Beond Quarterly Insight Q1-2019

Wholesale Market Changes

Gas

p/therm	28 Sept 18	31 Dec 18	Change
April 2019 12M	66.44	57.50	-13.5%

Source: ICE

Power

£/MWh	28 Sept 18	31 Dec 18	Change
April 2019 12M	62.33	59.21	-5.0%

Source: ICE

UK gas and electricity prices fell during Q4-2018, as lower gas demand in Asia and rising production of global liquified natural gas (LNG) increased the volume of LNG arriving in the UK and Continental Europe.

Several unplanned nuclear outages across Belgium and France also came to an end, adding supply capacity to the electricity grids in Northwest Europe.

It was also announced that the new 1,000MW Nemo subsea power interconnector has started commissioning. The project will enable trade of electricity between the UK's National Grid and Belgian transmission system operator Elia when it becomes fully operational in Q1-2019, helping supply the UK grid during times of peak demand.

As a result, gas prices for April 19 to March 20 ended the quarter 13.5% lower overall at 57.50 p/therm, with electricity prices down 5.0% to £59.21/MWh also driven by falling crude oil, coal and European power prices.

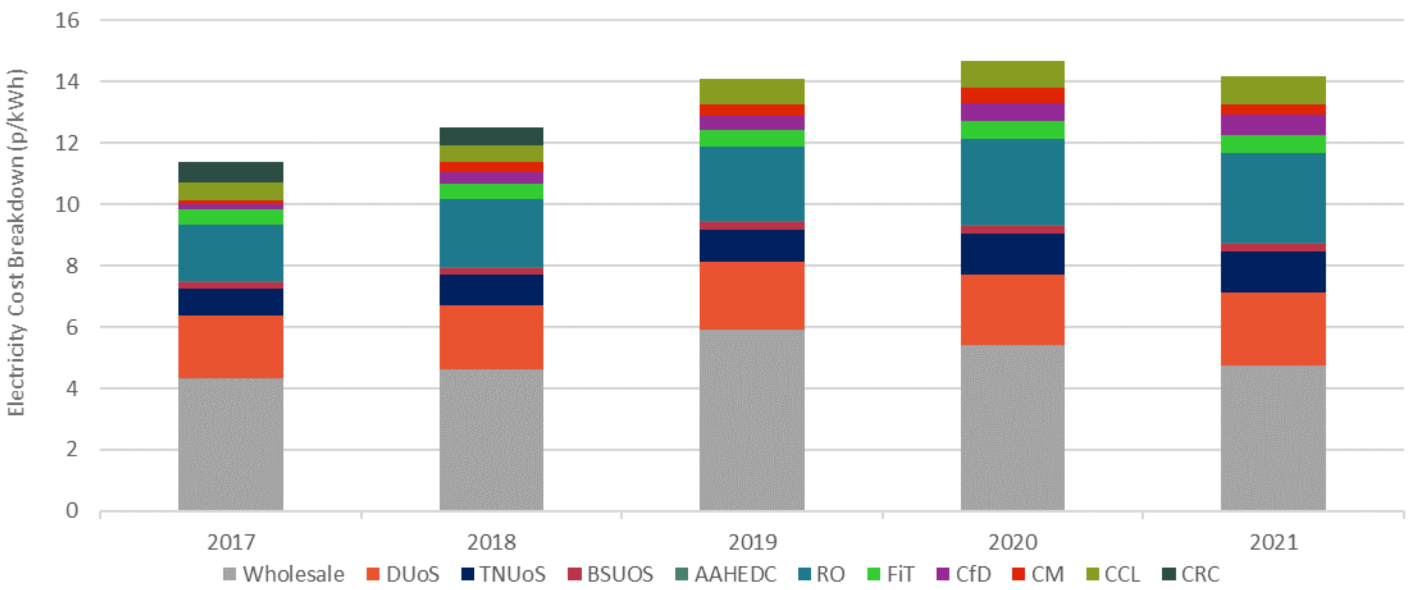
Brent crude oil prices fell 35% to $53.80/bbl quarter-on-quarter as planned output cuts failed to ease fears about a global economic slowdown. The latest falls come after a difficult year for oil markets, as prices continue to plunge amid fears of a slowing global economy and record production in the United States and Iraq. OPEC and Russia have both pledged to cut output for the first six months of 2019 in a bid to stabilise prices.

Outlook: With gas storage facilities now predominantly filled across Northwest Europe, supply risks are now lower than they were at the start of winter. OPEC's decision to reduce crude output may also reduce the oversupply in the global oil market, boosting energy prices. However, any unscheduled major supply outage or high winter demand caused by cold temperatures during Q1-2019 could cause volatility in electricity and gas prices.

