

Utility Focus July 2007

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The UK Energy White Paper

After numerous delays, the government finally published its latest Energy White Paper at the end of May, entitled *Meeting the Energy Challenge*. It marks the third major document on national energy policy since New Labour came to power in 1997, the previous two having received wide-spread criticism for being toothless and for raising more questions than answers. The latest Paper aims to set the framework for two clear objectives; ensuring energy security and combating climate change. This month, **FocusOn...** will look at what proposals are put forward by the White Paper, and whether the UK is any closer to gaining an insight into how the nation's future energy needs will be met.

Nuclear power – an opportunity missed

The government now seems to have come to the conclusion that nuclear energy will be an important part of the UK's energy future; according to Tony Blair "it is only right we consider how nuclear fuels can help underpin the security of our energy supply". It was originally expected that this year's White Paper would come out strongly in favour of atomic energy as a means of securing Britain's long-term energy needs whilst also cutting emissions of carbon dioxide. The government's hands were tied, however, by a court ruling in February that decided in favour of environmental campaign group Greenpeace and concluded that the consultation process on nuclear energy had been "seriously flawed". Even though the government seems to favour a new generation of atomic plants, those anxious to learn what role nuclear will play in meeting future electricity demand will now have to wait until the Autumn when the latest consultation is complete. Although firm proposals were conspicuous only by their absence from the White Paper, the atomic industry was given an unexpected boost two days prior to its release by a relaxation of planning laws for major UK construction projects. Large energy projects such as power plants, liquefied natural gas terminals and gas storage facilities have historically been tangled up in a web of red tape and planning disputes. As set out in the Planning White Paper, the government is to speed up the process for vital infrastructure projects, which should make it easier to build new nuclear power plants.

“it is only right we consider how nuclear fuels can help underpin the security of our energy supply”
Tony Blair

RO banding boosts tidal power

Until now, each unit of electricity generated from a renewable source has been exchangeable for a single Renewable Obligation Certificate [ROC] as a subsidy, in this way the government could not be accused of 'picking winners' with respect to individual technologies. The White Paper, however, proposes that electricity generated from different renewable sources could be subject to more or less than one ROC, dependent on the method used. It is proposed that mature technologies that have proven to be commercially viable will receive less of a subsidy in future; this will include power generated from waste gas from sewage and landfill sources. Immature generation sources, such as geothermal or tidal power will be eligible to receive twice the subsidy per unit generated under the proposed new banding regime (see Chart 1).

Cap-and-trade for UK business

In order to reduce carbon emissions from the UK's large commercial and public sector organisations, the government proposes a new cap-and-trade scheme, to be called the Carbon Reduction Commitment [CRC]. The CRC will be applicable to UK companies that use more than 6000 megawatt hours of electricity a year and are not already covered by the European Union Emissions Trading Scheme. Although key details of the CRC, including when it will come into force, were not revealed by the White Paper, the government hope that the scheme will eventually deliver carbon savings of 1.2 million tonnes per annum. The government were also keen to stress that the CRC should not be seen as another tax on energy, as it will be "broadly revenue neutral to the Exchequer".

Chart 1 : Proposed banding regime (Source: DTI)

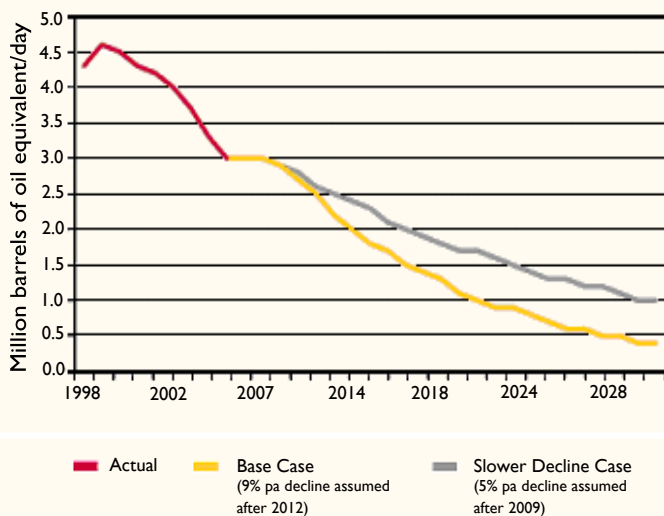
Band	Technologies	Level of Support ROCs/MWh
Established	Sewage gas, landfill gas, co-firing biomass	0.25
Reference	Onshore wind; hydro-electric	1.0
Post-demonstration	Offshore wind; dedicated regular biomass	1.25
Emerging technologies	Wave; tidal; solar photovoltaic; geothermal	2.0

