

npower Business Energy Index Summer 2005



Dear Reader,

In recent years, market economics as well as political and regulatory intervention at the EU and national level have transformed UK energy markets and this is having a significant impact on the operations of UK business.

To discover more about how companies are managing their energy needs, we sponsored an independent survey in April amongst a representative sample of business energy users. In addition, interviews were conducted with a small sample of organisations who are involved in determining and influencing energy policy in the UK.

This survey is the first in what will be a biannual programme of market research designed to (a) monitor trends and expectations in business energy costs, (b) track the incidence and impact of measures taken to improve energy efficiency, and (c) explore business views on public energy policy. In this first issue, the special policy topic is Energy and the Environment and there is a separate section dedicated to questions in this area.

The survey is sponsored by npower and in executing the research we are grateful for the co-operation of the Major Energy Users' Council (MEUC), the Energy Intensive Users Group (EIUG), and the Federation of Small Businesses (FSB).



The survey was designed and conducted by Moffatt Associates, an independent research and marketing consultancy based in London.

This Report contains npower's views on the various policy issues raised by the survey as well as measures that businesses can employ to best manage their energy needs. We hope that the research findings and commentary will provide a valuable contribution to the debate on market developments and the future of energy policy in the UK and Europe.

Yours sincerely,

Andrew Duff
CEO, RWE npower

Research Objectives

The npower Business Energy Index sets out to identify and monitor trends in, and expectations about, key energy issues. The Index is intended to be a twice yearly barometer of issues affecting the business user marketplace.

Specifically it will:

- review energy costs, their components and their impact on customers;
- measure and monitor the incidence and efficacy of measures to increase energy efficiency; and
- explore business attitudes and opinions to current and future public energy policy.

Each survey will also canvass opinion on a special topic; beginning with Energy and the Environment.

Research Sample

Telephone interviews were conducted with a representative sample of 100 organisations, comprising 30 small- to medium-sized enterprises with significant energy usage, 60 major energy users and 10 policy-makers and influencer groups. In the majority of cases the respondent was an energy buyer or a senior figure with responsibility for energy purchasing. The series of questions provided both comparable quantitative data and qualitative opinion and attitudes on energy user issues within the four main sections of the Report.

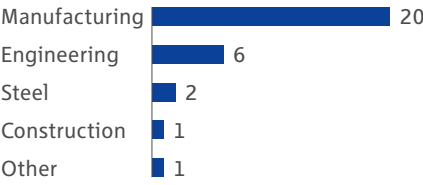
Policy-makers and influencers profile

In addition to business users, the following organisations were interviewed to canvass views on specific aspects of business energy and public policy issues:

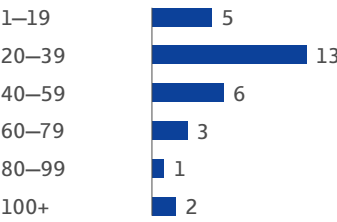
- Association for the Conservation of Energy
- Ceramics Foundation
- Cornwall Consulting
- DTI
- DTI Strategic Policy Unit
- Energy Intensive Users Group
- Energy Saving Trust
- Ofgem
- OGC Buying Solutions
- Scottish Energy Efficiency Office

