CATALYST ENERGY SOLUTIONS

Energy Element / April 2015

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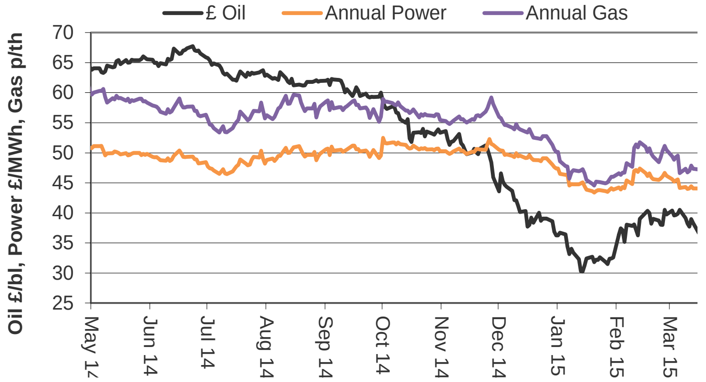
Commodities return to downward trends in March

Brent crude oil, coal and carbon prices returned to downward trends in March, impacting GB power and gas contracts. Oil prices dropped 2% to average $57.4/bl as concerns increased that US storage levels were reaching full capacity.

The falls fed into coal prices, which dropped 4.9% over March and hit a five-year low of $56.9/t. The coal market was also affected by falling global demand levels, which have increased oversupply in the market.

Crude oil and annual wholesale gas and power prices

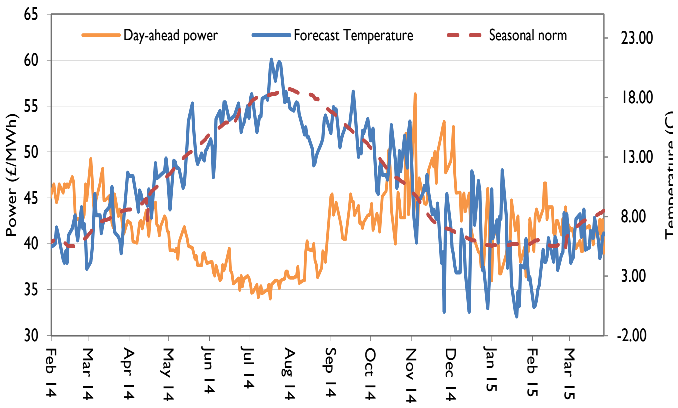


The carbon market was also bearish, with priced dropping 7% to average €6.8/t as talks on proposed market reforms slowed. Prices hit a five-month low of €6.3/t in the month.

Commodity prices feed into GB market

Falls in the commodity prices fed through to GB power and gas contracts over the month. Overall, seasonal gas contracts averaged falls of 4.1%, with the winter 15 contract dropping 3% to 50.9p/th. Gas contracts also dropped as continental deliveries picked up after previous outages over February. Power contracts followed the gas market lower as winter 15 power fell 2.7% to £46.7/MWh. The annual April 15 contract finished trading at £45.7/MWh, 13% below its level a year earlier. Prices rose towards the end of the month, however, as news of capacity closures and storage outages led to supply fears for the months ahead.

Spot power prices and temperatures



The month ahead: Capacity closures and gas storage restrictions

E.ON confirmed on 19 March that its 900MW Killingholme plant "would no longer be available to generate in the UK energy market". Moves towards closure could place further pressure on capacity margins and push power prices higher for next winter. The announcement followed similar news for the Longannet coal-fired station which Scottish Power said was likely to close by March 2016.

Closures at the Hornsea gas storage site and repairs for Rough storage, the UK's largest site, have led to fears for reduced storage capacity going into next winter. Gas prices rose in the last week of March following these announcements and the market is expected to be bullish going into the summer injection season. Forecasts of a colder-than-average April have also sparked fears over supply shortages.

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

Long-term gas contracts tracked the falls seen in Brent crude oil over March, and also lowered as continental supplies returned from previous outages.

Summer 15 gas dropped 3.1% to average 44.8p/th and ended trading at 46.1p/th, 22% below its level a year earlier. The annual April 15 contract shed 3.3% to 47.8p/th.

Spot gas prices

Shorter-term gas contracts also dropped in March. Lower demand levels and increased LNG and continental deliveries helped the system remain well supplied over most of the month.

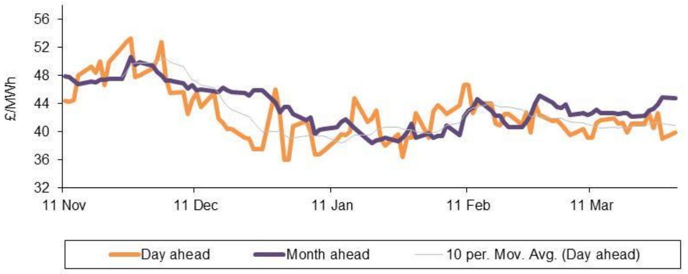
Day-ahead gas decreased 6.7%, to average 47.3p/th over the month.