A future for coal

The White Paper was keen to emphasise that coal will also continue to play an important role in meeting UK energy needs, however, the government also recognises that greater efforts must be made to promote the use of 'clean coal' technology to help meet ambitious environmental targets. One such technology, known as carbon capture and storage [CCS], involves the isolation of carbon dioxide from power plant emissions, before being transported and stored underground, most likely in depleted oil fields. This process, although promising, is largely unproven on a commercial stage and for this reason Whitehall announced that it is to launch a competition for companies to develop the world's first integrated CCS power plant in the UK. It is hoped that the contest, to commence in November, will launch the nation as a world leader in the technology and encourage other countries to follow by example. The government's proposals, however, did not go far enough for Scottish & Southern Energy and BP who had been planning to build a CCS power station in Peterhead, Scotland for over two years. After numerous government delays in setting the

framework for CCS, the companies decided to abandon the Peterhead project. An increased demand for coal could lead to a renaissance for the UK mining industry, which has been in terminal decline since the 1980s. The White Paper acknowledges the important role that indigenous coal reserves can play in meeting demand for the new generation of clean coal power stations, particularly viewed in the context of a maturing North Sea (see Chart 2). Any revival in the British mining industry, however, will be subject to the proviso that extraction of UK reserves is shown to be economically viable.

Chart 2 : Outlook for UKCS Oil & Gas Production (Source: DTI)



Demand-side initiatives

As well as a host of measures aimed at implementing change in the supply-side of the UK energy market, there was also talk of the need to promote greater efficiency in the way businesses and homes consume energy. A key part of this pledge is to extend the use of so-called 'smart meters' which, the government hope, will enable consumers to make more informed decisions and provide incentives for investment in energy efficiency. It is likely that all but the smallest businesses will be required to install an advanced half-hourly electricity meter within the next five years, although the White Paper does not specify how this will be achieved, or who will pay for this requirement. In addition, all consumers, regardless of size, will be obligated to have a smart meter within the next decade. The government's commitment towards smart meters was greeted with a mixed response from industry. The Energy Retail Association [ERA], which represents Britain's main electricity and gas suppliers, commented. "We welcome the government's recognition of the need to encourage people to be more energy-

aware". The ERA expressed disappointment, however, that the government appears likely to commit only to electricity display devices, which offer time-delayed information, rather than real-time interactive smart meters.

“We welcome the government’s recognition of the need to encourage people to be more energy-aware”

Energy Retail Association

Key issues can no longer be avoided

Considering that the government has the twin goals of improving energy security whilst reducing emissions of greenhouse gases, the White Paper offers plenty of proposals that will placate the environmental lobby but few that will ease concerns over how UK energy supplies will be secured in years to come. The fact that nuclear power was off the agenda left a gaping hole in the government's energy policy, a void will need to be filled with solid proposals this Autumn.

Even though the Energy White Paper was the third such document to have emerged from Whitehall in the last decade there are still fundamental questions that have yet to be answered concerning the country's future energy requirements. Instead, a series of consultations have been launched that may, or may not, provide greater clarity before the end of the year. Most pertinently, we have yet to find out what will replace Britain's ageing nuclear fleet, most of which will be decommissioned in the next ten years. The answers are not likely to be easy, but if the lights are to remain on across the UK, it is not a question that can be dodged much longer.

Points in brief...

- ... **Nuclear Energy:** The key topic is still subject to ongoing consultation; conclusion expected this Autumn;
- ... **RO Banding:** System of renewable energy subsidies to be tweaked in favour of immature technologies;
- ... **Carbon Reduction Commitment:** Medium-sized UK companies are to be subject to a carbon 'cap and trade' scheme; details to be finalised;
- ... **Coal:** Government to launch competition for CCS demonstration, which could signal a revival for the mining industry;
- ... **Greater Efficiency:** Smart metering to become compulsory over the next decade.

FocusOn...recap

- **June 2007...** The inadequacies of UK gas storage
- **May 2007...** A cautious outlook for Winter 2007/08
- **April 2007...** The EU's struggle with liberalisation

Ofgem remains cautiously optimistic for Win-07/08

National Grid [NG] has reasserted its view that additional gas infrastructure will continue to ease the supply situation this winter. Publishing the findings of its Winter 2007/08 Consultation Update Document – a progression to the preliminary report released late March (see **FocusOn...** May 2007) – the system operator maintains its forecast for an increase in gas supplies. NG has marginally increased its expectation of gas demand growth compared to last winter, however, due to a downturn in price levels and reiterates doubts over schedules for additional Liquefied Natural Gas [LNG] capacity. The network operator also highlights the effects that possible demand shocks in other countries might have on UK supplies, owing to the physical linkage between markets. Commenting on the report, industry regulator, Ofgem continues to advise against complacency as actual flows from Europe remain uncertain and a cold winter could significantly increase the need for gas across the region. In regard to the electricity supply outlook, NG is predicting that generation margins will remain “healthy even under severe weather conditions”.

