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Non-Domestic Supply Market Review: Consultation

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The view of JHA is that a review of the non-domestic supply market is necessary. Further, all non-domestic customer categories should be included within the scope of any such review.

Our main contention for this is that the wholesale cost of energy accounts for the single largest element of a customer's bill and the unprecedented increase in forward prices has precluded switching behaviour in consumers.

Accordingly, we cite evidence from the results of the JHA October 2005 electricity market tender round below.

- **High prices and new contracts put the brakes on switching: This is not consistent with a highly competitive functioning market**

The October 2005 tender round was conducted against a background of historically high wholesale prices and little competition between Suppliers. Unlike previous tender rounds, JHA did not see any individual Supplier particularly trying to win business. This resulted in 70% of the JHA database staying with their incumbent supplier and 25% of those moving onto flexible deals in order to spread their risk across the year.

Those clients that moved onto fixed deals were seeing increases to their "energy only" price of 40 to 50% or more. Some sites that were coming off two year contracts (that is contracts which commenced in October 2003) saw increases of over 100%.

With gas as the input fuel for 40% of UK generation, high gas prices have fed through to the price of power. The cost of gas has moved ahead of coal, making the dark spread more attractive to suppliers than the spark spread and providing a good opportunity for coal generators. However, because coal generation is more polluting, it increases the demand for EU Allowances, increasing their value in turn. With the commencement of the EU ETS in January 2005, the price of EU Allowances is an additional input cost to the price of power, pushing up the price of power across Europe, but particularly in the deregulated markets such as the UK.

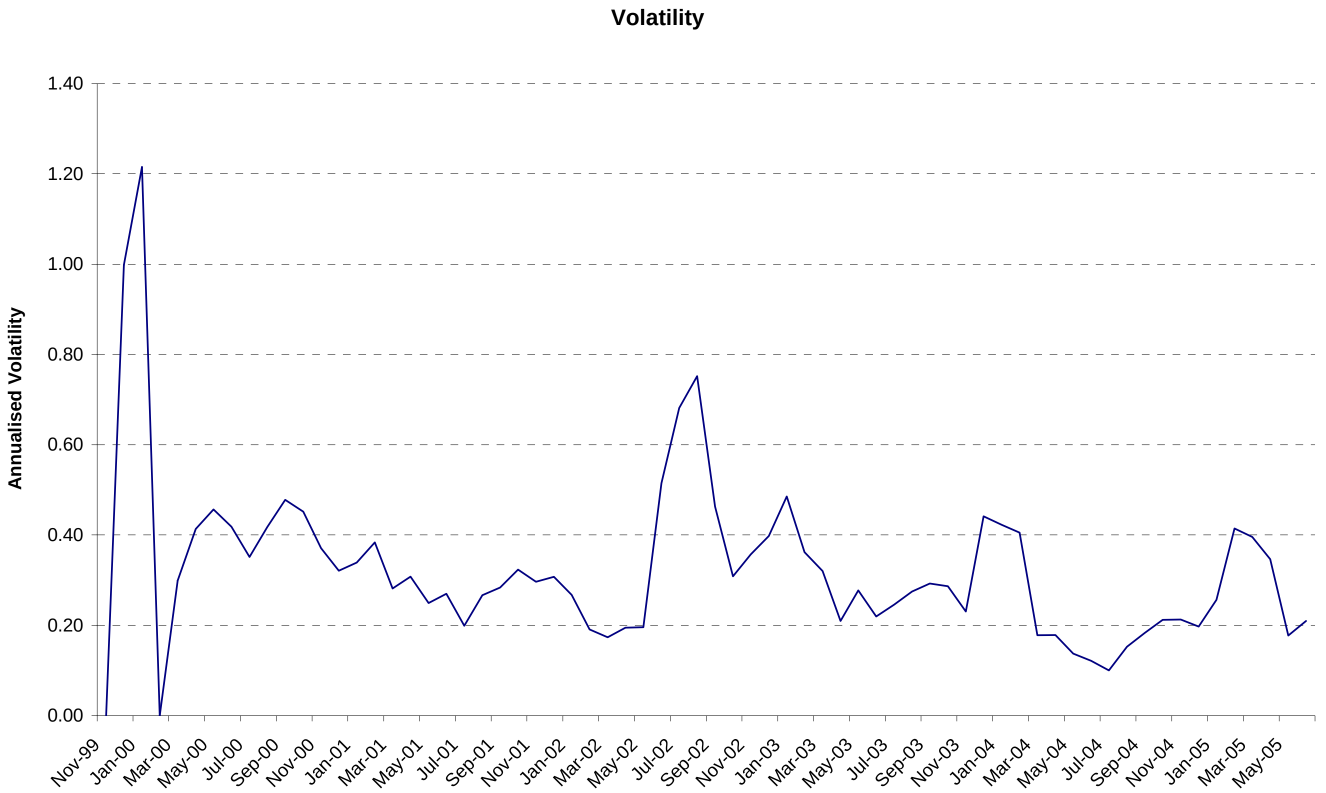
- **Exceptionally high Wholesale Prices have had a massive impact on the retail market it has-transferred risk down the supply chain: a sign of vertically integrated companies having market power across the supply chain**

In October 2004, the October 2005 wholesale contract price opened at £34.35/MWh and as can be seen in the chart below, moved down to £29.68/MWh in December. However, from February 2005 when there was a cold snap in the weather, the price started to climb, reaching a peak of £57.03 in July 2005. The connection that power has with gas and carbon prices was demonstrated when both of these peaked at the same time at 64 pence per therm and €29.15/tonne respectively.

