CATALYST ENERGY SOLUTIONS

Energy Element / July 2012

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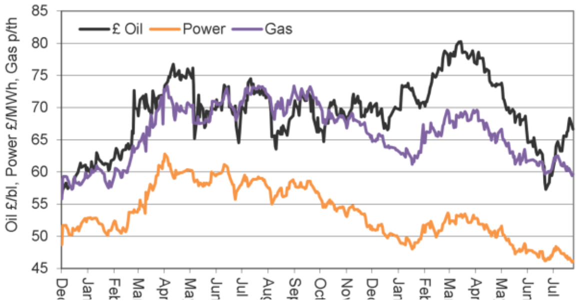
Power and gas remain at two-year low despite rising oil

Annual wholesale gas and power prices have remained at two-year lows, despite month-ahead Brent crude oil climbing back over $100/bl.

Power and gas prices fell below the low figures seen in January this year and remained at levels first seen in June on expectations of comfortable supply and lower demand.

Annual power prices rose to £48.4/MWh at the beginning of July but fell back down to a new low of £46.0/MWh on 23 July. Annual gas prices rose to 62.5p/th at the beginning of the month before dropping to a 16-month low of 59.4p/th on 23 July.

Crude oil and annual wholesale gas and power prices



The month-ahead Brent crude oil contract reached a two-month high of $107.2/bl on 20 July. Coal prices did not follow oil upwards as oversupply continued to depress the market. Low coal prices continue to favour high coal burn and National Grid expects coal to be the favoured fuel over the winter. Carbon prices followed the wider energy market upwards and were on average 12% higher than last month.

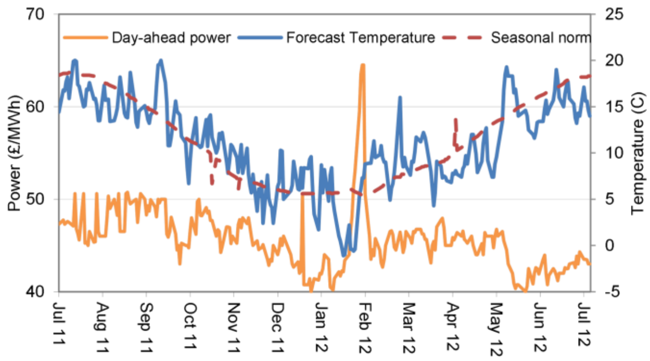
Summer power slump continues

Short-term prices were also low during July but varied notably as a result of gas supply disruptions in Norway, unplanned nuclear outages and fluctuating wind speeds. Day-ahead gas swung between a two-month high of 58.4p/th and a three-month low of 53p/th.

Day-ahead electricity was affected by gas price volatility, low wind speeds and unplanned nuclear outages. The day-ahead price dropped to a two-month low of £41.7/MWh during July. Power prices have been low throughout the summer and have remained 11% below last year's level.

Subdued outlook for prices

Spot power prices and temperatures



The power market is currently oversupplied keeping the annual power price roughly 20% lower than last year. This could continue over the winter unless older power stations close down. Centrica announced in its recent interim results that it was considering closing two old gas-fired plant if market conditions did not improve.

Prices could rise again if tensions in the Middle East escalate or there is another oil and gas supply disruption. But oversupply is likely to cap any increases in power prices.

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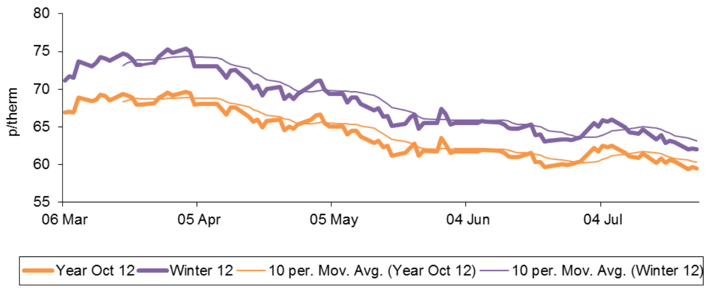
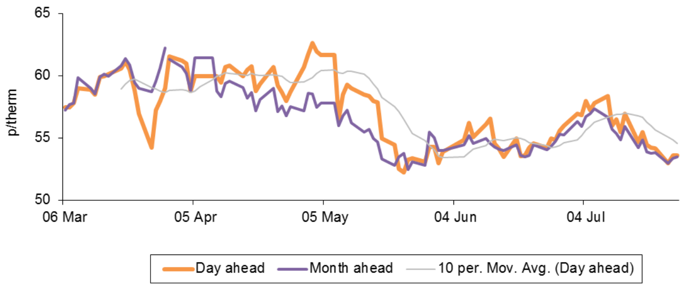
Annual gas prices



Annual gas prices rose at the beginning of the month on the back of higher oil and gas prices – but dropped again by the end of the month.

