CATALYST
COMMERCIAL SERVICES

# Energy element

2 March 2012

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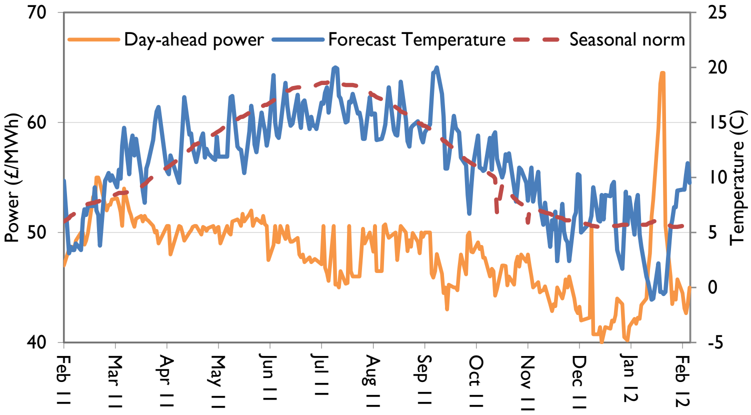
## Short-term market affected by weather, gas supply and rising oil

The mild winter that caused electricity and gas prices to drop to 12 month lows earlier this year came to an abrupt end in February as temperatures fell far below seasonal norms across Europe. The cold snap drove demand up, prompting prices to follow. As a result of the extreme cold, Russia to Europe gas supplies were withheld as the country struggled to meet its domestic needs. This led to EU countries turning to the UK market to meet demand.

The UK was consistently exporting during the cold snap, which pushed spot power and gas prices to new peaks. Day-ahead gas prices reached a six-year high after topping 100p/th, and day-ahead electricity prices peaked at a four-year high of £64.50/MWh. Prices slipped back down again during the month as temperatures returned to seasonal norms. But as we moved into March gas and power prices remained 9% and 6% higher respectively compared with January's figures.

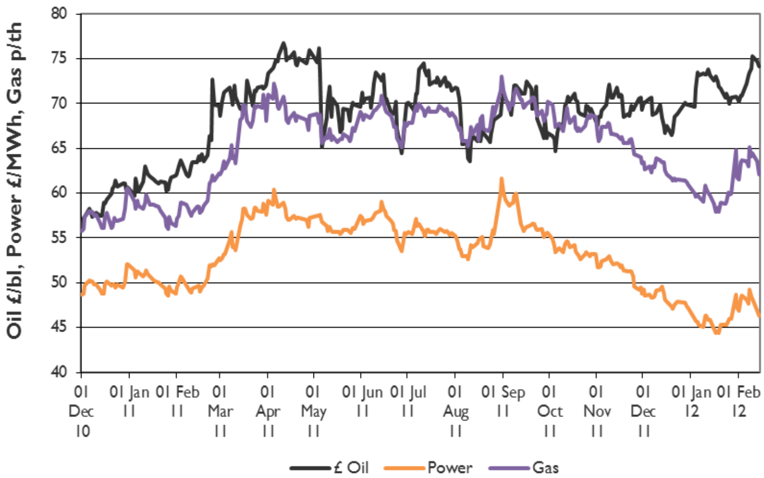
Forecast temperatures and spot power and gas prices




## Longer-term prices affected by rising oil prices and low LNG flows

Seasonal prices were also on a downward trend as speculation about the future of the Eurozone may collapse drove fears of a reduction in demand across the EU. But this trend was reversed as continuing tensions in the Middle East pushed oil prices to nine-month highs as Iran cut-off supplies to France and the UK ahead of an EU oil embargo from July. Month-ahead Brent crude reached $124.10/bl on 27 February. Record low LNG flows have also supported prices in the UK, causing more expensive gas to be withdrawn from storage. Storage is now less than 40% full.