There is “confusion and pessimism about how effectively industry and government can fight climate change”

- **Alistair Buchanan**, Ofgem chief executive

Customers prepared to pay for carbon cuts

Intended to gain a better understanding of customer concern surrounding energy consumption, Ofgem launched a Consumer First Programme, which found that people were prepared to accept increases in their energy bills to cover the cost of reducing carbon dioxide emissions. The survey found that most people are willing to pay up to £15 a year, whilst those who could afford it and felt more strongly about climate change were prepared to pay between £50 and £100 per annum. Ofgem’s chief executive, Alistair Buchanan, said, however, there was “confusion and pessimism about how effectively industry and government can fight climate change”. Tony Juniper, executive director of Friends of the Earth, highlighted this point when speaking about Shell’s sponsorship of a climate change summit. Mr. Juniper argued that the oil major was attempting to promote green issues whilst failing to clean up its own act. He pointed to the fact that Shell was spending money on carbon-intensive tar sand operations in Canada and failing to put out illegal gas flaring in Nigeria. Shell’s UK chairman, James Smith argued, however, that the company had major investments in wind farms, solar power and biofuels.

Whitehall signs innovative energy purchasing deal

EdF Energy has penned a £1 billion agreement with the UK government to supply one-terawatt hour [TWh] of green electricity per year until 2011; equivalent to one-third of energy consumed on an annual basis by the 300 parliamentary departments and civil service bodies, including Downing Street. Under the terms of the deal, EdF will also facilitate the government to procure power in the spot market, however, this could be sourced from any wholesale supplier. Although buying on a day-to-day basis can be more risky than longer-term contracts – owing to increased exposure to price volatility – Whitehall is hoping to cut its overall energy costs, which are

estimated to be in the region of £200-250 million a year. According to the treasury’s Office of Government Commerce [OGC], an increasing number of public sector consumers are willing to take the additional risks associated with acquiring energy in the day-ahead market. The National Health Service has reportedly made savings of approximately eight per cent over a two-year period through purchasing its electricity in the same way. Director of Procurement Buying Solutions at OGC, Derek Rothwell, commented: “This new procurement model ticks all the boxes – it will reduce costs, improve prices and provide an environmentally-friendly energy resource”. The move should also assist the government in its strive to obtain 10 per cent of its power from sustainable means by March 2008.

Gazprom plans for expansion in the UK

On announcing the company was on the brink of a deal that would provide expansion to its UK presence, deputy chairman of Gazprom, Alexander Medvedev reignited speculation that the Russian giant would be approaching a British utility with a takeover bid. The suggested targets were again Centrica and Scottish & Southern Energy, with Centrica having emerged as a possibility following last year’s declaration by Gazprom chief executive, Alexei Miller, that it regarded the UK company as an “interesting asset” and on its “watch list” of potential acquisitions. A spokesman for the Moscow-based firm’s UK arm, Gazprom Marketing and Trading [GM&T], however, rebuffed any such move to make “major acquisitions” in the UK market and declared that a growth in the small/medium-sized business sector would be a more likely option. GM&T hinted that this could be a takeover of Cheshire-based UK supplier, Natural Gas Shipping Services [NGSS], with whom it currently holds an administration contract. News of a smaller divestment would be better received by the UK government which continue to voice concern over the political repercussions of Gazprom’s move into the British market.

SSE buoyed by increasing customer base

Announcing a 28 per cent increase in second half profits to £481.5 million for the six months ending 31st March, the UK’s second largest power producer, Scottish & Southern Energy [SSE] also declared its client base had reached a record eight million; the highest since its conception in 1998. Within a period of just 11 months, the utility has managed to add one million customers, with total clients now standing at 5.03 million for electricity, 2.87 million for gas and 105,000 for telecommunications. The UK company attributed the rise to “responsible pricing” and “best-in-sector” customer service. It was also praised by price comparison website, SimplySwitch.com for delaying an increase in consumer tariffs after wholesale costs rocketed last year.

Government reshuffle sees change to DTI

The tentative future of the Department of Trade and Industry [DTI] was secured last week, with the cabinet reshuffling of Whitehall when Gordon Brown succeeded Tony Blair as prime minister. Instead of the planned amalgamation of energy with the environment, the DTI will continue to deal with energy-related matters, albeit under the name the Department of Business and Enterprise. John Hutton, secretary of state for the Department of Work and Pensions, will head the division.