Annual October 2012 gas prices rose to a monthly high of 62.5p/th at the beginning of July before dropping to a 16-month low of 59.4p/th on 23 July.

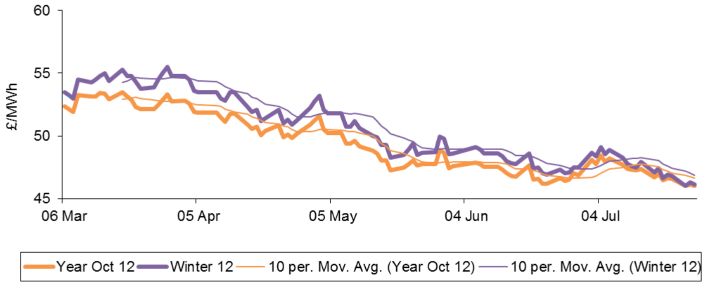
Spot gas prices



The day-ahead contract rose to 58p/th in early July on rising oil prices and concerns about Norwegian supply disruption, but they fell back to 53p/th by 23 July.

The average price over the month was 2% above the average price in June.

Annual power prices

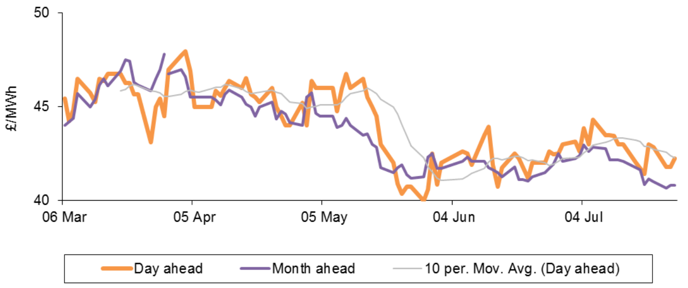


Annual electricity prices saw a similar pattern to their gas counterparts, generally falling in line with gas prices.

The annual October 2012 baseload electricity price was on average 0.4% up but reached a 27-month low of £46/MWh on 23 July.

The annual price is now 8% below levels seen at the beginning of the year.

Spot power prices



Short-term contracts were volatile following unplanned nuclear outages and low wind speeds.

Compared with June, day-ahead prices were up 1.2%. The contract peaked at £44.3/MWh on 6 July but dropped to £41.4/MWh on 18 July.

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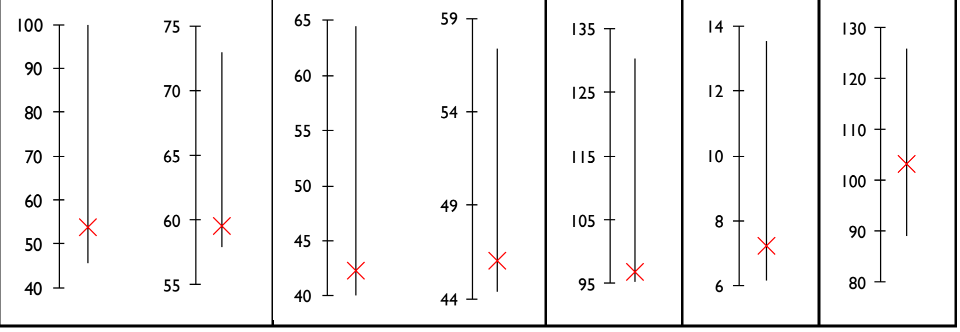
Key market indicators: 25/07/2012

		Gas (p/th)		Electricity (£/MWh)		Coal	Carbon 2012	Brent crude
		Day-ahead	Year-ahead	Day-ahead	Year-ahead	($/t)	(€/t)	($/bl)
July	25 Jul 12	53.65	59.50	42.25	46.00	96.90	7.21	103.20
June	25 Jun 12	54.25	60.08	42.00	46.65	98.50	7.89	90.43
Last year	26 Jul 11	54.55	73.13	50.60	59.00	128.25	12.90	117.94
Year-on-year % change		(2%)	(19%)	(17%)	(22%)	(24%)	(44%)	(12%)
Year high		100.00	73.00	64.50	57.40	130.25	13.53	125.95
Year low		45.50	57.88	40.00	44.38	95.35	6.15	89.14

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.