Crude oil and annual wholesale gas and power prices

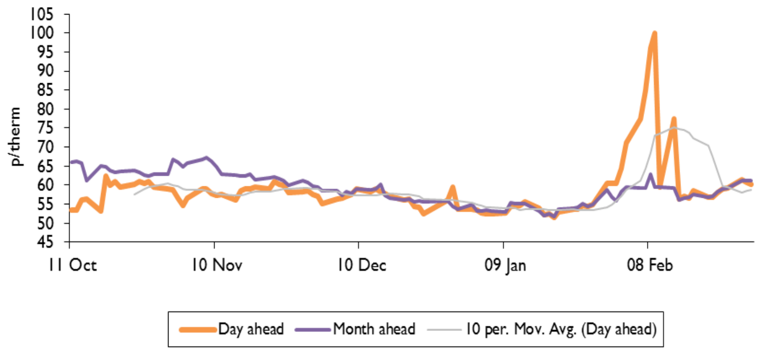



## Oil prices could reduce slightly

We believe that current high oil prices are likely to reduce slightly over the near-term as traders worry about the effects of high prices on economic growth. We have seen prices already beginning to slip, and we expect prices to stay relatively high throughout the year. But, as February has shown, unexpected price rises could occur at any time with continuing tensions in the Middle East adding a wildcard.

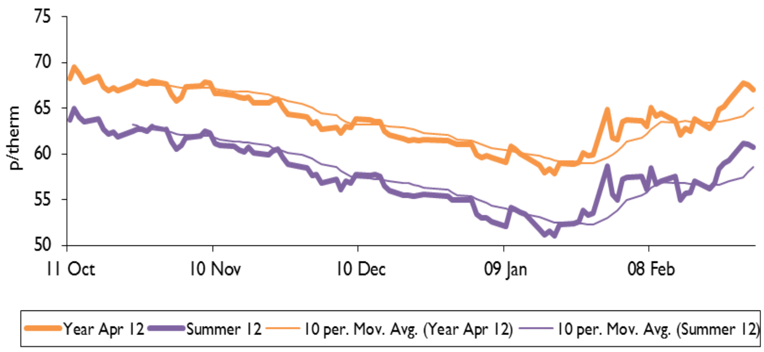
Catalyst Commercial Services' independent approach enables clients to manage their exposure to energy price risk, while at the same time benefiting from a first class service from a range of major and independent suppliers. Catalyst Commercial Services' procurement solutions make it simple, so contact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

## Spot gas prices

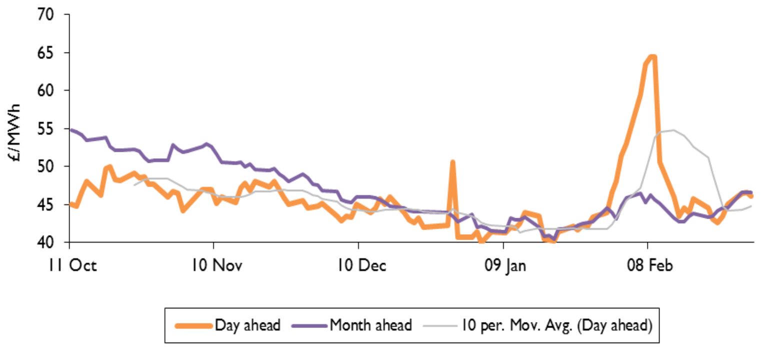



- Spot gas prices saw significant movement during February as a result of the cold snap.
- Day-ahead gas prices peaked at 100p/th on 9 February.
- Month-ahead gas prices peaked at 63p/th on 8 February.
- Annual gas prices also saw significant movement during February tracking high oil prices.
- Annual April 2012 gas prices peaked at 67.73p/th on 27 February.
- The summer 2012 contract peaked at a three-month high of 61.20p/th on 27 February.

## Annual gas prices

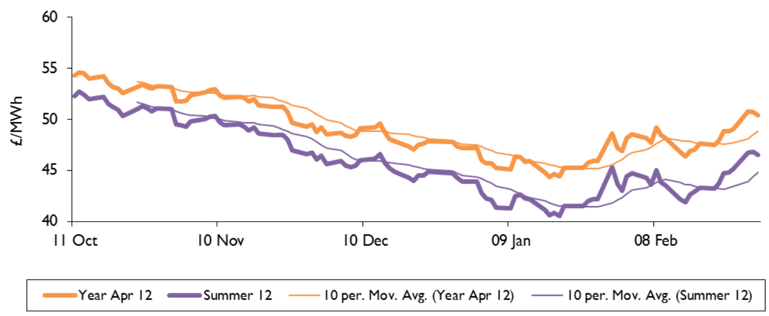



## Spot power prices




- Spot electricity prices were also driven upwards by the fall in temperatures and the rise in gas prices.
- Day-ahead electricity prices peaked at £64.50/MWh on 9 February.
- Month-ahead power prices peaked at £46.25/MWh on 8 February.
- Annual electricity prices saw significant increases following the rise in their gas counterparts.
- Annual April 2012 power prices peaked at £50.75/MWh on 27 February—a three-month high.
- The summer 2012 electricity contract peaked at £46.85/MWh on 28 February.