Annual power prices

Power contracts followed the falls seen in gas and coal over March.

Summer 15 power dropped 2.4% to average £42.5/MWh and ended trading at £43.9/MWh. The average price for the contract over the winter months, at £45.4/MWh, was the lowest for a seasonal contract since winter 2010-11.

Spot power prices



Spot power prices fell over March as cheaper gas prices fed into the market.

Day-ahead power dropped 4.6% to average £40.9/MWh and hit a two-month low of £39.0/MWh towards the end of the month.

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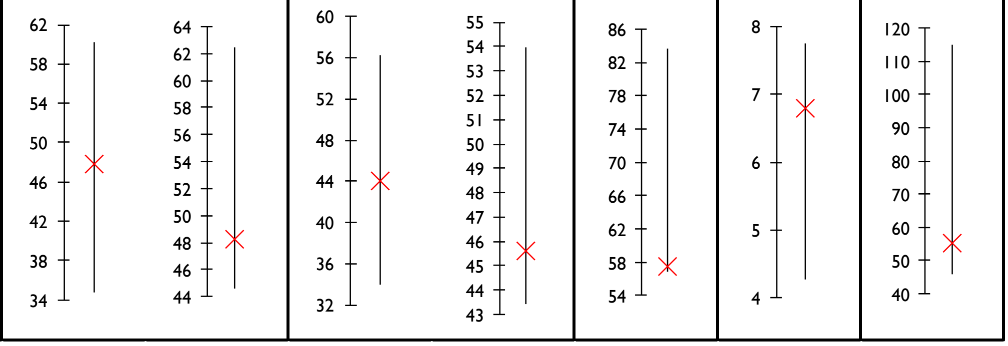
Key market indicators: 31/03/2015

		Gas (p/th)		Electricity (£/MWh)		Coal	Carbon	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	($/bl)
This month	31 Mar 15	47.80	48.23	44.10	45.60	57.50	6.80	55.35
Last month	27 Feb 15	52.70	50.43	42.45	46.48	63.40	7.05	61.42
Last year	31 Mar 14	50.65	62.10	42.50	53.00	80.50	4.27	107.90
Year-on-year % change		(6%)	(22%)	4%	(14%)	(29%)	59%	(49%)
Year high		60.20	62.45	56.30	53.98	83.70	7.75	115.20
Year low		34.70	44.56	34.00	43.40	56.90	4.27	45.98

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.

Budget brings North Sea tax reforms

Chancellor George Osborne delivered the last Budget of the current Parliament on 18 March. The statement included a number of significant announcements for the energy industry, with reforms to the fiscal regime for the oil and gas sector, and a further easing in the costs of decarbonisation for energy-intensive industries.

Tax cuts for oil and gas industry

Measures to support the North Sea industry had been widely anticipated in light of the low oil price, which Osborne said represented a "pressing danger" to the sector.

The government reduced the Supplementary Charge (a charge levied on companies' ring fence corporation tax profits) from 30% to 20%.Meanwhile, the Petroleum Revenue Tax was cut from 50% to 35%, so as to help extend the life of key infrastructure, and to promote investment in older fields.

The government is to provide an extra £20mn for a series of seismic surveys to boost offshore exploration. It will also introduce a new Investment Allowance; this will seek to boost investment in all stages of the industry life cycle, and to simplify the existing system of offshore allowances.

Industry body Oil & Gas UK has estimated that, in the near-term alone, these measures could incentivise an additional £4bn of capital investment. This, it says, would facilitate the development of 500mn barrels of oil equivalent, worth around £20bn at today's prices.

Relief for heavy industry

The government also outlined plans to bring forward its planned relief for energy-intensive industries (EIIs) from the cost of environmental policies. Osborne said that he would introduce, earlier than had been intended, planned compensation from the costs of the small-scale feed-in tariffs scheme, for EIIs, to 2015-16. Osborne had first announced the compensation package at Budget 2014, saying that it was necessary in order to ensure that manufacturers remained as competitive internationally as possible. Analysis by the independent Office for Budget Responsibility (OBR) suggested that manufacturers would save £25mn overall as a consequence of the earlier introduction of the scheme.

