CATALYST ENERGY SOLUTIONS

Energy Element / March 2016

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Power and gas prices at nine-year low

Most seasonal UK power and gas prices continued to fall in February, despite a boost in oil prices.

Seasonal gas contracts remained at their lowest levels since 2007, as a strong UK gas supply outlook offset rising oil prices. Total's £3.3bn Laggan-Tormore gas project has entered production, and once operational the fields are expected to produce enough gas to supply 8% of the UK's total consumption. In addition, LNG delivery to the UK is already at a five-year high this winter. Summer 16 gas dropped 4.7% to average 28.0p/th.

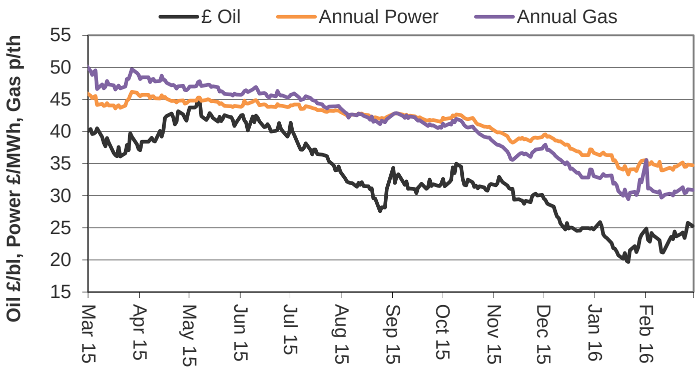
Seasonal power contracts showed diverging trends. Summer contracts followed gas and coal markets lower, while winter contracts were supported by tightening supply margins following the likely closure of multiple coal-fired power stations. The summer 16 power contract fell 4.8% to average £31.5/MWh, but winter 16 power gained 1.9% to £37.9/MWh.

Spot power prices also dropped last month. Day-ahead power reduced 7.9% to average £34.0/MWh as a combination of high wind output and low day-ahead gas prices pressured the contract lower. Day-ahead gas slid 6.9% to average 29.4p/th in February, hitting a near six-year low of 28.8p/th on 5 February, as strong European and LNG supplies kept prices low. Consequently, gas storage levels have stayed above normal.

Oil prices gain, but coal prices continue to fall

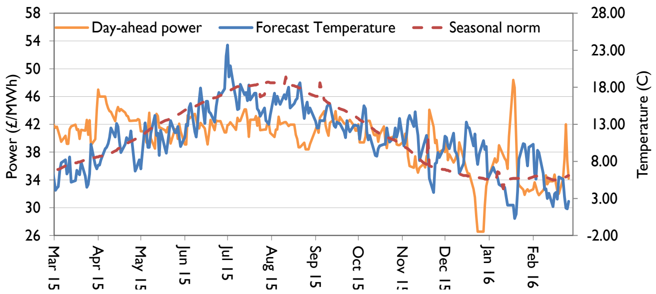
The price of Brent crude oil rose last month as nations discussed the possibility of a supply freeze. Saudi Arabia, Qatar, Venezuela and non-OPEC producer Russia said on 16 February they would freeze output at January levels. Overall the price increased by 5.1% to average $33.7/bl. Analysts are forecasting that the global supply glut is set to continue for the foreseeable future. Morgan Stanley has downgraded its outlook for oil prices, predicting the supply and demand imbalance will continue for at least another two years.

Crude oil and annual wholesale gas and power prices



API 2 coal declined 7.0% to average $38.0/t, hitting a fresh low of $36.6/t on 18 February. A stall in global coal demand growth has caused prices to plummet by 42.0% compared with February last year. Coal demand growth will slow to 0.5% a year, compared with around 3% annual growth over the past 20 years, BP said in its annual *Energy Outlook*. Most notably, coal demand in China has fallen as the government seeks to curb pollution levels.

Spot power prices and temperatures



EU ETS carbon fell 25.3% to average €5.1/t, hitting a 15-month low of €4.7/t on 10 February. However, Thomson Reuters has suggested that the price will recover slowly from its slump.

The month ahead: Tightening supply margins

Five UK coal-fired power stations could close in summer 2016. This sudden loss of capacity could tighten supply margins for next winter, and may lead to price spikes if sufficient reserves are not contracted.