European energy markets fully open – theoretically

July 1st marked the final stage in the deregulation of Europe's energy sector, or theoretically at least, as all households across the Union were given the freedom under Brussels' Second Energy Market Directive to select their power and gas providers. The degree at which industrial and commercial consumers have taken up the opportunity to switch supplies, however, varies greatly across the region. According to figures released in 2006 by the European Commission, cumulative switching of medium industrial/commercial gas users in the UK since market opening is over 50 per cent. This statistic compares with between 5 and 20 per cent in France and less than 5 per cent in Holland. In fact, the French energy regulator, Commission de Régulation de l'Énergie [CRE], has revealed in its latest market opening report that 92.6 per cent of those eligible still remain with gas supply incumbents. Full liberalisation of Europe's energy sector represents a major transition for government controlled Gaz de France [GdF] – as well as its sister company Electricité de France – whose 60-year monopoly over household energy supply potentially ends. Despite newspaper reports to the contrary, GdF issued a statement last month insisting its preparations for full market opening were on track and that its retail business will be operating independently from its distribution arm. A third legislative package aimed at increasing competition throughout Europe is expected to be released by the Commission in September.

Growth in world energy consumption slows

Global energy demand growth declined for the second year running in 2006, according to BP's latest Statistical Review of World Energy, as high prices continued to impact on consumption. Despite stronger economic expansion, primary energy usage increased by 2.4 per cent last year, down 0.8 percentage points from 2005. Nuclear power bucked the trend, however, to be the only fuel whose demand growth did not slow; atomic output was up 1.4 per cent on a combination of increased utilisation and plant capacity upgrades in mainly Organisation for Economic Co-operation and Development [OECD] countries. Although down 1.2 per cent year-on-year, coal remained the world's fastest growing hydrocarbon in 2006, with China's appetite for the fuel contributing over two-thirds of the 4.5 per cent increase. Speaking at the launch of the review, BP's deputy chief economist, Christof Rühl, warned that in spite of an overall decrease in the energy intensity of economic growth, carbon dioxide emissions were continuing their upward trajectory, largely because of the rate at which coal continued to be the fastest growing primary fuel. The study, widely recognised as an industry standard reference, also asserted that there are enough proven crude reserves (see **Explained...** section) to cover global demand at current levels for another forty years, whilst verified natural gas supplies will last another six decades of present-day consumption. Dismissing the theory that oil production is already at or near its peak, BP's chief economist, Peter Davies, said "there is no absolute resource constraint...when peak oil comes it is just as likely to come from consumption peaking...as from production peaking". The

London-based Oil Depletion Analysis Centre, criticised Mr. Davies' statement, however, by suggesting that crude production across the globe was set to reach its apex in the next four years before declining steeply. One thing that can be said with surety is that Britain's North Sea production has climaxed. According to BP's figures, the UK has enough oil and gas to last just six more years at current output rates.

EU market coupling to be expanded

The success of trilateral electricity market coupling, hailed earlier this year by the European Union [EU], has paved the way for a Memorandum of Understanding to be ratified by a further two countries. Germany and Luxembourg, as well as the nations who originally participated in the market coupling; France, Belgium and the Netherlands, signed a new treaty that has been described by EU energy commissioner, Andrei Piebalgs as the "founding stone of the largest integrated regional energy market in Europe". The agreement will see transmission system operators and regulators in all five countries working in conjunction to achieve improved market transparency. It is intended that by 1st January 2009, the coupling will increase co-operation between each of the countries' electricity grids, converge pricing levels and facilitate cross-border trade; thus effectively working as a single power market. The addition of Germany to the alliance has been described as "extremely important" by chief executive of Dutch gas & power exchange, APX group, Bert Den Ouden. Mr. Piebalgs added that Germany would provide the means for eastern Europe to be integrated and that "important progress will have been made in creating a European wholesale market functioning in a fairly harmonised way". Norway, Scandinavia and Iberia are also set to join in the near future.

Belgium's nuclear future uncertain

In the run up to Belgium's 10th June general election, which ultimately saw prime minister Guy Verhofstadt ousted after eight years, the future of atomic energy was high on the political agenda. The Christian Democrats of Flanders, who will now begin talks to form a new coalition having made big gains, argued that it is unrealistic to phase out the country's seven nuclear reactors by the scheduled date of 2015. The absence of alternative capacity remains the concern; with the nation currently deriving just under half of its energy from nuclear, whilst gas accounts for a fifth of the generation mix. A drawn-out debate on this issue is anticipated, owing to the fact that the Flemish Socialists, the party with which the Christian Democrats are widely expected to form a coalition, have demanded that the reactors are decommissioned on time. In related news, although Germany has confirmed it is planning to close its reactors and Spain has postponed a decision on whether to build new reactors until 2008, nuclear power in Europe is experiencing a renaissance. Maurizio Boella, head of nuclear safety at the EU's Directorate-General Transport and Energy, drew attention to this; "Finland and France are building new capacity, the Netherlands is extending the lifespan of plants and the UK recently moved towards a new build".

PriceFocus...