## Annual power prices



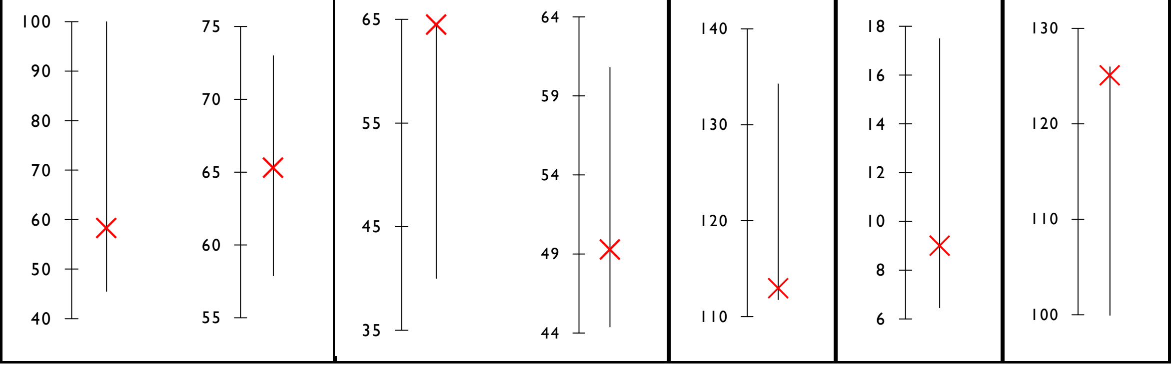
# Energy element

2 March 2012

## Key market indicators: 02/03/2012

| | | Gas (p/th) | | Electricity (£/MWh) | | Coal | Carbon 2012 | Brent crude |
|---|---|---|---|---|---|---|---|---|
| | | Day-ahead | Year-ahead | Day-ahead | Year-ahead | ($/t) | (€/t) | ($/bl) |
| March | 2 Mar 12 | 58.25 | 65.30 | 64.48 | 49.28 | 112.95 | 9.00 | 125.06 |
| February | 1 Feb 12 | 60.45 | 61.53 | 59.79 | 46.88 | 116.25 | 8.14 | 111.40 |
| Last year | 3 Mar 11 | 57.00 | 63.18 | 59.65 | 53.63 | 121.75 | 15.63 | 115.93 |
| Year-on-year % change | | 2% | 3% | 8% | (8%) | (7%) | (42%) | 8% |
| Year high | | 100.00 | 73.00 | 64.50 | 60.83 | 134.25 | 17.50 | 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.

## Disclaimer



## Ofgem tackles Big Six market dominance

Energy regulator Ofgem late last month unveiled a new “roadmap” of reforms as part of a drive to increase competition and tackle the electricity market dominance held by the Big Six. Currently E.ON UK, Scottish Power, SSE, EDF Energy, Centrica and RWE, collectively known as the Big Six, supply over 90% of the nation’s electricity and gas. Lack of liquidity in the energy market has long been a concern for successive governments, the regulator and consumer advocates. Liquidity is the degree to which an asset, say electricity, can be bought and sold in the market without affecting the asset’s price. A high liquidity value usually means more trading of the asset as different parties battle to keep the price down and remain competitive.

Ofgem has been monitoring the lack of market liquidity since 2008. In February 2010 it set out some potential solutions but said the market should be given time to fix the problem itself. Although small suppliers and independent generators were sceptical that this would be the case, Ofgem wanted trading exchanges such as the new N2EX to be given time to take off. The commissioning of the BritNed (Britain-Netherlands) interconnector was also expected to help address the situation. The regulator then promised action within a year. A year further on from that deadline, while there have been improvements (predominantly with E.ON UK and SSE stepping-up power sales in the day-ahead market operated by the N2EX exchange), small suppliers and independent generators continue to call for urgent action.