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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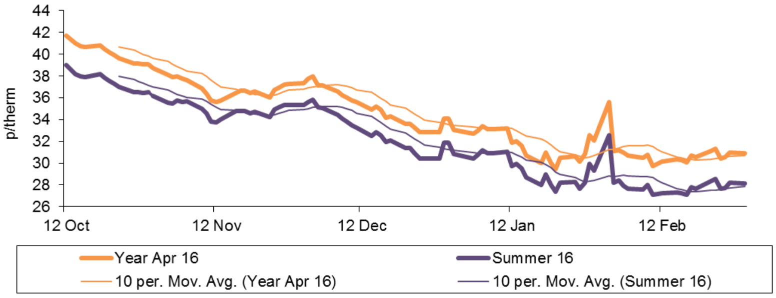
Annual gas prices



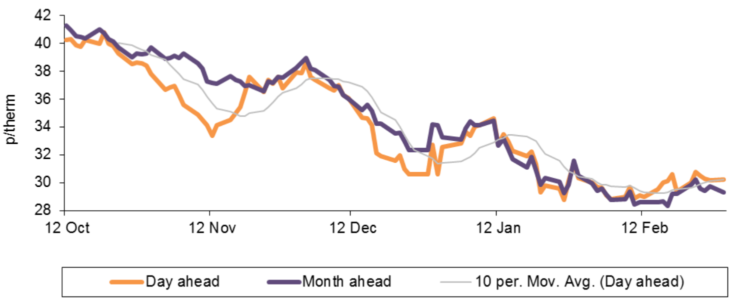
Seasonal gas prices continued to fall in February as a strong gas supply outlook offset rising oil prices.

The annual April 16 gas contract declined 2.3% to average 30.9p/th, hitting a one-month low of 29.7p/th on 10 February. Summer 16 gas dropped 4.7% to average 28.0p/th.

Seasonal gas contracts have remained at their lowest levels since 2007.

Global LNG capacity is expected to rise significantly in coming years, and much of this additional supply is likely to enter the European market.

Spot gas prices

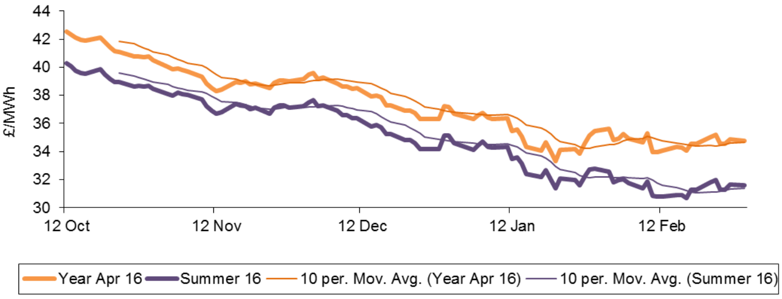


Day-ahead gas prices slid 6.9% to average 29.4p/th in February, hitting a near six-year low of 28.8p/th on 8 February.

Strong supplies, mild temperatures early in the month, and high wind output pressured prices lower. However, prices recovered by the middle of the month as colder temperatures increased demand.

The month-ahead contract slipped 7.0% to average 29.2p/th, finishing the month at 29.2p/th.

Annual power prices

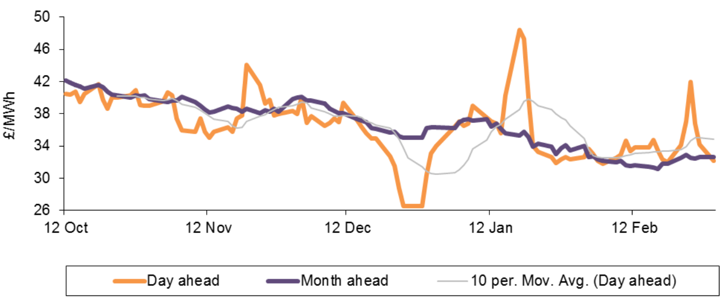


The annual April 16 power contract also fell as falling commodity markets continued to drive prices down. Annual April 16 power reduced 1.3% to average £34.7/MWh. The summer 16 contract fell 4.8% to average £31.5/MWh.

However, the winter 16 contract gained 1.9% to average £37.9/MWh as the likely closure of numerous coal-fired power stations could tighten supply margins for next winter.

Seasonal power contracts are also at their lowest levels since 2007. Backwardation also remained in the power market, meaning further-out contracts were lower than those in the nearer term.

Spot power prices



Day-ahead power reduced 7.9% to average £34.0/MWh, 20.7% under February last year (£42.8/MWh).