MPs send draft *Energy Bill* back to the drawing board

Government plans to offer low-carbon electricity generators a fixed price for energy produced risk becoming “botched" as a result of the Treasury's refusal to underwrite the contracts, according to an influential committee of MPs tasked with reviewing the proposals.

In a report published on 23 July, the Commons energy and climate change select committee warned the government that its draft *Energy Bill* also risks locking the UK into a higher carbon electricity mix, with increased use of gas-fired generation. This could impose unnecessary costs on consumers, reduce competition in the market, and deter investment. The committee also suggested the root of many of these problems can be traced back to interference by the Treasury.

Not FiT for purpose

The draft *Energy Bill*, which implements the government’s Electricity Market Reform (EMR) package, has been designed to move Britain “to a secure, more efficient, low-carbon energy system in a cost-effective way”. But according to the committee, to inspire the investor confidence required to achieve these goals, the Bill must be made more transparent and precise. Of the four parts of the EMR, the heart is a subsidy mechanism based on contract for difference feed-in tariffs (CfD FiTs) for all low-carbon generation, including nuclear power.

Investors had previously been led to believe that CfD FiTs would be guaranteed by the state, which would play the “single counterparty” role and underwrite the contracts. But the “multiparty model” now being proposed will instead spread the liability across energy suppliers and generators. The MPs raised concerns this option is likely to have a detrimental effect on the cost of capital and push up borrowing costs for developers, which will be passed on to consumers in the form of higher electricity bills.

The committee also said there is “genuine uncertainty" whether these contracts will be legally enforceable.

To give the market confidence to make long-term investment decisions, the committee said the government should revert back to the proposed approach and use its “AAA-credit rating to underwrite the new contracts to keep the costs of energy investment down for consumers”.

EMR not lost cause

The other components of the Bill itself are a capacity mechanism to reward predictable generators to keep spare capacity on the system, a carbon price floor to boost the price of the commodity and incentivise new low-carbon generation, and an Emissions Performance Standard (EPS) to prevent new coal and oil-fired power stations being built without carbon capture and storage technologies.

The capacity mechanism, although recognised as being a good idea, was criticised for not being clear enough by MPs. But the EPS was said to be “pointless” and a danger to the EMR's goal of achieving low-carbon generation because it encourages new gas-fired generation.

Despite these criticisms, the committee said EMR is not a lost cause, but it must be revised with haste.

A revised *Energy Bill* is due to be presented to parliament later this year, and the implementing legislation is planned to reach the statute book by end-2013.

Committee

The challenge is now for the government to meet its timetable to deliver the final Bill to parliament by the autumn and to provide more detail and an impact (and cost) assessment on its choice of counterparty model.

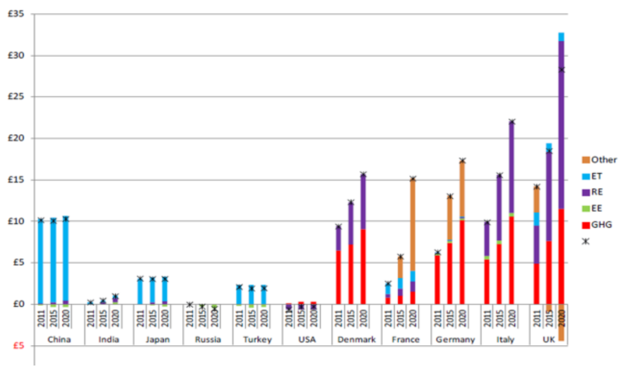
Energy and climate policies leaving UK businesses on brink

The UK's energy and climate change policies could risk putting the nation out of business, according to a government-backed report.

The *International Comparison of Energy and Climate Change Policies Impacting Energy-intensive Industries in Selected Countries* report found that energy and climate change policies are hitting British businesses harder than any other country.

The headline finding was that low-carbon policies added £14.2/MWh to British non-domestic electricity prices in 2011. But the report suggested this is set to more than double as the government's focus on energy security and climate change mitigation intensifies.

Indicative incremental impacts of policies in 2011, 2015 and 2020 on electricity price (£/MWh)



Source: Government

Base—the electricity price applicable to the relevant sectors, excluding the impacts of energy and climate change policies, GHG—greenhouse gas policies, EE— energy efficiency policies, RE—renewable energy policies, ET—energy taxes

The report, issued on 13 July by consultant ICF International but paid for by the government's business department, predicted that by the end of the decade green and energy policies will add nearly £30/MWh to electricity bills for energy-intensive industries – more than double the increase expected in other EU nations. The report put this differential down to the fact that, from April 2013, the UK will be the only country to have a carbon price floor in addition to the EU Emissions Trading Scheme. The report, though, does not take account of the £250mn compensation package for energy-intensive industries announced as part of the 2011 *Autumn Statement*.