Brent Blend (dated)

June 2007

Brent Blend (Dated) Oil

Opening Price:	\$67.98/barrel
Closing Price:	\$72.21/barrel
Maximum Price:	\$72.47/barrel
Minimum Price:	\$68.40/barrel
Overall Change:	+6.2%

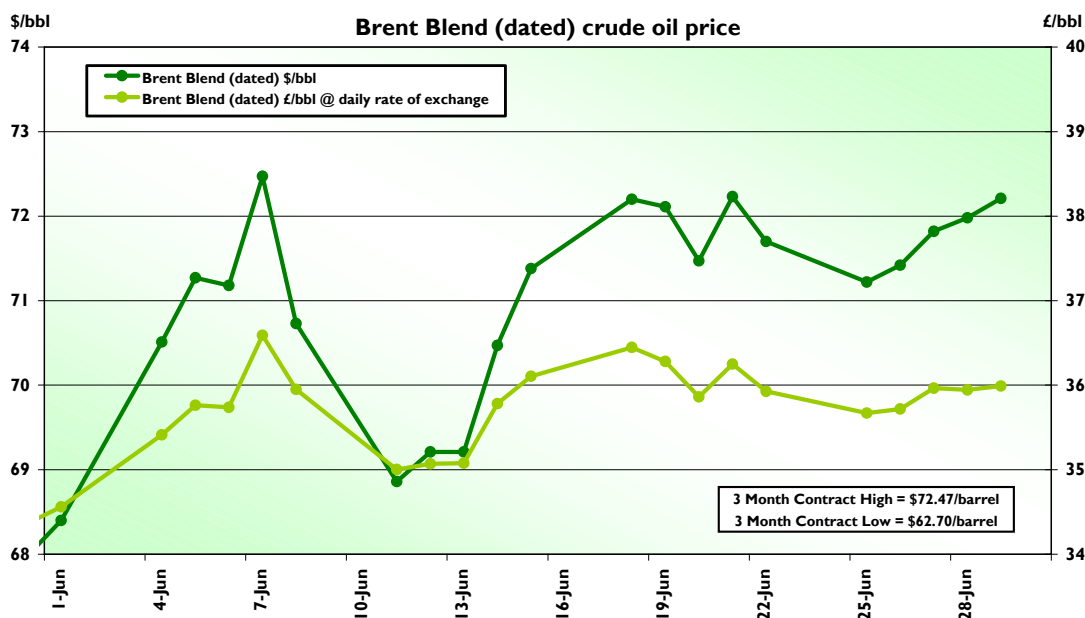
The oil markets were dominated throughout June by speculation over gasoline production in the US; more specifically that extra crude needed to be refined during the peak summer demand season. Crude prices did shed nearly three and a half dollars in just two sessions mid-month as immediate supply fears were allayed. Positive sentiment was short-lived, however, as a strike in Nigeria threatened to curb oil output from the world's 8th largest exporter. The Brent Blend (Dated) contract eventually settled the review period 6.2 per cent higher.

After ticking higher during the first trading session of June, Brent Blend, the benchmark European physical oil contract, gained substantial value during Week 23, to hit its highest level since August 2006. The oil markets were driven upwards after a tropical storm in the Persian Gulf threatened to disrupt tanker shipments from the Middle East. Prices began to fall back at the end of the week after the storm, named Cyclone Gonu, began to dissipate having missed the region's major oil platforms.

Week 24 opened in bearish fashion with the spot crude contract falling nearly \$2 a barrel; traders reportedly speculated that recent gains could not be justified. In a reversal of the short-term trend, oil prices pushed higher during the final days of the week. Market participant's concerns were raised on news of planned strike action in Nigeria, Africa's largest oil producer, which threatened to further limit supplies to the global marketplace.

The oil markets seemed to find a period of relative stability during Week 25 as the dated contract settled only slightly higher than the previous 5-day period. The first sessions of the week were dominated by reports of militant violence and industrial action by workers in the Niger Delta. Crude values dipped towards the end of the week, however, after US inventory data revealed a 6.9 million barrel leap in oil stocks – much larger than had been anticipated.

European spot oil edged lower on the opening day of trade in Week 26 after Nigerian trade unions called-off strike action. Industrial leaders ended the walkout after the Abuja-based government agreed to freeze fuel prices for one year, a key cause of worker unrest. Crude oil increased in value during each session until the end of June after it was revealed that demand for petrol in the US currently stands at nearly ten million barrels a day, 1.4 per cent higher than 12 months previously. Revelations that heating-oil stocks are severely down against preceding years also contributed to the product-led rally.



Outlook

With US refineries struggling to produce enough petroleum products to meet burgeoning demand levels, the possibility that crude prices will fall significantly during the next month looks remote. As the Gulf of Mexico progresses further towards the peak summer hurricane season, oil traders will also look anxiously at Atlantic weather forecasts. Consuming nations will no doubt seek to pressure Opec into increasing output ahead of their next meeting in September, however, the oil cartel considers global markets to be "adequately supplied". Poor refinery performance in the US and the subsequent lack of oil products remains the key topic for market discussion, however, with heating oil stockpiles also in need of a major replenishment, prices looked set to remain above \$65 a barrel for some time to come.