The contract fell as lower day-ahead gas prices and high wind output supressed the contract.

The month-ahead contract slid 6.4% to average £32.2/MWh, and is now 22.7% below the equivalent contract last year (£41.6/MWh).

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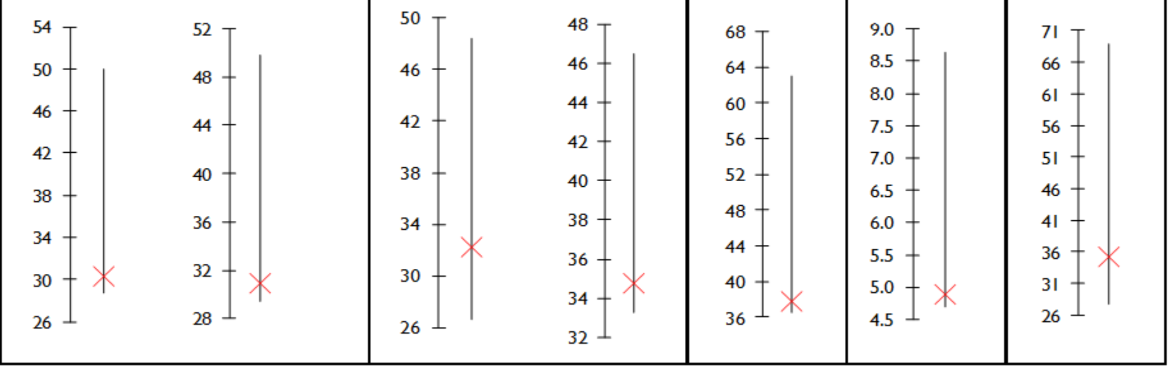
Key market indicators: 29/02/2016

		Gas (p/th)		Electricity (£/MWh)		Coal	Carbon	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	($/bl)
This month	29 Feb 16	30.25	30.92	32.20	34.78	37.75	4.90	35.25
Last month	29 Jan 16	30.35	32.08	32.35	35.45	39.30	6.08	33.95
Last year	2 Mar 15	49.95	49.82	41.50	46.50	63.00	6.99	62.07
Year-on-year % change		(39%)	(38%)	(22%)	(25%)	(40%)	(30%)	(43%)
Year high		49.95	49.82	48.40	46.50	63.00	8.64	68.94
Year low		28.75	29.46	26.56	33.31	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.

Government aims to boost investment in gas power

A key policy mechanism will be reformed to help encourage the development of a new fleet of gas-fired power stations, the government has confirmed.

Design concerns

On 1 March the government announced plans to make significant changes to its capacity market scheme, which aims to ensure Britain's supply security over the coming years. Established in 2014, the mechanism sees power generators bid into an auction, offering to make capacity available in a given delivery year. In return, successful bidders receive contracts that guarantee them a stream of revenue.

But, in the two auctions held in 2014 and 2015, the capacity market proved insufficient to encourage investment in new gas-fired power stations. These are widely regarded as an essential component of the UK's low-carbon transition over the next 20 years. The price offered to successful bidders in the auctions has, until now, been too low to make new gas projects viable.

Moreover, there have been growing concerns about the ability of the capacity market to "keep the lights on", as companies have continued to announce the closure of major thermal plants, despite the revenues on offer. In February, SSE confirmed that it intended, later this year, to close one of its coal plants – despite the fact that it had a capacity market contract for winter 2018-19. The company said that, given conditions in the wholesale market, it was no longer economic to keep the plant running.

Policy reforms

The first electricity supplies contracted within the capacity market scheme had been due for delivery in winter 2018-19. However, to boost Britain's supply security in the short term, the government has now proposed to bring this forward by a year. An auction, for the delivery of capacity in winter 2017-18, will therefore be held next January.

Meanwhile, the government has also taken steps towards improving the chances for new gas plants to be successful in the next auction, which will be held in December. In particular, it has decided to increase the amount of capacity that will be procured in the auction. This will raise the price awarded to successful bidders, making new gas projects more competitive.

A more stringent penalty regime has also been proposed, so that successful bidders are less likely to renege on their commitments.

While procuring capacity within the scheme has been cheaper than many analysts had expected, it has thus far been unsuccessful in supporting the energy transition, as the government had hoped.

Government

Businesses paid to increase demand when wind generation high

Demand response provider Flexitricity has launched a new scheme that incentivises businesses to support the integration of wind power into the electricity system.