Small- and medium-sized enterprise profile

Number of companies by sector

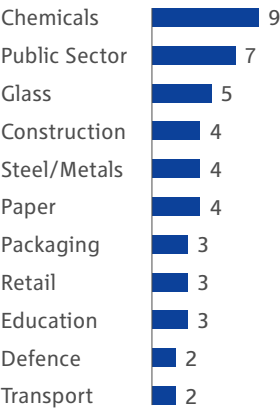


Employees

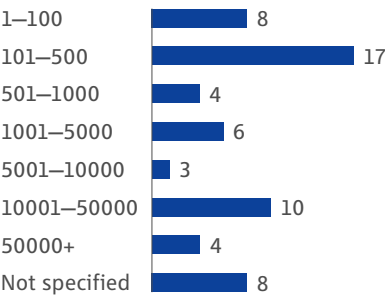


Major energy users profile

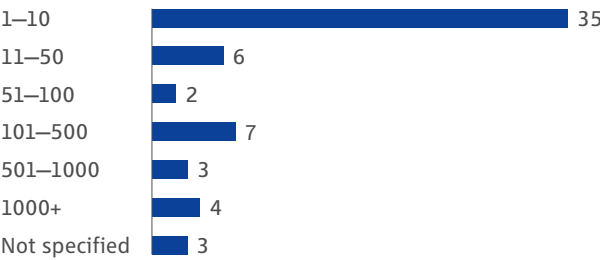
Number of companies by sector



Employees



Sites



Research Highlights

Rising energy costs...

- Half of small or medium enterprises (SMEs) and nearly two-thirds (65%) of major energy users (MEUs) have experienced an increase in energy costs in the last 6 months. SMEs claim that their energy costs have risen by 14% during that time; larger corporates by 23%.
- Rising energy costs are having a negative impact on profits and competitiveness. Nearly half (47%) of SMEs and almost two-thirds (65%) of MEUs say rising energy costs have reduced profits. Furthermore, 27% of SMEs and 51% of MEUs say the increase in energy costs has reduced their competitiveness.
- Looking to the next 6 months, more MEUs (40%) than SMEs (27%) are predicting a further increase in their energy costs. Predicted cost increases range from 6% to 29%.
- There is more uncertainty regarding likely energy cost trends over the next three years, with only 35% of all respondents predicting further cost increases, which range from 16% to 25%, with MEUs forecasting higher increases.

...prompting increased energy efficiency...

- Increases in energy costs have highlighted the importance of energy efficiency and, not surprisingly, the issue is of greater significance for MEUs, with nearly all respondents actively monitoring their energy efficiency.
- In response to rising energy costs, some 52% of all respondents have changed their heating and lighting requirements and 51% have introduced more efficient equipment and technologies.

- When asked what Government needed to do to help companies improve their energy efficiency, the vast majority (78%) say they would like to see incentives for energy efficiency innovation with 42% proposing some form of financial incentive.

...with conflicting views on environmental policy

- The vast majority of companies in the UK would appear to support the Government's emissions targets set out in the Kyoto Protocol. However, there are serious doubts about the practicality of the target. There are also concerns about costs – in terms of higher prices that industry and consumers will have to bear to reach the target – and the negative impact on the competitiveness of UK industry.
- In terms of renewable energy, there is broad political support for encouraging investment in wind power generation but again there are concerns about the cost of wind energy and the feasibility of the target (10% of UK energy by 2010).
- In terms of fuel mix priorities, wind power is rated highly but so is nuclear power with views being expressed that CO₂ reductions cannot be achieved without more investment in nuclear energy. Amongst MEUs, with concerns about security of supply and cost, nuclear power is top priority.

Section 1: Energy Costs

For the first npower Business Energy Index, respondents were asked a range of questions relating to energy costs, creating a benchmark for comparison in future surveys.

Facts and figures – the business energy market in the UK

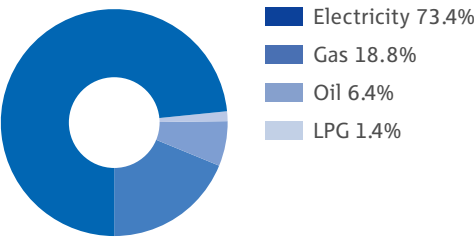
- The business market for electricity covers over 2 million sites across the UK. In the gas market there are over 500,000 sites.
- Small- and medium-sized enterprises (SMEs) represent 78% of the total customer numbers in the business energy market.
- Major energy users (MEUs) comprise three quarters of the business energy market by volume. Industry sectors range from agricultural businesses to multiple site industrial, telecommunications and engineering groups.
- The complete spend of UK businesses on electricity over the course of a year is in the region of £7.5bn.
- Small and medium enterprises combined annual electricity spend is over £1.85bn.