Tidal lagoon to be backed

The government said that it would enter into the first phase of negotiations on a contract for difference (CfD) for the Swansea Bay tidal lagoon, which has been proposed by Tidal Lagoon Power. CfDs are the government's new mechanism for supporting the deployment of low-carbon power generation, and are usually allocated in competitive auctions. However, owing to the relative immaturity of tidal technology, the government will negotiate possible support for this project on a bilateral basis – as it did with EDF Energy over support for the Hinkley Point C nuclear power plant.

The government will seek initially to determine whether the project is affordable and offers value for money to consumers, while also considering whether it could help to drive down the costs of tidal lagoon power in the UK.

Criticism from green groups

The Budget was met with some criticism from green groups, and particularly from stakeholders in the renewables and energy efficiency industries. Responding to the tidal lagoon announcement, Greenpeace UK executive director John Sauven said that the UK's renewables industry needed a "long-term strategy, not just a belated wink to green voters".

The UK Green Building Council (GBC) argued that, while the chancellor's backing of the tidal lagoon project showed some promise of the government's commitment to the green agenda, it was an "otherwise barren Budget" for energy efficiency.

Government

Relocated solar projects to keep government support

From summer 2019 it will be possible to move medium and large solar PV installations between buildings without losing subsidy payments, the government has confirmed.

Portable panels

The government's feed-in tariff (FiT) scheme provides payments for those who are able to generate their own electricity from certain renewable sources. Participants under the scheme receive a payment for each kilowatt-hour of electricity they generate; the rates available depend upon the size of the system, the technology installed and the date of installation.

Previously, installations would lose support from the FiT scheme if they were relocated. But changes to the scheme, confirmed on Friday 20 March, will mean that landlords and tenants who cannot guarantee being in the same building for the long term will be able to move their installation and retain support.

The move is part of the government's effort to shift the focus of solar deployment from ground-based systems to rooftops. It estimates that the UK has around 250,000 hectares of south-facing commercial rooftops - the equivalent of 350,000 football pitches - so there is very significant potential for generation from commercial buildings. The government hopes that allowing the FiT to be retained will provide investors with more confidence and should reduce costs.

Definition change

The definition of building-mounted solar will also be amended, so as to require the building on which the system is sited to use at least 10% of the electricity generated.

Junior energy minister Amber Rudd said: "Solar PV is already used by thousands of businesses and by removing barriers more will be able to reap the benefits of lower energy bills. People have the power to generate their own electricity and now there is even more of an incentive. Not only will rooftop solar drive down bills and create jobs, it will help us deliver the clean, reliable energy supplies that the country needs."

Government

Business group sets out election priorities

Influential business lobbyist the CBI set out its energy and environmental priorities for the next Parliament on 20 March.

The group argued that there were five issues in particular on which the next government should focus. Firstly, it advocated that the government complete the implementation of its Electricity Market Reform package, in order to provide incentives for the investment required in energy infrastructure. It would also be critical, the CBI said, to respect the decision of the ongoing Competition and Markets Authority's investigation into the energy markets in order for "good policy, not good politics to drive decisions".

The CBI said that energy efficiency should be elevated to a key infrastructure priority: the Green Deal was said to be "something of a damp squib due to the complexity and cost of the policy", while the Energy Company Obligation (ECO) was in need of a successor. The group pressed for energy-intensive industries to be given exemptions from green policies so that they could compete on the world stage, and it urged reform of EU Emissions Trading Scheme so that it could support emissions reduction and investment.

Rhian Kelly, CBI business environment director, said: "Decisions taken over the next Parliament will have a major impact on whether or not we can meet this ambition so it's essential that the business community is united and steers a new government along the right path."

CBI

Energy network price controls “too generous”, warn MPs

Ofgem is failing to deliver value for consumers in its regulation of the transmission and distribution networks, an influential committee of MPs has said.

The energy and climate change select committee published a report on *Network Costs* on 23 February. The investigation was launched in February 2014 to examine concerns about the way in which network charges were determined and the energy regulator Ofgem’s effectiveness in scrutinising the profits of companies in the sector.

High profits

Ofgem has agreed price control settlements, under the so-called “RIIO” framework, with the gas and electricity transmission companies and gas distribution companies until 2021, and the electricity distribution firms until 2023. But it said that, for the first year of the RIIO price controls, 38 out of 40 targets had been reached by the network companies, allowing most of them to make higher than expected profits.

The committee said: “We believe that the price controls are too generous and the targets too low. We want Ofgem to utilise the RIIO price control frameworks to put more pressure on the networks to limit their costs and provide better value for customers, for example through a mid-term review, ideally supported by an independent auditor to enable more accurate calculations of future price controls.”

Charging regime

The committee also questioned the need for maintaining distinct regional network charges. It said that an approach akin to that of Royal Mail - where the price of one stamp covers the cost of delivery to anywhere in the country - might be preferable. However, the report acknowledged that to introduce a national tariff “would require major changes to the existing charging system for network costs”.