Gas 12 months from April 2019

Power 12 months from April 2019

Electricity Cost Breakdown



Overall electricity costs expect to rise 1.59 p/kWh from Apr-18 to Apr-19

It's not long now until one of the biggest changes to the energy tax landscape takes effect. From April 2019, the CRC scheme (a huge administrative and cost burden on participating businesses) will be abolished, benefiting ≈1,800 large UK organisations:

- Carbon Reduction Commitment (CRC) ↓ 0.56 p/kWh

However, businesses not involved in CRC should be careful to budget for the increase in total electricity supply costs.

In its place, all businesses will see a significant increase to the Climate Change Levy (CCL) rate. Along with CCL, the cost of schemes to support renewable generation growth and security of supply continue to play a major role in the increasing cost of non-energy charges in electricity bills:

- Renewables Obligation (RO) ↑ 0.21 p/kWh
- Contracts for Difference (CfD) ↑ 0.13 p/kWh
- Climate Change Levy (CCL) ↑ 0.27 p/kWh

However, the biggest increase in overall electricity costs is from wholesale costs, which are estimated to rise ↑ 1.31 p/kWh.

A full breakdown of electricity costs is available on the last page of this report.

Network Charges

- The UK's Capacity Market (CM) scheme for ensuring the National Grid has sufficient power supplies during the winter months has been suspended after a ruling by the European court of justice that it constitutes illegal state aid. All payments to energy firms with CM agreements have been halted until the government can win permission from the European Commission to restart it. Many suppliers will opt to exclude CM from fixed-priced electricity quotes, and pass-through any costs if the scheme is reinstated. Our analysis includes CM as government policy is to resurrect it.

Environmental Taxes & Levies

- The UK Government will end the Feed-in Tariff (FiT) scheme, closing it to new entrants. The FiT Scheme pays renewable energy generators and exporters for electricity they produce for the grid. The plans propose a strict cut-off date of 31 March 2019, with no special provisions for projects in oversubscribed areas. The FiT scheme closure should see costs to consumers plateauing.
- The exemption for energy intensive industries (EIIs) is now in place for both the CFD (since Nov 2017) and RO (since April 2018) schemes, with non-EII businesses picking up the EII costs. The majority of consumers who do not have an EII exemption, will have to pay a combined 0.161 p/kWh uplift (included in the estimates above). Rather than a rebate, the change will directly exempt EIIs from 85% of the cost of these schemes. An exemption from FIT remains on track to be completed in 2019, subject to State Aid approval.

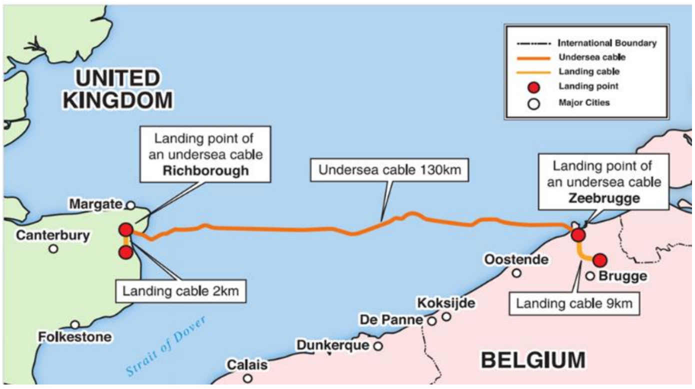
Last Quarter Industry News

New Nemo Link cable between the UK and Belgium begins final phase of commissioning

The 1,000MW Nemo subsea power interconnector that links the UK and Belgium has officially been launched.

Stretching 80 miles from Herdersbrug on the Belgian coast to Richborough in Kent, the £600 million Nemo Link will help deliver a more flexible energy system for consumers in both countries.

The project will enable trade of electricity between National Grid and Belgian transmission system operator Elia when it becomes operational in early 2019.



Source: Nemo Link

John Pettigrew, Chief Executive of National Grid said: "Nemo Link will bring great benefits to consumers in the UK and Belgium by offering both countries access to a broader energy mix and providing opportunities to expand into other electricity markets.

"By connecting the UK and Belgian electricity markets, we will ensure customers have access to different sources of generation and lower priced electricity. This will mean that customers pay less for their energy."

National Grid added it will be investing more than £2 billion in new interconnectors to Europe over the next five years. Last month, it received financial approval for the construction of the 1.4GW Viking Link, which will connect the UK with Denmark.

Business and Energy Secretary Greg Clark said: "Nemo Link is the UK's first interconnector since 2012, increasing our electricity capacity from these power cables by a quarter and further enhancing security of supply for us and Belgium.