Source: npower Business

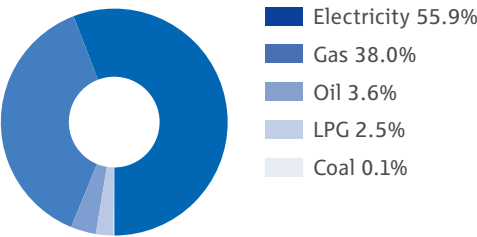
Components of energy expenditure

1.1 Components of company energy costs

SMEs



MEUs



Trends and forecasts

1.2 Estimated increase or decrease in company energy costs over the last 6 months (%)

	SMEs	MEUs	All
Increased	50.0	65.0	60.0
Same	33.3	21.7	25.6
Decreased	0.0	1.7	1.1
Don't know	16.7	11.7	13.3

1.3 Average increase in energy costs – last 6 months



1.4 Perceived significance of selected cost drivers – last 6 months

(scale 1–10 where 10 = highly significant)

	SMEs	MEUs	All
Fossil fuel price movements	5.1	8.2	7.2
Power/gas supplier charges	4.7	4.8	4.7
Environmental obligations	3.9	5.7	5.1
Other government policies	3.4	5.2	4.6
Seasonal fluctuations	3.5	4.6	4.1

1.5 Perceived impact of rising energy costs (%)

	SMEs	MEUs	All
Lower profits	46.7	64.8	58.3
Lower competitiveness	26.7	51.0	42.0
Changed pricing	10.0	22.4	18.2
Changed equipment	13.8	32.2	26.1
Fewer operations	6.7	16.1	12.8
Changed process	34.5	31.4	32.5

How has your business been affected by recent changes in energy costs?

Selected comments

SMEs

'We build any energy cost increases into our pricing of products and these are passed onto the customer.'

'All our UK competitors are in the same boat as far as costs are concerned. It is the international competition that is a greater threat.'

MEUs

'There has been a decrease in profitability as we can't pass on our costs to our customers.'

'Profitability has decreased because energy costs have risen so much, but we have had to become more competitive anyway – it's a cut-throat world.'

1.6 Estimated increase or decrease in company energy costs over the next 6 months

	SMEs	MEUs	All
Overall Average Prediction (%)	1.4	15.4	10.1
Predicting Increase	8	24	32
Average Increase (%)	6.5	28.9	23.3
Predicting No Change	16	19	35
Predicting Decrease	3	1	4
Average Decrease (%)	4.3	15.0	7.0
Don't Know	3	16	19

1.7 Energy cost trends – next 3 years

	SMEs	MEUs	All
Overall Average Prediction (%)	12.3	14.2	13.2
Predicting Increase	18	14	32
Average Increase (%)	16.2	24.5	19.8
Predicting No Change	4	4	8
Predicting Decrease	1	3	4
Average Decrease (%)	10.0	15.0	13.8
Don't Know	7	39	46

What are the key issues that will impact on your energy costs over the next three years?

Selected comments

SMEs

‘Fossil fuel prices continue to rise and regulation from both the UK and EU coupled with the impact of agreements post-Kyoto will hit costs.’

‘The upward trend in energy prices coupled with the decreasing efficiency of our plant machinery.’

MEUs

‘Capacity in the market for power and gas. The supply of oil into the UK, and general volatility in worldwide energy markets.’

‘The price of gas and the Emissions Trading Scheme.’

‘A whole range of issues, mostly taxation, the CCL, the RO and the ETS.’