### The proposals


On 22 February Ofgem launched a roadmap for liquidity reforms. The document sets out a detailed plan to "open up the wholesale electricity market" by setting out three objectives the Big Six energy suppliers will have to meet to ensure the market: delivers enough contracts to help energy traders hedge price risks; has trusted reference prices for future contracts; and provides the right signals to switch on power stations. To ensure these objective are met Ofgem is proposing to the regulation require the UK’s largest energy companies to sell 25% of their generation volumes through open auctions in order to make it easier for independent suppliers and generators to engage with the market.

Ofgem expects to publish its favoured proposals in summer 2012, followed by a statutory consultation in autumn 2012. Any resulting regulations would not come into force before the end of the year.

### Broadly welcomed

Introducing the proposals senior partner for markets Andrew Wright said: “Since Ofgem announced that the Big Six companies needed to change radically their ways; they have made progress. We have seen pledges to simplify tariffs, moratoriums on door-step sales and now auctioning of power in the short-term market. This is to be welcomed [but] the needs of independent suppliers have not yet been met and this is why Ofgem is proposing to introduce mandatory auctions to force the pace of change and increase transparency.”

But he made clear that the Big Six do not have to wait until the auctions are in place to act and said energy suppliers now have the chance to “take the lead and deliver this increase in liquidity.”

The reform proposals have been welcomed by the new energy and climate change secretary Ed Davey. He said: "Consumers will get the best deals when suppliers face tough competition and that is what both the government and the regulator are working to achieve”.

“We have cut red tape for small suppliers to give them a leg up into the market, and we are also working with the Ofgem to deliver clearer bills and simpler tariffs. We have strengthened Ofgem's own hand by making it harder for energy companies to block licence changes, and we are looking at beefing up Ofgem's powers further to ensure fairer outcomes for consumers", he added.

Responses to the consultation are invited before 8 May.

Ofgem—consultation          Ofgem—factsheet



## Company finance for Green Deal scheme inches forward

Heralded as a “revolution” in the UK energy sector, the Green Deal is the flagship government initiative to increase the energy efficiency of British properties in the public and private sector. First proposed to parliament in 2010, the Green Deal will allow private companies to provide domestic and commercial customers with building improvements designed to boost the energy efficiency of their premises. The idea is that loans will be provided to cover upfront finance for energy efficiency improvements to domestic and business premises that will be recouped through the savings made on the electricity bill of the premises. But stakeholders have raised concerns that some businesses may find they cannot access the scheme because of a lack of lending support.

A not-for-profit organisation–the Green Deal Finance Company (GDFC)–was launched in October as a partnership between 16 companies, including big suppliers, Goldman Sachs, HSBC, Kingfisher and PwC, to offer low-cost loans under the Green Deal. The GDFC will pool available finance to allow it to access the capital and bond markets and so decrease the interest paid on loans. And on 24 February lead partner at PwC Paul Davies confirmed that another four businesses have joined its ranks.

### Help is at hand (for some)

Although the GDFC will help some of the smaller players, Davies acknowledged that there is a "risk around the middle ground" of the small-to medium-sized enterprise (SME) sector of qualifying for Green Deal loans. These companies may face the situation where they are told that they are too big to qualify for GDFC loans, but too small to get loans from conventional banks. But he added "there is an obvious opportunity there for some banks to focus on [this sector]."

Davies said the big five banks (Barclays, HSBC, Lloyds Banking Group, RBS and Santander UK) could provide Green Deal loans to businesses that do not qualify for GDFC loans under Project Merlin, which has been set up to make it easier for smaller firms to get access to credit. Another bank likely to step in if the gap cannot be filled is the Green Investment Bank—expected to be launched in April—which has been tasked with addressing potential market failures of the Green Deal as one of its top priorities.

Businessgreen

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## CBI calls on chancellor to re-think green taxes

In mid-February business lobbyist the CBI called on chancellor George Osborne to merge the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme with the Climate Change Levy (CCL) as part of a raft of reforms to the green tax system.

The CRC is a mandatory scheme aimed at improving energy efficiency and cutting emissions in large public and private sector organisations. It features a range of reputational, behavioural and financial drivers, which aim to encourage organisations to develop energy management strategies that promote a better understanding of energy usage. The CCL is a tax on the supply of specified energy products for use as fuels by business consumers. But unlike the CRC, the levy is recycled back to business through a 0.3 percentage point cut in the employer’s national insurance contributions.