August 2007 gas contract renewal

June 2007	August-07 gas renewal
Opening Price:	36.36p/th
Closing Price:	34.50p/th
Maximum Price:	36.33p/th
Minimum Price:	33.56p/th
Overall Change:	-6.2%

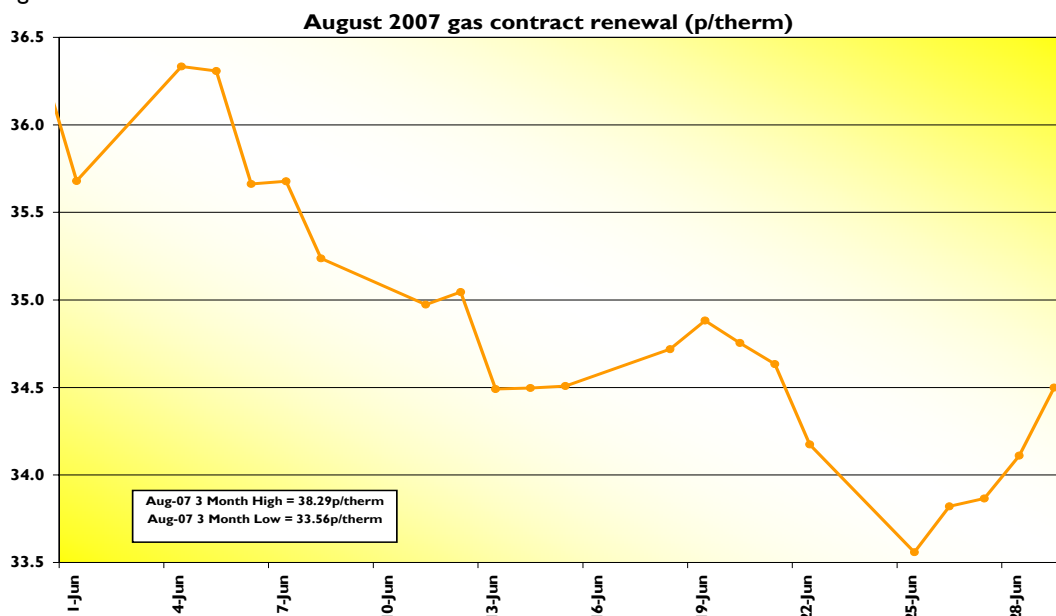
The August contract travelled a largely bearish path over the course of June, as the prospect of lower-than-expected demand during the residual summer months conspired with a softening in the Win-07 component; which seemed to continually search for a fresh resistance point. Brief increases occurred owing to persistently firm oil values, however, these were swiftly followed by price corrections. The August renewal eventually finished the review period some 6.2 per cent lower at 34.50p/th.

The annual contract opened in bearish fashion, losing ground on predictions of lesser demand during Q3-07, as well as a reduction in the value of Win-07 gas (which took its lead from a considerable drop in the emissions sector). The beginning of Week 23 saw NBP prices advance; the prompt climbed on reduced Langede flows, whilst a stronger crude sector sparked speculative bidding activity along the curve. Forward gas prices declined mid-week, however, as third-quarter discussion again centred on the system's current ability to cope with maintenance programmes and a number of supply glitches. The contract struggled to find clear direction at the end of the week, with traders generally reluctant to take up new positions.

Withdrawals from Rough Storage and a fall in UK exports via the Bacton-Zeebrügge Interconnector pressured the spot market lower at the start of Week 24. Summer supply confidence and weaker crude prices also aided the annual renewal's descent. The contract ticked higher in the next session, before decreasing mid-week as the Win-07 component seemingly sought for a new technical resistance point. Although bearish sentiment arrived from the months of July and September, August retained a risk premium owing to renewed anticipation of heavy maintenance schedules. Interest was limited in the final trading day of the week.

Strong spot values – following production problems – filtered through to the renewal, whilst a slight increase in Win-07 added further bullish impetus in the first couple of sessions of Week 25. The contract ignored firmer prompt prices mid-week to soften with the residual summer months and an oil-led slippage in the front season. Forward gas prices continued to nudge lower, despite questions surfacing over how much more downside remained in Q3, before speculative selling saw the renewal dip notably at the end of the week.

The annual contract ticked lower at the beginning of Week 26 with the Win-07 component; which softened on improved confidence that supplies could meet demand during the period. In a change of direction, the August renewal moved upwards in the following sessions; taking its lead from brief financially driven advances in the front season. Players closing out short positions for Q3 ahead of its expiry, filtered through to the annual contract at the month's end. Further gains of the Win-07 contract, which decoupled from the oil futures, also weighed on discussion.