Policy-makers and influencers

‘The key one will be security of supply linked to world oil prices.’

npower Commentary – fuel price movements over the long-term

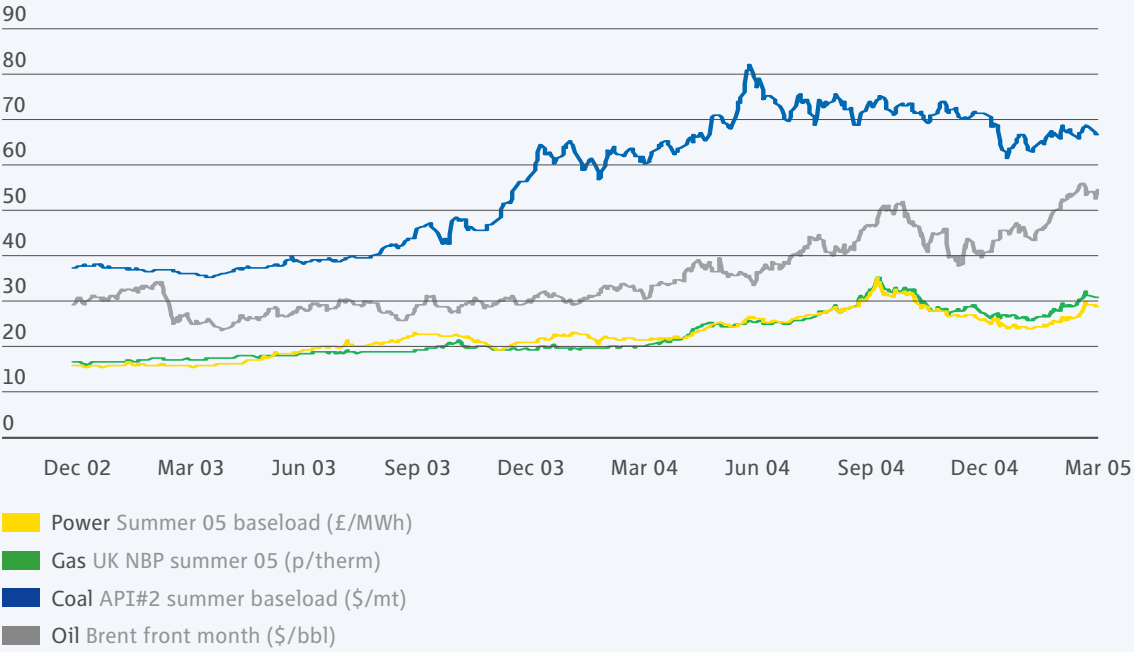
The introduction of the simpler and more transparent New Electricity Trading Arrangements (NETA) in 2001 helped to bring about significantly lower electricity prices to the UK energy market. However, due to an increasingly complex market – and added political and regulatory factors – wholesale prices since 2003 have begun to rise.

Considerable pressure on power prices in recent years has come from the introduction of environmental regulatory instruments designed to deliver reductions of carbon dioxide and other emissions. This has come from both the UK and European governments. The introduction of the Renewables Obligation, the EU Emissions Trading Scheme and the forthcoming Large Combustion Plant Directive all bring costs associated with the move to a lower carbon economy and reductions in emissions from power stations.

Meanwhile, the movement of gas prices has shown a continuing upward trend since the early 90s. This is due in part to the indexing to oil prices, but the depletion of UK continental shelf (UKCS) reserves is likely to maintain upward price pressures. The UK has already become a net importer of gas and investment is required in transportation and storage. Following the ‘dash for gas’ in the ‘90s, approximately a third of the UK’s power generation is now provided by modern Combined Cycle Gas Turbine (CCGT) power stations. This has resulted in a strong correlation between gas and electricity wholesale prices over the course of the last few years (as shown in the graph below).

New fundamentals in the worldwide energy markets have also had a significant impact on UK electricity prices. Demand for coal and oil from fast-growing economies such as China and India has led to a marked increase in prices for these global commodities. In particular, the coal price has doubled since the summer of 2003 and oil prices have reached record levels in the last year.

Commodity prices
Price



Source: RWE Trading

npower Viewpoint

Respondents are claiming a real impact on competitiveness and profitability. The survey also indicates widespread understanding amongst energy buyers in both SMEs and MEUs of the underlying factors behind recent retail price increases, principally fuel costs.

