third Energy's application to drill at Kirby Misperton was "controversial" and that many objections had been expressed. However, it noted that local councils were required to work within the national policy framework that indigenous oil and gas remained key to energy security, while facilitating the reduction of greenhouse gas emissions.

The council's chief executive, Richard Flinton, said: "We are proud of our beautiful county which attracts so many visitors and maintains a thriving tourism industry. We have no intention of jeopardising those qualities and our rural industries and livelihoods. For that reason the planning conditions must be fully discharged and monitored."

Speaking at an industry conference on 18 May, energy minister Andrea Leadsom provided assurances over the safety of fracking. UK regulations were, she explained, among the strongest in the world, and development would only ever take place "in appropriate locations". She argued that the UK was not facing a choice as to whether it needed gas – as this was clearly the case – but needed to consider whether it wanted to produce the resource domestically or rely on growing levels of imports.

The government will welcome the significant levels of industry interest in taking forward shale projects, but there are challenges in persuading the public that it is necessary and beneficial.

North Yorkshire County Council

Climate change policies not harming UK's competitiveness, study finds

The proposed Fifth Carbon Budget, which would set a greenhouse gas emissions target for 2030, would not harm the UK's competitiveness and could help deliver economic growth, a new report has claimed.

The study was published on 10 May by the Grantham Research Institute on Climate Change and the Environment, and the ESRC Centre for Climate Change Economics and Policy at the London School of Economics. It found that businesses were no less competitive globally as a result of existing policies that aimed to reduce emissions; in fact, it said, ambitious and well-designed climate change policies were likely to create opportunities for the majority of British businesses to expand in economies around the world.

The report said: Climate change policies can increase the competitiveness of the UK in the long term by encouraging greater innovation and efficiency. Well-designed climate change policies could offer business opportunities in fast-growing global markets […] The UK is well-positioned to benefit from a global transition to a more resource-efficient and renewable economy, provided flexible structural policies allow it to utilise its comparative advantages."

LSE

Commercial landlords unprepared for new energy rules in Scotland

Commercial property landlords in Scotland are unprepared for new energy efficiency regulations, an independent property and construction consultancy has said. From 1 September 2016, owners of buildings greater than 1,000sq metres will be required to provide an "action plan" when they sell or rent out their properties. They will also be required to ensure that energy improvement data, including the plan and Energy Performance Certificate (EPC), are submitted to the Scottish EPC register.

Analysis by Tuffin Ferraby Taylor (TFT) has warned that around 70% of commercial property owners are yet to prepare their action plans, detailing measures that will improve the energy performance of the buildings.

TFT partner and head of sustainability Mat Lown said: "We believe the regulations offer an enlightened approach to energy performance by making relevant compliance information publicly available and recognising that such regulation is an essential part of implementing Scotland's energy efficiency programme over the next 20 years."

TFT

Businesses concerned by cost of policy reforms

UK manufacturers have expressed increasing concern about a forthcoming government review that could sharply increase their energy costs.

The government announced in March that energy regulator Ofgem would undertake a review of the "embedded benefit". These are the costs that local energy users, who generate their own power onsite, avoid through their use of only the distribution, not the transmission networks. The government is concerned that these embedded benefits are overcompensating distributed power generators.

In analysis issued on 23 May, industry group the Association for Decentralised Energy warned that the review could increase costs for local energy users by more than £170mn overall.

ADE

UK energy security boosted by gas field inauguration

The UK's newest gas field was official opened by energy and climate change secretary Amber Rudd on 16 April.

The Laggan-Tormore field, 125km west of the Shetland Isles, is operated by Total, with SSE owning a 20% stake, and began producing gas in February this year. The fields are now running at full capacity, producing 90,000boe/ d. The nearby Edradour and Glenlivet fields being developed by the same firms are expected to start in 2017 and 2018 respectively, keeping production at peak rates through to 2020.

Jim Smith, SSE's managing director of generation, said: "As well as helping to meet the needs of SSE and its customers, the gas from these fields will make a significant contribution to the security of gas supply in the UK."

SSE

NIC outlines plans for assessing UK's infrastructure needs

The government's new National Infrastructure Commission (NIC) has opened a consultation on its approach to assessing the UK's key infrastructure needs over the coming decades.

The NIC has been established with a responsibility to analyse the UK's long-term infrastructure requirements, outline a strategic vision over a 30-year time horizon, and set out recommendations for how the needs identified might be met. This will be completed through the publication of a National Infrastructure Assessment (NIA) once in every Parliament, and the NIC is now consulting on how that work will be taken forwards.

The commission intends to develop the assessment in two phases. The first stage will determine a vision for the UK out to 2050 and highlight priority areas for action over the medium term, with a report to be published in summer 2017. A consultation will then be held on these priorities, with the NIA to be published in 2018.

NIC