"Not only will this interconnector help us to accommodate more renewable energy on our grid and provide cheaper, greener energy for consumers as part of our modern Industrial Strategy, it will also see continued and close cooperation on energy across borders with our European partners."

LINK: Nemo Link - Interconnector begins commissioning

Npower looks set for merger with E.ON after deal with SSE scrapped amid 'challenging conditions'

The merger of two of the UK's biggest energy firms has been called off after Npower and SSE blamed the Government's price cap and increasing competition for their failure to reach a deal.

Initial indications that the merger might collapse came in November when the companies admitted they were having to reconsider their terms and would have to inject more capital into the new energy supplier because of changes in the market.

In December, concerns were raised over job losses at Npower after staff were told the ownership of the big six energy supplier will be transferred to the German energy utility E.ON. The two firms are midway through a complex asset swap involving Innogy's owner RWE.

However, it has emerged that Npower will end up at E.ON, which poses a headache for E.ON because it already has a UK business supplying energy to households and businesses under the E.ON brand. It is expected that E.ON would likely have to absorb Npower and would spend several painful years to restructure and integrate it.

Npower has been loss-making for the last few years and the owner Innogy warned after the merger collapsed that keeping Npower would burn a £226m hole in its revenues in 2019.

LINK: Guardian - E.ON & Npower merger

Ofgem tightens rules for new energy suppliers as money goes missing

The UK energy regulator Ofgem plans to make it more difficult for new energy suppliers to start trading as it looks to tackle a growing number of failed ventures and poor customer service among smaller players in the sector.

Proposed rules for new energy suppliers will require applicants to demonstrate they have the money and the resource to operate for at least a year before being granted a licence.

The move comes after efforts by the government and Ofgem to increase competition in the sector in recent years prompted a flurry of new entrants. There were 73 active electricity and gas suppliers in June this year, compared to 60 a year ago and just 14 at the end of 2011.

At the same time the dominance of the "Big Six" energy suppliers has reduced, and a quarter of customers are now with smaller providers. But questions have been raised over the viability of some of the newer players: eight exited the market in 2018.

LINK: Ofgem - new rules for energy suppliers' licenses

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What's coming up?

General Regulatory:

- Ofgem is consulting on new rules to put energy suppliers through a series of financial tests before they are allowed to enter the market to ensure that firms have sufficient financial resources to meet customers' expectations. Ofgem said the tests, which are to be in place by **spring 2019**, should ensure new entrants are robust while encouraging competition and innovation in the market.

Electricity:

- Nemo Link, the 1,000MW subsea power cable that will connect the UK and Belgium is expected to begin full operations by the end of **Q1-2019**. The project will increase security of supply by increasing electricity trading between the UK and Continental Europe during times of high demand.
- Following European court of justice ruling that Capacity Market payments constitute illegal state aid; the UK government has stated that it will consult on what regulatory changes would be needed in order to allow CM auctions to be restarted in the summer.
- The UK government is still looking into the possibility of widening eligibility criteria for the exemption schemes supporting Energy Intensive Industries (EII) - potentially lowering the threshold from 20% to 10%. Changes could be introduced as soon as **1 April 2019** for CfD and FiT and **1 April 2020** for RO.
- An exemption for energy intensive industries (EIIs) from FIT is on target to be introduced from **1 April 2019**, subject to EU State Aid approval. The FIT scheme will remain compensation-based until further notice.
- Companies that fall under the remit of the Carbon Reduction Commitment (CRC) scheme will be happy to see it abolished. The final reports and final payments to the government will need to be made in summer 2019.

Gas:

- The UK gas industry's problems with high Unidentified Gas (UIG) costs haven't gone away. Ofgem has rejected all proposed supplier Modifications to quickly rectify the issue, but they have put together a task force with the objective of investigating the charging methodology and coming up with a suitable solution.
- In the domestic market, millions of households see their energy bills drop as the government's price cap takes effect. However, Centrica has launched a legal battle with the regulator in over the cap in an attempt to avert a £70m hit to profits this winter.

Oil:

- Crude oil prices are expected to rise over the next quarter after OPEC and Russia agreed to cut oil production by 1.2 million bpd effective **January 2019** for an initial period of six months.
- There is also a growing possibility that the OPEC-led supply cuts could be further extended. Saudi Arabia has floated plans to cut its crude exports by 800,000 bpd from around 7.9 million bpd in November 2019, in a move aimed at lifting prices above $80/bbl.