Although, going forward, opinion appears to be mixed over future energy price movements. Rises are expected over the longer term, but less so in the next 6 months.

Forward power prices, however, and the level of expected demand in the winter of 2005, indicate short-term as well as long-term price pressures.

Major businesses should be looking now for energy suppliers to provide flexible purchasing and risk management packages, rather than seeking simple renewals in the twice yearly contracts round. SMEs should be focusing more on the help energy suppliers and others can give in improving their energy efficiency (see Section 2).

Section 2: Energy Efficiency

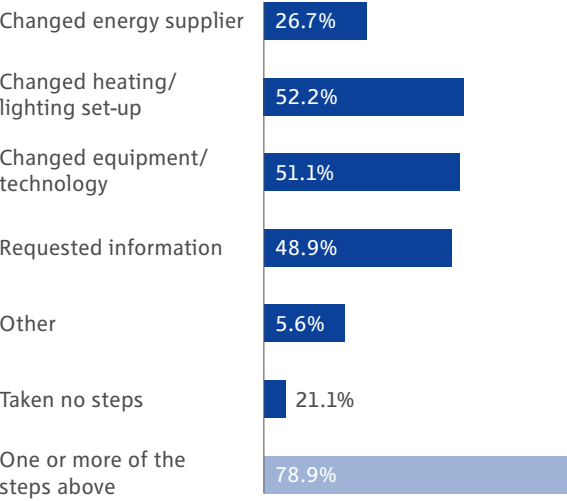
Respondents were asked to rate energy efficiency in terms of its importance to their business, and their own performance in implementing energy efficiency measures. The research also sought to identify barriers to optimal implementation of energy efficiency measures, and possible facilitators.

2.1 Significance attached to energy efficiency
(scale 1–10 where 10 = highly significant)

	SMEs	MEUs	All
Average	5.8	8.0	7.3
Minimum	1.0	2.0	1.0
Maximum	10.0	10.0	10.0

2.2 Steps taken to increase efficiency – last 6 months
SMEs MEUs All All %

Changed energy supplier	6	18	24	26.7
Changed heating/ lighting set-up	11	36	47	52.2
Changed equipment/ technology	7	39	46	51.1
Requested information	3	41	44	48.9
Other	2	3	5	5.6
Taken no steps	15	4	19	21.1
One or more of the steps above	15	56	71	78.9



2.3 Significance of barriers to achieving greater energy efficiency
(scale 1–10 where 10 = highly significant)

	SMEs	MEUs	All
Behavioural/cultural	2.8	5.0	4.3
Organisational/structural	3.0	4.6	4.1
Technical	4.7	4.4	4.5
Economic	5.3	6.0	5.7
Lack of information	4.1	2.8	3.4

What steps has your company taken in the last six months to improve energy efficiency?
Selected comments

SMEs
‘We have invested in more energy efficiency cooling equipment – so we have already altered our production processes.’

MEUs
‘There has been some change in equipment, but not significant, while the prices of some products are increasing.’

‘The type of equipment has changed because of greater energy efficiency. There is no link to pricing, as unit costs have actually decreased.’

npower Viewpoint

It is not surprising that energy efficiency has become a higher priority in recent years, but the speed and scale is worth noting. Over half the businesses (51%) sampled in the survey had changed their equipment and technology in the last 6 months in order to improve energy efficiency, and 52% had made changes to their heating and lighting facilities for the same reason.

Nearly half (49%) had also requested further information either from suppliers, industry groups or other advisors on energy efficiency.

Improvement of energy efficiency measures was strongest amongst the major energy users group. The advantages to businesses, both large and small are clear. Minimising energy waste means saving money through lower bills and, in many cases, lower Climate Change Levy payments.

Despite the overall trend though, around a fifth (21%) of businesses had taken no steps at all in the past 6 months to improve energy efficiency.