The "Footroom" service focuses on periods in which wind is generating more electricity than is needed by the system. It works by sending a signal to connected businesses that notifies them of an opportunity to increase their demand. Those who respond to this notification receive a payment, along with the increased electricity supply.

Flexitricity chief strategy officer Alastair Martin said: "Currently, when the wind is at its strongest, the Grid turns large power stations down or off. But it can't turn down all of them, so sometimes it has to turn off some of the windfarms. This wastes a free resource. With Footroom, businesses can boost productivity for minimal extra cost and are incentivised to do so."

Flexitricity

Chancellor told to ease energy cost pressure on businesses

A business lobbyist has told the government that energy costs must not be allowed to undermine the UK's international competitiveness.

Carbon tax freeze

On 15 February the Confederation of British Industry (CBI) submitted to the government its view on the upcoming Budget, which will be announced by the chancellor later this month. It said the government needed to set out "globally competitive tax and regulation" for UK industries, balancing the need to limit carbon emissions against ensuring that companies were not disadvantaged. The CBI warned that, if UK companies faced too high a burden from climate policies, they may be undercut by foreign competitors who faced more lenient tax regimes.

The CBI's first recommendation was that the current freeze on the UK's unilateral carbon price support rate be extended, for at least one more year. It said that maintaining the tax without raising it would strike the required balance between encouraging low-carbon investment and protecting UK companies.

Easing administrative burdens

Secondly, the CBI recommended that two business energy efficiency schemes – the Carbon Reduction Commitment (CRC) and the Climate Change Levy (CCL) - should be combined, so that businesses found it easier and cheaper to comply with them. The CRC is an emissions reporting scheme for large public and private sector organisations, covering those emissions not already covered by formal national or international arrangements. The CLC is a tax on the electricity, gas or solid fossil fuels that are supplied to business customers.

The government is already considering this option as part of a review it is undertaking on the administrative burden faced by businesses in complying with climate change policies. The CBI said the move would represent a "sensible compromise" to balance the interests of investors and consumers. It recommended that a single, higher rate of the CCL be introduced for all businesses.

In addition, the CBI suggested that the government needed to provide a longer-term view on the trajectory of energy policy. This would require providing greater clarity on the level of subsidies that would be available for low-carbon development beyond the end of the decade.

Business groups are asking the government to be mindful of energy costs, but are also seeking a simpler policy regime that eases the costs associated with compliance.

CBI

EU seeks to bolster gas supply security

The European Commission (EC) has made a series of proposals intended to improve the EU's energy security - including measures that could see UK businesses having their gas supplies cut off in a crisis.

Presented on 16 February, the new package is intended to support the integration of the EU's energy market. It is built around four policies: new regulations on gas supply security; closer EU oversight of intergovernmental energy agreements; and strategies on gas storage, and heating and cooling.

The new regulations, which are designed to protect against supply interruptions to the gas network, include a "solidarity principle". This would mean that, if a country were facing a gas supply crisis, supplies would, as a last resort measure, be diverted from non-protected sectors in neighbouring countries, in order to keep households and essential services supplied. The measure has proved controversial and is being opposed by the UK government.

Opponents argue that the measure could lead to UK businesses losing their supplies in order to send gas supplies overseas.

European Commission

Biomass boilers most popular form of renewable heat

A new survey has shown that the majority of applicants to the government's non-domestic Renewable Heat Incentive are small businesses, and that they favour biomass boilers.

Popular technologies

The RHI is a government subsidy scheme through which organisations can apply to receive funding for the operation of renewable heat systems.

The survey, published on 11 February, found that the scheme had proved most popular among the leisure and commercial sector, which represented nearly six in 10 (57%) of all applications.

More than four fifths (82%) of all applicants to the scheme were from small businesses with under 10 employees. In almost three quarters (72%) of cases, installations were refits into existing buildings.

The devices most commonly selected were small-scale biomass boilers (87%). The largest proportion of the remainder was made up of medium-sized biomass systems, with ground-sourced heat pumps and solar-thermal panels also popular.

Financial savings

The most common reason given for installing a renewable heating system was the financial savings on offer. Over six in 10 (61%) used their own finances to purchase their installation, and a similar proportion said they would not have installed their technology were it not for the RHI.