Ahead of the Budget to be unveiled on 21 March, CBI director-general John Cridland wrote to Osborne asking him to reform green taxes. The letter is accompanied by a formal Budget submission in which the CBI sets out a series of proposals to boost jobs and growth, including rolling the CRC into a reformed CCL. But it proposed that these changes should happen in "tandem" with the roll-out of mandatory carbon reporting for businesses.

### Another burden for business

Meanwhile manufacturers’ organisation EEF issued a call on 24 February for the government to abandon its plans for the UK’s unilateral carbon tax in the Budget 2012. EEF said if the government continues with its current price trajectory this will double the rate of the Carbon Price Support levied on fossil fuels used for power generation from £4.94/t$CO_2$ in 2013-14 to around £10/t$CO_2$ in 2014-15. Carbon Price Support is the government’s device to increase certainty for infrastructure investors. The introduction of a carbon price floor, announced by the chancellor in the 2011 Budget, forms part of a wider reform of the electricity market. It will essentially provide a fixed top-up for the carbon price set under the EU Emissions Trading Scheme in a bid to bring low-carbon investment to Britain.

The EEF called for the government to stick to the original estimated price for 2014 of £7.28/t$CO_2$. It said the increased tax could push industrial electricity prices up by 6%-7% and estimated this would cost the UK economy approximately £300mn.

CBI EEF



## Businesses step up to support new energy secretary

A number of large UK organisations and businesses have recently written to the newly appointed energy and climate change secretary Ed Davey to offer support to take the country to a lower-carbon future. The Aldersgate Group, National Grid, Ecotricity, SSE, Sony, and Unilever are among the signatories to a letter that have called for the secretary to provide “credible long-term policies” and “vocal ministerial support” to give businesses sufficient certainty to invest and expand in the UK. The companies have offered support for the secretary to: invest in ambitious programmes to increase energy efficiencies; establish the UK as a leading green economy; and create confidence for businesses to invest in UK renewable energy.

Aldersgate Group

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## Government turns to Supreme Court on solar feed-in tariff case

On 21 February a spokesperson from the governments energy department (DECC) announced it has lodged an appeal case to the Supreme Court against two rulings that found its proposed plans to cut subsidies for solar photovoltaic (PV) installations to be “legally flawed”. The application to the Court will seek to impose reductions in feed-in tariffs (FiTs) for installations completed after 12 December 2011.

At the Court of Appeal in January three judges separately ruled that DECC would be acting unlawfully by trying to impose retrospective cuts to the solar PV tariffs. The spokesperson said DECC is now awaiting a decision from the Supreme Court on permission for the appeal to go ahead. The delay is causing further uncertainty for businesses and homeowners looking to participate in the scheme.

Government

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## Shale gas opportunities should not be missed, says report

Think-tank Policy Exchange published a new report on 24 February *Gas Works? Shale Gas and its Policy Implications* arguing that the government is “unnecessarily gambling with bill payers' money”. The report said the UK’s energy generation plans are based on a “flawed” strategy that forecasts future gas prices. It said focusing on these plans will potentially result in the UK missing out on the economic and environmental benefits presented by shale gas. The report said no-one can predict future gas prices, but the level of current shale gas developments suggests prices may be lower than previously assumed.

Policy Exchange

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## New electric vehicle grant available for business

Transport secretary Justine Greening announced on 21 February that a new grant of up to £8,000 will be available for plug-in commercial vans that are powered by electricity. Business minister Mark Prisk said the upfront purchase grant, lower running costs and tax benefits can “make switching to an ultra-low carbon van an attractive choice” for businesses.

The same day the Energy Savings Trust published a new report that found electric vehicles (EVs) can be commercially viable in business fleets. The report, *EV20 Plugged-in Fleets*, detailed the economic and environmental benefits of employing EVs in fleets and provided businesses with guidelines for those fleet managers already looking to introduce them.

Department for Transport Energy Savings Trust

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## Analyst predicts turbulent year for carbon trading market

Newswire *Businessgreen* reported on 23 February that a new forecast by analyst Thomson Reuters Point Carbon shows a large drop is expected in the value of the carbon market in 2012. The forecast showed the volume of carbon traded globally will reach 9.5Gt, up 13% compared to 2011, as companies prepare for the launch of phase III of the EU Emissions Trading Scheme in 2013. But the value of the carbon market is set to fall 36% in 2012 to €61bn because of an over-supply in allowances.

Businessgreen

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