Barriers to improving energy efficiency were principally cost and, for the SME market, lack of expertise and resource. Even in relatively energy-intensive sectors of the SME market, energy efficiency gains are frequently stymied by a lack of time to call in specialist advice and reluctance

to pay consultancy fees. Furthermore, there are organisational culture issues such as an unwillingness to make an initial financial outlay on measures which are perceived to take several years to repay the investment. However, good energy suppliers are increasingly offering services that go beyond simple information provision, including free energy audits and discounted efficiency packages.

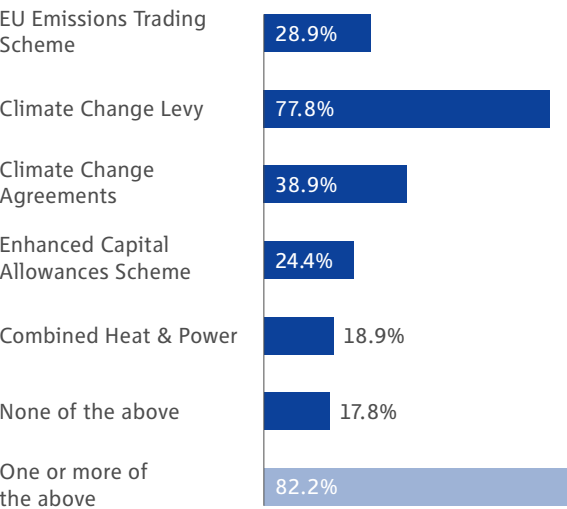
For SMEs, energy surveys and consumption assessments, as well as energy reduction targets tailored to each individual business, are good examples of best practice. For MEUs, national multi-sites assessments and large-scale installation of Combined Heat and Power (CHP) facilities on-site can provide considerable energy savings and even extra revenues through the sale of surplus generation.

Section 3: Public Policy

Respondents to the survey were asked a series of questions on their current involvement in official energy schemes as well as what else could be done at a central level to promote energy efficiency. A selection of comments from SMEs and MEUs, as well as from policy-makers and influencers themselves, highlight a number of concerns with current energy policy.

3.1 Involvement in official energy schemes

	SMEs	MEUs	All	All%
EU Emissions Trading Scheme	1	25	26	28.9
Climate Change Levy	14	56	70	77.8
Climate Change Agreements	3	32	35	38.9
Enhanced Capital Allowances Scheme	1	21	22	24.4
Combined Heat & Power	1	16	17	18.9
None of the above	15	1	16	17.8
One or more of the above	15	59	74	82.2



What are the key policy issues that will impact most on your company's energy costs in the medium-term (i.e. 1–2 years)?

Selected comments

SMEs
'The impact of EU environmental regulations.'

MEUs
'Energy prices, plus the structure of the markets, lack of transparency in gas and electricity, ineffective regulation and government taxation.'

'Oil prices are the main driving factor and the mechanism now links the European gas price to oil prices. We need the government to change its stance on nuclear.'

Policy-makers and influencers
'Energy security from a geopolitics perspective alongside the new gas pipelines and whether enough buffering is put in place at the end of the pipelines.'

'We will have the added costs of subsidising uneconomic renewables for some time to come and that subsidy as a cost will rise. We also need to see how the distribution and local generation of CHP can truly work.'

3.2 What Government could do to help energy efficiency (%)

	SMEs	MEUs	All
Encourage technical innovation	93.3	70.0	77.8
Introduce specific financial incentives	63.3	31.7	42.2
Introduce further regulation	20.0	10.0	13.3
Provide more relevant information	83.3	21.7	42.2
Other	3.3	0.0	1.1

3.3 Highest priority (scale 1–5 where 1 = high Priority)

	SMEs	MEUs	All	No.1s
Encourage technical innovation	1.9	1.1	1.4	50
Introduce specific financial incentives	1.5	1.7	1.6	17
Introduce further regulation	3.0	1.8	2.4	2
Provide more relevant information	2.3	1.8	2.1	12

npower Viewpoint

The survey respondents’ involvement in a variety of official energy schemes reflects the diverse range of instruments currently governing business energy use. Not surprisingly, these stem from the need to meet the Government’s environmental targets, but there is dissatisfaction, particularly amongst MEUs, with the uncertainty that such a diverse and changing regulatory framework creates. In particular, the impact of international directives alongside national policies.