Outlook

Spot market values will ultimately respond to Norwegian gas deliveries through the Langede pipeline as well as Bacton-Zeebrügge Interconnector flows. Expectations that average temperatures will not, after all, be as hot as initially thought should cap near-curve prices. The new front month of August is likely to retain a risk premium over Balance-of-Month and September, however, on anticipation that it will see the heaviest maintenance during Q3-07. Potential declines in the month of September will be limited by uncertainty surrounding the affect of annual maintenance at both Rough Storage and the Interconnector. Win-07 could continue to drift in a tight range, with only a significant supply outages or notable upturn in speculative interest set to push it higher.

PriceFocus...

August 2007 electricity contract renewal

June 2007	Aug-07 power renewal
Opening Price:	£39.67/MW/h
Closing Price:	£38.13/MW/h
Maximum Price:	£40.11/MW/h
Minimum Price:	£37.64/MW/h
Overall Change:	-3.9%

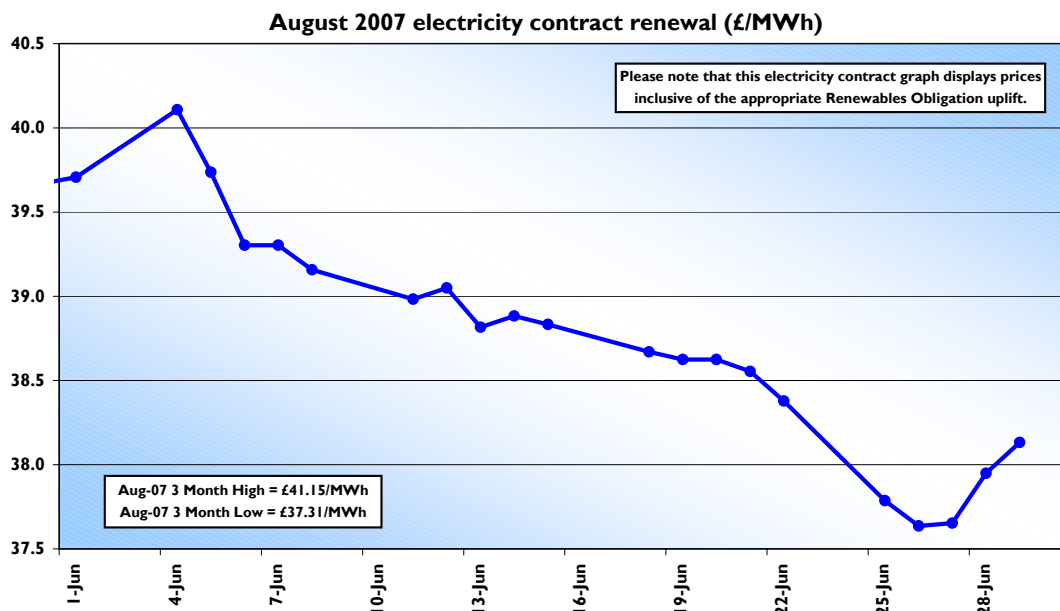
Against a backdrop of persistent concerns over short-term generation margins, which caused Day-ahead prices to hit their highest level since January, forward electricity values managed to lose ground at a reasonably constant rate during June. Belief that average temperatures across the continent will not be as warm as previously anticipated saw risk premiums in the months of July, August & September erode, whilst costs associated with power for delivery this winter endured a neutral-to-bearish passage. The renewal lost some 3.9 per cent to £38.13/MWh.

Overlooking a weaker UK gas market, stronger coal and an upturn in carbon permits helped the August power renewal edge higher in the opening session of the review period. Having gained further ground at the beginning of Week 23, electricity futures then experienced bearish sentiment for the remainder of the week. A drop in the emissions sector and erosion in the third-quarter risk premium – on a downward revision in forecast temperatures across the continent during the summer – were attributed to the softening.

The annualised electricity contract drifted marginally lower over the course of Week 24 on the availability of cheaper natural gas at the NBP. Falls were less pronounced than those witnessed in the gas sector, however, largely due to stronger Phase II carbon certificates. Firmer prompt power prices also limited potential decreases; only days after returning to service from a six-month outage, a unit at British Energy's Hunterston atomic plant was closed after a temperature control was discovered to be faulty.

Week 25 saw the renewal lose negligible ground. A financial institution-led sell-off in the carbon market and softer continental power prices allowed forward power contracts to ignore firmer UK gas values at the beginning of the week. A continuation of falling emissions permits – which reached a one-month low – and National Grid reaffirming its confidence in UK production margins for the coming winter contributed to movements during the residual sessions.

Despite a late recovery in Week 26, the renewal lost further ground. The opening session witnessed the largest day-on-day movement during the month as sentiment on the power curve was principally derived from a weaker NBP gas market. Permits for Phase II of the EU-ETS continued to aid the power market's descent during the next couple of sessions. Further erosion in the Q3-07 risk premium with diminishing expectations of a heat-related supply crunch this summer also contributed. With both natural gas and carbon allowances gaining value during the final two sessions, the August renewal price inevitably followed suit.



