Government announces energy policy "reset"

Energy and climate change secretary Amber Rudd delivered her first major policy address on 18 November. She detailed the energy strategy that the government will follow over the next five years to keep the lights on, reduce costs to consumers, and decarbonise the energy system.

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Rudd announced that, subject to consultation, all unabated UK coal-fired power stations would close by 2025. Coal is the most polluting source of power used by the UK, with many plants ageing and comparatively inefficient. However, government figures show that the resource still meets a significant proportion of the UK's electricity demand.

The government will seek to replace these coal plants with new gas-fired power stations. But these will require government incentives; indeed, Rudd said that the UK had an electricity system in which "no form of power generation, not even gas-fired power stations, can be built without government intervention". But she said a new fleet of gas plants could make a significant contribution to the UK's low-carbon transition.

Gas-fired power stations can bid to receive support through the government's capacity market auctions. Generators who are successful in these auctions benefit from a steady, predictable revenue stream (capacity payments), in return for being available to provide power to the system at times when supplies are low. However, in the first capacity market auction, held in December 2014, only one new gas-fired power station was successful.

Rudd reaffirmed the government's commitment to renewables development; she said that the government would aim to hold three more auctions for contracts for difference (CfDs) before 2020. Renewables generators who hold a CfD are paid the difference between a "strike price" – a price for electricity that reflects the cost of investing in a particular low-carbon technology – and the "reference price"– a measure of the average market price for electricity. The costs of the support offered through the scheme are ultimately covered by consumers through their energy bills.

But the government has opted against providing further subsidies for the most mature and low-cost renewables technologies, such as onshore wind and solar power. Instead, the CfD auctions will aim to promote the development of offshore wind power, in which the UK is already a world leader.

The speech won the cautious backing of business groups. Rhian Kelly, business environment director at the Confederation of British Industry (CBI), said: "A smooth transition from coal to gas is critical, so we must ensure we have new capacity before we take coal out of the energy mix. Getting this right should deliver a successful energy policy that works for consumers, businesses and investors."

The CBI also cited research, first unveiled in its most recent *Infrastructure Survey*, that found nearly three quarters (74%) of firms saying energy security was crucial, and that almost all businesses (97%) regarded investment in a diverse and secure energy mix as vital.

Climate watchdog sets out scale of emissions challenge

The government needs to cut the UK's greenhouse gas emissions by 57% by 2028-32, if it is to continue on the lowest-cost pathway towards the nation's long-term environmental targets.

On 26 November the Committee on Climate Change (CCC) published its advice to Parliament on the Fifth Carbon Budget: the level of emissions that the UK can afford between 2028-32 to remain on a cost-effective path towards its long-term climate goals.

The CCC said that, to meet the budget, progress needed to be made in "increasingly difficult" areas. It said that by the 2030s over half of business heat demand would need to be met from renewable sources. The business sector would also need to deliver improved energy management and process control, while making use of more energy efficient equipment.

What is the CCC?

The Committee on Climate Change (CCC) is an independent, statutory body established under the Climate Change Act 2008.

Its purpose is to advise the UK government and devolved administrations on emissions targets.

It regularly reports to Parliament on the progress made in reducing greenhouse gas emissions and preparing for climate change.

The report analysed the cost impact of low-carbon policies, and confirmed that businesses would see higher electricity bills as a result of green subsidies. The CCC explained that a substantial proportion of these costs were already committed and would largely continue into the 2020s.

However, the report said the low-carbon transition also presented businesses with significant opportunities: these included "investing in new markets and resource efficiency measures, and innovation in new technologies and processes across a range of sectors and applications."

Compliance deadline passes for energy efficiency scheme

The Environment Agency has confirmed that it does not expect to immediately take enforcement action against companies that fail to comply with the Energy Savings Opportunity Scheme (ESOS).

ESOS is a mandatory energy assessment programme for all UK organisations that employ more than 250 people or that have an annual turnover of over €50mn. It was implemented by the government to comply with EU regulations, and requires businesses to perform energy assessments every four years - identifying their major sources of energy use and cost-effective ways to save energy.

The government believes that ESOS will deliver £1.6bn in overall benefits to the UK, mostly in the form of energy efficiency savings to businesses. But recent media reports suggested that only a fraction of eligible businesses were compliant at the 5 December deadline.

In updated guidance on the scheme, released on 8 October, the Environment Agency said that enforcement action would "not normally" be taken against companies for failing to meet the deadline, provided that they contacted the Environment Agency and had made progress towards meeting the obligations of the scheme.

Companies fully compliant with the international industry standard ISO50001 do not need to carry out ESOS assessments, but the standard may only cover parts of the organisation. Those committing to ISO50001 will not be at risk of enforcement action so long as they achieve certification by 30 June 2016.

Businesses act to help balance the grid

National Grid was forced to use "last resort" measures to maintain Britain's electricity supplies on 4 November, after several unexpected outages as power stations.

The company issued a Notice of Inadequate System Margin (NISM) at 1.30pm - the first time it has employed this measure since 2012. A NISM is a signal that National Grid can send to the market calling on generators to help it to balance the system by making more power available. The company made the move as a consequence both of plant outages and low imports from Europe, and requested an additional 500MW of power for the period between 4.30pm-6.30pm.

National Grid later confirmed that in addressing the shortage it had, for the first time, made use of its Demand Side Balancing Reserve (DSBR) mechanism. The DSBR is a new scheme in which businesses voluntarily reduce their demand on the system in return for payments. Market commentators welcomed the success of National Grid's emergency measures, but warned that the costs would ultimately be borne by energy consumers.