Brexit:

- Theresa May's government survived a vote of no confidence after MPs rejected the Prime Minister's Brexit deal by a convincing 432 votes to 202. The PM is now under intense pressure to clarify the UK's Brexit intentions on Monday 21 January 2019.
- At this point, any outcome other than a 'hard-Brexit' is expected to boost the value of the Pound. A stronger Pound would make gas and power imports less expensive.
- There is little risk that the UK would abandon EU decarbonisation targets, as the UK consistently sets among the most ambition targets in the EU. As a result, we expect to see little change to other network and green subsidies.

Economics & Financial Markets:

- Following the decision by the Bank of England to raise interest rates from 0.5% to 0.75% in November, the BoE's Monetary Policy Committee is set to consider a further increase in **February 2019**.
- The OECD has forecast economic growth in the UK to increase slightly in 2019 before slowing in 2020. GDP is expected to grow 1.4% in 2019 and 1.1% in 2020. However, their prediction is based on the assumption that there is a smooth exit from the European Union. This outlook is likely to be revised as the UK government outlines its next steps following its Commons defeat on the negotiated Brexit deal.
- The eurozone's economic growth is expected to slow dramatically as Europe continues to grapple with new trade barriers, ongoing uncertainty over Brexit and political spats that undermine confidence in the euro and put banks under further stress. The OECD estimates that eurozone growth will slow to 1.8% in 2019, and 1.6% in 2020.

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Electricity Bill Breakdown & Glossary

p/kWh	Apr-17	Apr-18	Apr-19	Apr-20	Apr-21
Wholesale	4.35*	4.61**	5.92	5.41	4.73
DUoS	2.02	2.10	2.19	2.30	2.41
TNUoS	0.86	0.98	1.07	1.35	1.31
BSUOS	0.23	0.23	0.24	0.25	0.26
AAHEDC	0.02	0.02	0.02	0.03	0.03
RO	1.86	2.21	2.42	2.79	2.93
FiT	0.49	0.52	0.54	0.57	0.60
CfD	0.19	0.36	0.49	0.61	0.64
CM	0.12	0.33	0.35	0.47	0.35
CCL	0.57	0.58	0.85	0.89	0.93
CRC	0.68	0.56	0.00	0.00	0.00
TOTAL	**11.38**	**12.50**	**14.09**	**14.67**	**14.19**

**Price on 31/03/2017; **Prices on 31/03/2018; All other prices are taken on 30/09/2018; Costs exclude Supplier margin and shaping fees*

Glossary:

Distribution Use of System (DUoS) - DUoS charging reflects the costs of installing, operating and maintaining the regional distribution networks in the UK. There are 14 distribution networks covering the UK (excluding Northern Ireland) plus a small but growing number of independent networks.

Transmission Network Use of System (TNUoS) – TNUoS charges recover the cost of installing and maintaining the transmission system in England, Wales, Scotland and offshore.

Balancing Service Use of System (BSUoS) - BSUOS charges represent the costs incurred by National Grid in maintaining the balance of demand and quality and security supply on the network. BSUoS charges are daily charges received from Elexon (but levied by National Grid) and are paid by suppliers and generators based on their energy taken from or supplied to the National Grid in each half-hour Settlement Period.

Assistance for Areas with High Electricity Distribution Charges (AAHEDC) - Provides financial assistance to areas of the country with high distribution costs (i.e. North of Scotland). This allows a reduction in the distribution charges in that area.

Capacity Market (CM) - A scheme to secure additional winter capacity from both generators and Demand Side Response providers. Successful bidders receive stable payments in return for commitment to deliver energy when required. The subsidy payment for these generators is paid for by electricity consumers on their consumption in the winter period.

Renewables Obligation (RO) - The RO is a responsibility on Electricity Suppliers to source an amount of their supply position from renewable sources. Eligible renewable generators receive Renewables Obligation Certificates (ROCs) for each MWh of electricity generated and these certificates can then be sold to suppliers in order to fulfil their obligation. The subsidy payment for RO generators is paid for by electricity consumers through their supplier.

Feed-in Tariff (FiT) - A subsidy scheme introduced in 2010 to support small-scale renewable generation in the UK, providing a fixed price set by Government to generators for each unit of electricity they generate. The subsidy payment for FiT generators is paid for by electricity consumers through their supplier.

Contracts for Difference (CfD) - CfD generators have a contract with the government-appointed Low Carbon Contract Company (LCCC), guaranteeing them a fixed price for their exported electricity. The subsidy payment for these generators is paid for by electricity consumers through their supplier.

Climate Change Levy (CCL) - The CCL is an environmental tax on commercial energy use. It is designed to encourage businesses to be more energy efficient and to reduce greenhouse emissions.

CRC Energy Efficiency Scheme (CRC) - A mandatory carbon emissions reduction scheme in the United Kingdom that applies to large non-energy-intensive organisations in the public and private sectors.