Outlook

Although the gravity of concern surrounding generation margins eased slightly in the latter stages of June, available power station capacity will continue to govern prompt market discussion in the month-ahead. With apprehension over a possible heatwave related supply crunch across Europe starting to abate, risk associated uplifts in the balance of quarter-three could allow for further weakening in the corresponding periods. The carbon and NBP gas markets will dictate movements on the electricity curve, whilst technical resistance could stifle volatility and liquidity.

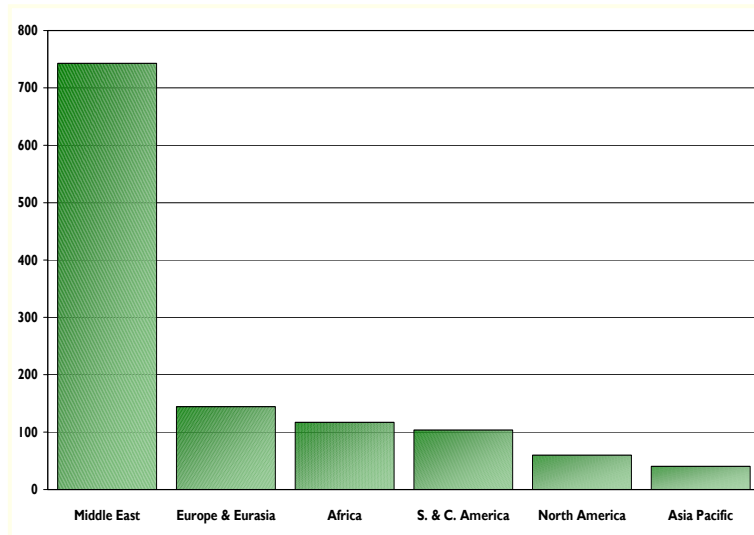
Explained...

Crude oil reserves

Proved reserves of oil

Generally taken to be those quantities that geological and engineering information indicates with reasonable certainty can be recovered in the future from known reservoirs under existing economic and operating conditions.

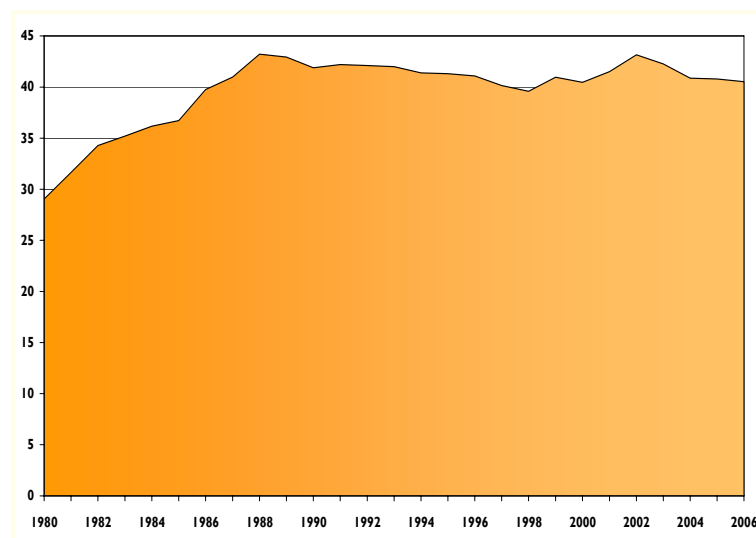
Chart 1 – Proved oil reserves by region (thousand million barrels)



Reserves-to-production (R/P) ratio

If the reserves remaining at the end of any year are divided by the production in that year, the result is the length of time that those remaining reserves would last if production were to continue at that rate.

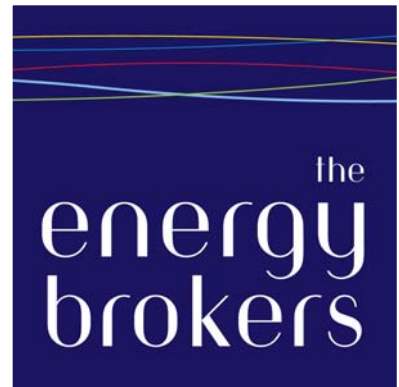
Chart 2 – Reserves-to-production [R/P] ratios (number of years)



(source: BP Statistical Review of World Energy June 2007)

JulySpotlight... the month ahead

- 1st July ... European energy market fully deregulated.
- 4th July ... US Independence Day – American exchanges closed for public holiday.
- July ... Heavy maintenance on UK Continental Shelf.



your power to negotiate

ContactUs...

the **energybrokers** ltd.
Sheene Road, Leicester, LE4 1BF
Tel: +44 (0) 116 235 7300
Fax: +44 (0) 116 235 7400
E-mail: info@tebl.com

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