Chancellor seeks to ease cost pressures on energy intensives

Chancellor George Osborne has announced that energy-intensive industries (EIIs) are to be permanently exempted from the cost of some of the government's green energy schemes.

The Renewables Obligation (RO) and small-scale feed-in tariff (FiT) policies support the deployment of renewables projects. However, their costs - which are covered by businesses and households as part of energy bills – are expected to increase over the coming years. Before the chancellor's statement the latest government assessment of the estimated average impact of green policies on gas and electricity bills paid by medium sized businesses showed such costs increasing from 28% of a typical bill in 2014 to 39% in 2030.

The chancellor's announcement came on 25 November as part of the government's Autumn Statement, and was designed to "ensure that [EIIs] have long-term certainty and remain competitive". Osborne said that further reforms to the RO and the FiT, which will curb deployment under the schemes, will also save the average small business user £500 on their energy bills in 2020-21.

It was also confirmed that the government's Renewable Heat Incentive (RHI) programme would be reformed so as to cut costs by £690mn/ year by 2020-21. The RHI is open to both business and household energy users, offering payments in return for the deployment of renewable heat systems. The government will also provide £295mn over the next five years to improve the energy efficiency of schools, hospitals and other public sector buildings.

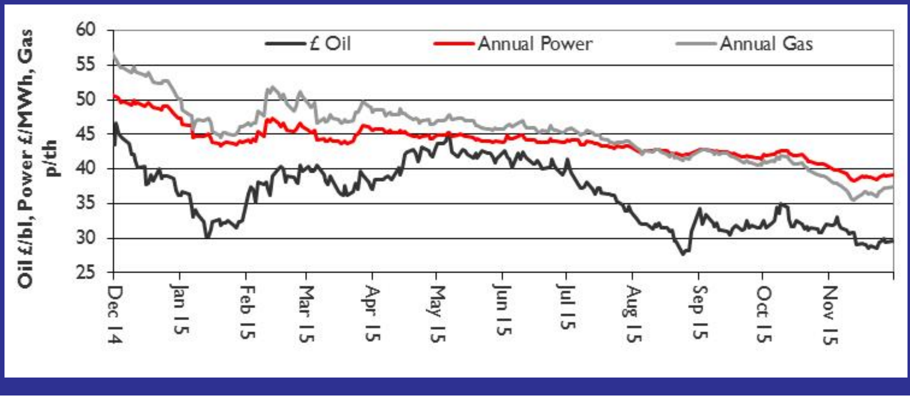
Ones to watch

- The government's *Energy Bill 2015-16* has completed its initial passage through the House of Lords and is now progressing through the Commons. The bill seeks to lower the costs to end users of onshore wind subsidies as well as to set up a regulator for the North Sea in order to maximise the extraction of oil and gas.
- The Paris climate talks started on 30 November and will conclude on 11 December. The meeting will involve nearly 200 countries who will seek to reach an agreement that will limit temperature rises to no more than 2°C. Agreements made at the conference will have implications for the UK's low-carbon transition.

Price of power falls to new lows

Seasonal power and gas contracts declined to record lows in November, before making small recoveries later in the month and into December.

Crude oil and annual wholesale gas and power prices



Lower oil prices and a comfortable supply outlook continued to pull gas contracts down, while falling coal and gas prices remained the principal driver of longer-term power contracts, which broadly continued their downward trend.

The Annual April 16 gas contract fell 9.0% to average 36.9p/th, the largest monthly fall since January 2015, as lower oil prices and a strong supply outlook pushed prices down. Rising supplies of Liquefied Natural Gas (LNG) are expected to continue in the medium and long-term, with imports up 35.9% in November compared to the same month last year. However, the contract lifted to 37.4p/th at the month's end as production cuts came into effect at Europe's largest gas field, Groningen, reducing European supplies. Annual April 16 power followed gas and coal prices down, slipping 6.3% to average £39.1/MWh, reaching a contract low of £38.3/MWh on 12 November.

Contracts for gas and power to be delivered one-day ahead also decreased, experiencing unusually low prices for this time of year. Day-ahead gas fell 9.2% to average 36.0p/th, reaching a five-year low of 33.4p/th on 12 November. This resulted from forecast temperatures being over one-fifth (20.6%) above the seasonal norm for the month, limiting demand for heating. Day-ahead power dropped 5.7% to average £38.1/MWh, hitting £35.0/MWh on 12 November, the lowest price since July 2014. Greater wind generation, up 91% on the previous month, and mild temperatures also depressed prices.

Commodities such as oil and coal also saw record lows. Brent crude oil declined 6.2% to average $46.4/bl in November. Oil began the month rising on supply concerns from Libya and Brazil; however, prices later declined, hitting a three-month low of $43.9/bl on 23 November. The US Energy Administration has, in its latest *Short-term Energy Outlook*, suggested that prices will average $54/bl in 2015 and $56/bl in 2016, with the 2016 forecast now $2/bl lower than in the previous month's report.

API 2 coal declined 2.7% to average $47.0/t, hitting a fresh low of $45.8/t on 23 November. Previous expectations of continued strong demand growth triggered major investments in supply in recent years; however, actual coal use has fallen short, resulting in over-capacity and plummeting prices.

OPEC decided last year to maintain high production levels, resulting in a glut that sent oil prices plummeting.

To discuss anything in this newsletter, or for any more general enquiries, please contact your Account Manager, or:

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