The application process is becoming increasingly user-friendly, and satisfaction with the scheme is high. The number of applicants encountering problems with their applications fell from more than half (54%) to little more than a third (35%), and just under nine in 10 (87%) were satisfied with the operation of their system. However, fewer were happy with the cost of operating it: the government believed that this might be a consequence of the increased use of wood pellets, which are more expensive than other fuels.

To save money, the government has steadily reduced the tariffs available for the RHI. Around four in 10 (39%) applicants said this had influenced their plans, but the average payback time of projects remained around 10 years.

The non-domestic RHI has proved a successful and popular scheme, though cost-cutting reforms are in the pipeline.

Government

Commercial properties lacking energy efficiency, report finds

A commercial estate agent has claimed that almost a fifth of business properties in England and Wales could be barred from letting as they do not meet required energy efficiency standards.

Cushman & Wakefield published on 17 February the findings of a study it had conducted into the energy efficiency of commercial properties. It said that 19% of them would be at risk of fines if let from April 2018 under new legislation that made it unlawful to let out a commercial property that had an Energy Performance Certificate rating below E. The company also found that around another fifth of all commercial buildings were near the cut-off point, with an E rating - placing almost 40% overall in jeopardy.

Cushman & Wakefield said the new law represented a "significant tightening" of energy efficiency legislation. Currently, all properties need an EPC when being sold or let, but there is no legal obligation for landlords to carry out improvements. However, failure to comply with the new law may lead to penalties of up to £150,000.

Philip Webb, head of project management at the company, said: "Owners should also bear in mind that occupiers will increasingly favour higher EPC-rated buildings, which will have lower running costs."

Cushman & Wakefield

Future energy system to be smarter and less centralised, industry says

The energy industry expects customers to gain increasing control over their energy use in the next 20 years, a new survey has found.

Released on 23 February, the survey found stakeholders arguing that by 2030 smart meters and smart grids would provide customers with better awareness of their energy use, and the ability to optimise it. The system would become increasingly decentralised, with distributed renewables, self-generation by large organisations, and local heating systems all meaning large centralised power stations would become less necessary.

Stakeholders agreed that energy efficiency was very important; they called for the government to set out a "long-term holistic policy framework" that would prompt customer demand for energy-saving technologies. However, they were less confident there would be significant uptake in the electrification of transport and heating without government intervention.

Energy UK

Analyst warns against new interconnectors

A new report by energy analyst Aurora has warned that the costs of plans to build electricity transmission interconnectors to other countries may outweigh the benefits.

Published on 8 February, *The Dash for Interconnection* examined the costs of implementing the EU's strategy of increasing interconnection. It argued that the drawbacks of new interconnection were being overlooked, saying that the costs faced by consumers to support projects were high.

The report acknowledged that increased interconnection could make an important contribution towards Britain's energy security. However, it warned that interconnectors would allow cheaper European electricity to undercut generation in Britain – meaning interconnectors provided a different form of "insurance", rather than improved energy security.

Aurora

Low-carbon subsidy reforms could save customers £2bn, report claims

A report by economic consultancy NERA has said that the government could cut the costs of decarbonisation by refocusing its allocation of renewables subsidies in the contracts for difference (CfD) scheme.

Renewables generators who own a CfD are paid the difference between a so-called "strike price" – a price for electricity that reflects the cost of investing in a particular technology – and a measure of the average market price for electricity in GB. The contracts are awarded in competitive auctions.

Published on 16 February, the study suggested that the current structure of CfD auctions favoured "intermittent" renewable technologies – such as wind and solar power – over technologies like biomass, which could provide reliable, baseload power. It said the government could save money by instead prioritising CfDs for technologies with low system integration costs, or by allowing them to bid into the government's capacity market auctions.

NERA

Smart meters prompt energy-saving action, says campaign group

A survey by Smart Energy GB - the campaign group set up to support the roll-out of smart meters - has shown that four fifths (80%) of smart meter owners have taken at least one action to reduce their energy use.

More than half (52%) of users said that that smart meters were helping them save money. Around eight in 10 (79%) would recommend the technology to others, and an even higher number (85%) said that their awareness of their energy use had increased. In addition, smart meter owners were more confident, than people with traditional meters, in the accuracy of their bills and had a greater understanding of them.

Energy minister Lord Bourne said: "Smart meters are a key part of our plan to build a system of energy infrastructure fit for the 21st century, bringing an end to inaccurate bills and giving bill payers more control of their energy use."

Smart Energy GB