The report was critical of the volatility of network charges, labelling it “unnecessary”. The inquiry heard evidence from one smaller supplier that this volatility - with charges sometimes set only 40 days ahead of their implementation - added a risk premium to tariffs, raising consumers’ energy prices. This, the supplier said, was particularly challenging in light of the growing popularity of fixed-term tariffs, which limited suppliers’ ability to pass cost shocks on the network side through to consumers.

The committee consequently recommended that Ofgem adopted the proposal to provide suppliers with 15 months’ notice of network price changes. It also said that network companies needed to provide clearer explanations for the reasons behind such changes.

Tougher regulation

Committee chair Tim Yeo said: “Ofgem must get its act together and scrutinise these near monopolies more effectively. Simpler charging methodologies are needed to strengthen the market’s ability to scrutinise costs and increase the pressure for greater cost-saving efficiencies.”

Parliament

Energy supplier profits highest in SME sector: CMA

Analysis by the Competition and Markets Authority (CMA) has shown that energy suppliers are making their highest profit margins from small-to-medium sized enterprises (SMEs)

A working paper issued by the authority on 16 March examined which components of energy suppliers’ businesses were most profitable. It found that earnings before interest and tax (EBIT) for the firms combined more than trebled from £0.5bn in financial year 2007 (FY07) to £1.6bn in FY13. EBIT margins also increased, from 1.4% in FY07 to 2.8% by FY13 - with a high over the period of 4.2% in FY10. Within this analysis, it found that EBIT margins varied considerably between the different retail segments, but that the SME sector generated the highest EBIT margin for both fuel types: 7.9% for electricity and 10.1% for gas. The CMA said that it would carry out additional research to understand the drivers of these relatively high margins.

CMA

European energy efficiency plans criticised

EU Member States still have much work to do in order to implement the bloc's energy efficiency legislation, according to a report released on 16 March.

Published by campaign group the Coalition for Energy Savings, the report suggested that member states' national action plans, detailing how they intended to reach the minimum level of energy savings required by the Energy Efficiency Directive, continued to lack credibility. The UK's plan was criticised for including savings from buildings standards that "may not go beyond European minimum requirements and thus will not be eligible".

Coalition for Energy Savings

Rising energy costs unlikely to impact European trade, study claims

A large increase in energy prices in the EU would have only a very small effect on exports by European industry and the balance of trade, according to an academic paper published on 2 March. The paper, *Asymmetric Industrial Energy Prices and International Trade*, was prepared by the Grantham Research Institute on Energy and Climate Change and the ERSC Centre for Climate Change Economics and Policy at the London School of Economics (LSE) and Political Science.

The study found that energy prices "explain less than 0.01% of the variation in trade flows, suggesting that differences in energy prices are a marginal driver of trade globally". It calculated that a ten-fold increase in the carbon price—which is currently around €7/ tonne—to €65/ tonne in the EU Emissions Trading Scheme would be equivalent to a 30% increase in energy prices, but would cause exports to fall by only 0.5%, while increasing imports by 0.07%.

LSE

Government consults on smart meter programme for businesses

The government opened a consultation on 24 March on two decisions that need to be taken on the roll-out of smart meters to businesses. It is seeking views on the current policy position that suppliers will, from April 2016, no longer be able to install advanced meters to meet their smart meter roll-out obligations. Advanced meters are often technologically similar to smart meters, but do not meet all of the essential technical requirements. The government is also considering whether it should end the option for suppliers to use communications services other than those provided by the central Data and Communications Company (DCC).

Government

MPs outline future energy challenges

The commons energy and climate change select committee set out its ideal future for the sector in a report released on 12 March. The committee hoped that, by 2030, renewable energy technologies would have matured and fallen in cost, and that this would consequently limit the role that government would need to play in the market. It accepted that fossil fuels would continue to prove an essential part of the energy mix, but said that carbon capture and storage should be deployed at scale. The committee said that three factors would be essential to the energy transition: maintaining political stability; promoting new technologies, particularly demand reduction; and building consumer trust.

Parliament

Ofgem backs three new interconnectors

The energy regulator Ofgem announced on 5 March that it was minded to support three new electricity interconnectors through its new "cap and floor" regime.

Interconnectors allow energy to flow between the UK and other countries, providing additional security of supply. Ofgem intends to apply the new regulatory regime to the proposed FAB Link and IFA2 interconnectors, which both connect to France; and Viking Link, which will connect to Denmark. It is estimated that these three interconnectors will provide around £8bn of benefits to British consumers over 25 years, and provide an extra 3.4GW of capacity.

Ofgem