Several respondents felt that the weight of process and bureaucracy involved, with no long-term confidence that requirements will remain unchanged, was frustrating and distracting (see Section 4 for more on Emissions and the Environment).

In our view, business will be best served if regulators stand back from the day-to-day management of the energy markets and instead focus on custodianship of public policy issues and providing a route of appeal for market disputes.

This applies throughout the energy supply chain; with a stable regulatory framework and certainty about policy in the medium- to long-term, investment in power generation would follow, helping to ensure security of supply.

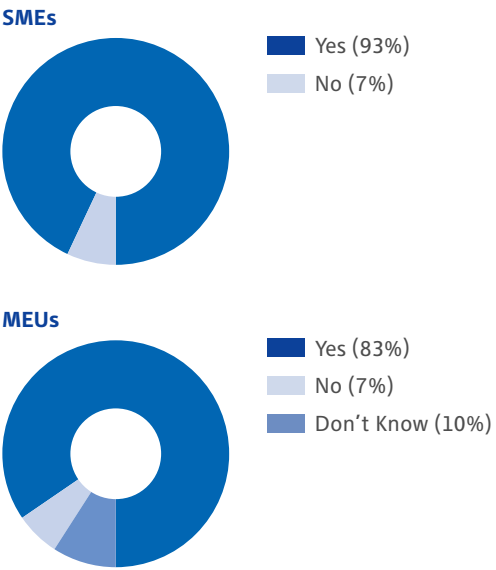
Meanwhile, wholesale energy markets would reflect the stability achieved in the regulatory environment via the reduction of price volatility and, therefore, more certain returns for businesses.

Regarding energy efficiency, as mentioned in Section 2, there is already strong evidence that the market for energy efficiency packages is developing and suppliers will respond to demand. From a policy perspective, further regulatory intervention in this area would be unhelpful and we believe that existing conditions will continue to give energy suppliers the flexibility to deliver effective energy efficiency solutions to all end users.

Section 4: Energy and the Environment

In the final section of the survey, questions focused on business attitudes to energy and the environment. Respondents were asked about the credibility and desirability of the Government’s environmental stance. This included its CO₂ emissions reduction target and its focus on renewable energy. Businesses were asked about the impact of environmental obligations and their opinions on the relative merits of different fuel sources for future energy needs.

4.1 Do you support the Government’s emissions reduction target?



Do you support the Government’s emissions reduction target?

Selected comments

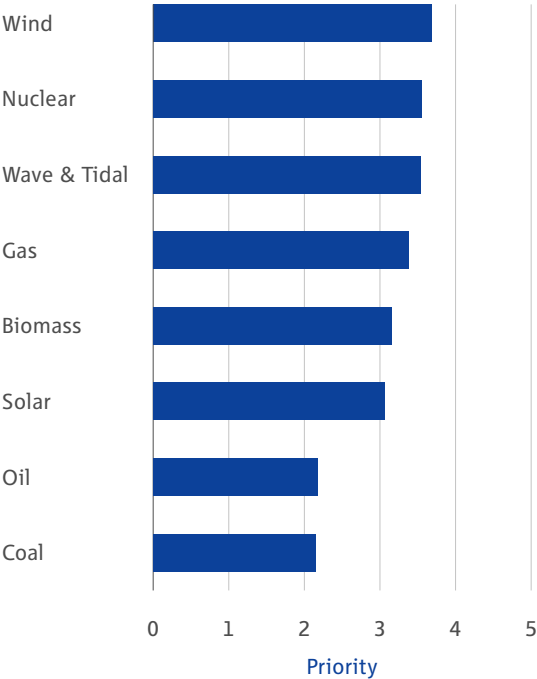
- SMEs**
- ‘I do, but I don’t think they’ll get there... it’s a hell of a leap forward!’
 - ‘Yes – but only if everybody else in the world complies!’
 - ‘No – the costs for the industry are too high to absorb.’
- MEUs**
- ‘We never asked for this in the first place, but understand why they are doing it, we have nothing against it.’
 - ‘We won’t do it, although I am in favour. However, why is the UK always taking the lead in these things as it always penalises UK manufacturing.’
 - ‘Yes, but it is the method of doing this that is the nightmare.’