This report ups the pressure on the government to protect those sectors most at risk of carbon leakage.

Business groups, most notably the CBI, said the report was extremely worrying and without government intervention energy-intensive industries could be driven abroad to countries with less stringent environmental protections.

Government CBI

Government amends small-scale renewables subsidies

New feed-in tariff (FiT) rates for a range of small-scale renewable energy technologies under 5MW designed to "provide long-term certainty" have been unveiled by the government.

While most of the changes to the rates announced are in-line with reductions proposed earlier this year, some technologies will see an increase in tariffs. Micro-combined heat and power (CHP) was the biggest winner, with its FiT rate rising from 10.5p/kWh to 12.5p/kWh. Hydroelectric schemes in a newly created band of 100kW-500kW will see support levels rise from 12.1p/kWh to 15.5p/kWh. FiTs for small-scale wind projects up to 100kW have seen the biggest reductions (through all bands).

A system of advance tariff guarantees will also be introduced so all anaerobic digestion, hydro installations and larger wind and solar installations (over 50kW) will know before construction whether they will be accredited.

Changes will be implemented from December this year and will impact all newly eligible technologies. The new tariff for small-scale solar photovoltaic technologies (16p/kWh down from 21p/kWh), announced in May, took effect on 1 August.

The government is trying to stop costs of the scheme – equivalent to 1% of bills this quarter – from running out of control.

Government

Government outlines plans for "predictable" RHI funding cuts

The government has set out proposals to improve the performance and manage the future budget of the non-domestic Renewable Heat Incentive (RHI) scheme.

In the announcement on 20 July, the government said a flexible degression-based system is key to new proposals designed to ensure the effective management of the RHI budget. Under this system tariffs would be reduced for new applicants if uptake approaches pre-determined trigger points. Tests to see whether degression is necessary would take place quarterly, and one month's notice will be provided in the event of a tariff reduction.

Government

Ofgem and National Grid dispute network upgrade plans

National Grid has warned that Ofgem's £22bn proposals for its next generation of network revenue controls are inadequate to ensure reliability.

Under Ofgem's proposals, unveiled on 16 July, energy bills could rise significantly to help pay for upgrades to Britain's gas and electricity networks. But National Grid has said £22bn is not enough, claiming that the upgrade programme is more likely to cost £30bn by 2020. Ofgem curbed this sum under price control regulation, but proposals will still lead to a £7 rise in household bills in 2013 – the impact on businesses is likely to be greater. Final proposals are expected in December 2012.

Ofgem National Grid

Companies dispensed £100,000 in CRC fines

Substantial penalties have been handed to four companies after they failed to comply with the Carbon Reduction Commitment Energy Efficiency Scheme's regulations. Henkel, the company behind Sellotape, was given a £38,000 penalty for submitting footprint and annual emissions reports 28 days late. Water company Saur was fined £41,000 for late reporting, and engineering firms BI Group and Tomkins were each handed £10,000 fines.

The fines, unveiled on 22 June, relate to the 2010-11 reporting year. These companies account for just 0.2% of firms obligated under the scheme, suggesting compliance has otherwise been good.

Environment Agency

Businesses fear consequences of further price rises

Businesses in the UK fear their futures are bleak following news the price of energy they pay has increased by more than a half on average since January 2010.

According to a new report by the Aldersgate Group, over 60% of businesses expect energy prices to be higher in the UK than competitor economies in 2015. Only 5% of respondents expected the UK to offer lower prices than competitors, and 3% expected energy prices to fall over the next two years. Yet when companies were asked what would happen to their business if energy prices were to rise 25% a year for the next few years, almost 10% said they would expect to close.

Aldersgate Group

Government sets out guides for corporate sustainability reporting

New guidelines to help UK companies to measure and report on their environmental performance effectively have been issued by the government. Unveiled for consultation by environmental department Defra on 25 July, the guidelines aim to help businesses demonstrate their sustainability credentials in a "clear and concise way". They include advice on a wide range of green "key performance indicators" and outline how companies can measure and report against these.

On the same day, the government issued a draft regulation confirming listed companies will be required to annually report their greenhouse gas emissions from April 2013. Both consultations close on 17 October.

Defra—guidelines Defra—regulation