There has been an overall downward movement since that time, although prices remained historically high during August and the contract closed at £45.33/MWh at the end of September, which was 32% higher than it had started in October 2004. In August when the oil price rose to nearly €70/barrel, the UK gas and electricity markets resisted another spike, it is thought because gas and power prices in the UK were already over inflated.

- **Market volatility has had a big impact on clients cash flows**

Volatility has been an important driver for suppliers to off load risk towards their clients. Since the price spike of 1999/2000 the markets have become more volatile. Consumers are unable to effectively budget/ plan for the year. Volatility has meant that it is harder to make investment decisions in new plant (and variable prices always increase rather than reduce the cost of capital).



- **What I&C customers actually pay for their energy**

JHA Database – Average Energy Only Prices by Load Factor (p/kWh)			
Load Factor Band	0-35%	35-60%	60-100%
Pence Per kWh	5.42	4.77	4.49

The JHA "energy only" price excludes DUOS, TUOS, CCL, Distribution Losses, Settlements and the Hydrobenefit Charge.

When comparing prices settled in the JHA October 2005 tender round, it can be seen that the higher the load factor, the more competitive the energy price. If a site has a high load factor, this means that the demand profile of the site is flat. The more varied the profile, the lower the load factor.

However, it is important to note that the actual price agreed is largely dependent upon the time at which the contract was placed and the level of the wholesale market at that time. Those that settled their prices earlier in the year would have achieved a more competitive price. For example, the average of energy only prices settled in February 2005 for an October 2005 start, averaged at 3.44 pence per kWh. This compares to an average of 5.50 pence per kWh for those settled in August 2005.

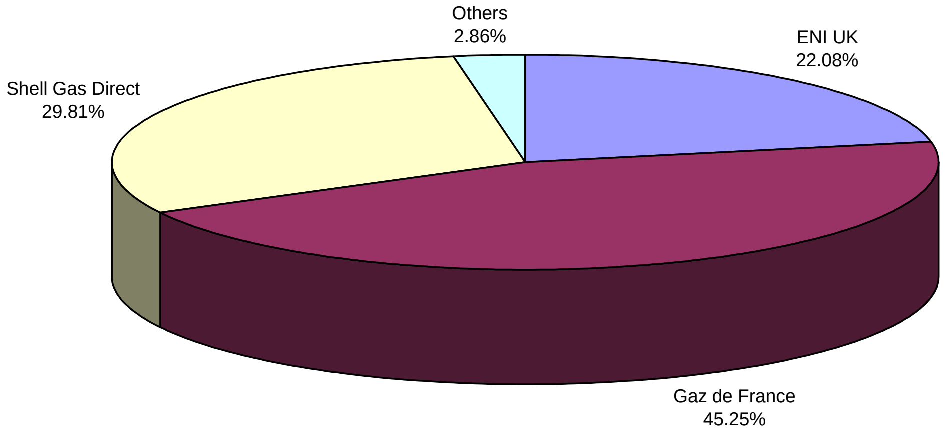
Of the total volume tendered by JHA for an October 2005 start, 25% moved onto a flexible deal. 40% of the total JHA database now buys on a flexible contract. A wide range of flexible products are now being offered by suppliers. A large consumer is able to opt to buy baseload power in blocks. A medium consumer can buy on a "market tracker", which follows a specific index or market. Large buyers that took this route were generally planning to take a flexible deal as their strategy. It takes the price closer to the market and protects the buyer who can purchase small amounts at a time, thereby spreading their risk throughout the year.

However, many medium buyers were forced to take the route of a flexible deal, once wholesale prices became so high that they could not accept a fixed contract at that level. However, once the price fell back, these buyers were able to then lock in their position and buy 100% at the lower level. This gives the buyer the advantage of being able to pick their time to fix their contract. The disadvantage of flexible deals is that the expectation on the part of the buyer is to gain a lower price by being closer to the market. However, they will have to contend with price spikes and don't have the advantage of knowing what they will be paying in advance.

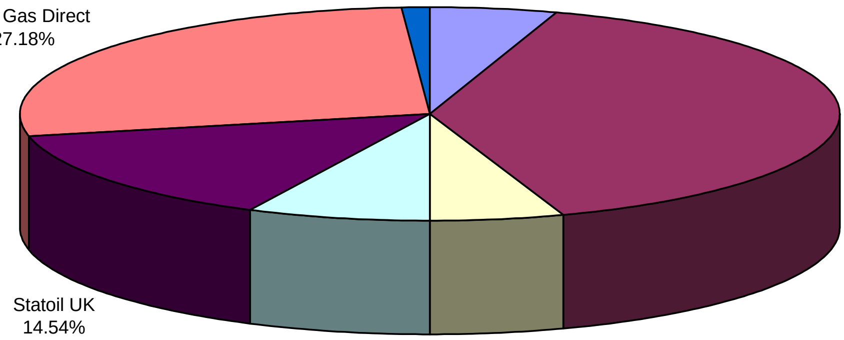
- **Supplier Share: a Concentrated market: not a sign of a highly competitive market**

With a large proportion of the database staying with incumbents, there was little significant movement of suppliers to report. Two examples are shown bellow-

Gas Market Share - Interruptible Sector - October 2005



Gas Market Share - >25K Firm - October 2005



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