4.2 Priority focus of power generation in the UK
(scale 1–5 where 1 = highest priority)

	SMEs	MEUs	PMIs	All	Rank
Wind	4.0	3.6	3.2	3.7	1
Nuclear	2.7	4.0	4.0	3.6	2
Wave & Tidal	3.9	3.5	2.3	3.5	3
Gas	3.1	3.4	4.5	3.4	4
Biomass	3.3	3.1	2.7	3.2	5
Solar	3.4	3.0	2.2	3.1	6
Oil	2.3	2.1	2.2	2.2	7
Coal	2.2	2.0	3.3	2.2	8

This table includes the ratings of policy makers and influencers (PMIs).



Do you agree with the Government's support for increasing renewable energy sources?

Selected comments

SMEs

'Yes, I think that it's reasonable enough. But it needs to be done with clear consultation with the local communities.'

'Yes, but I cannot see how it will be achieved... without incurring huge costs.'

MEUs

'I'm in favour, and the company would be if it doesn't impact too much on costs.'

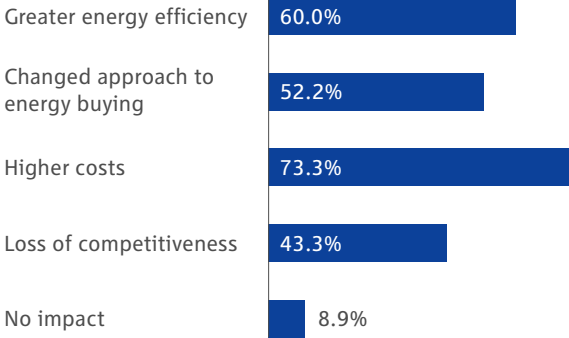
'Absolutely. However, with wind power, it seems unlikely that the Government will meet its 10% target by 2010, and it will be lucky to reach 5%. I welcome as many wind power plants as possible, but you would need to build one a day for the next 5 years to be able to achieve this.'

'I support the objective but not the specific targets.'

'Yes, but whether supplies will be sustainable if we use so much wind power is another matter. Nuclear power may be necessary.'

4.3 Impact of environmental policy on business – last 3 years

	SMEs	MEUs	All	All%
Greater energy efficiency	16	38	54	60.0
Changed approach to energy buying	9	38	47	52.2
Higher costs	16	50	66	73.3
Loss of competitiveness	7	32	39	43.3
No impact	8	0	8	8.9



What impact have environmental obligations had on your business in the last three years?

Selected comments

SMEs

'We've suffered a loss of competitiveness because major competitors, such as the US and China, are non-signatories to Kyoto and they continue to flout the emissions targets.'

'Increasing environmental obligations have meant that we've spent more and installed more expensive equipment. A lot of UK manufacturing (like Dyson) has gone overseas to avoid these costs... I now compete internationally – with India and China.'

'I think there is now a greater awareness of the need for energy efficiency within the company.'

MEUs

'We wanted to increase energy efficiency anyway. We already buy energy efficiently, and we have consultants who say that prices will rise, so it was the threat of higher prices that is driving us to reduce energy consumption.'

'The Climate Change Levy has caused a loss of competitiveness across borders but less domestically. The payback on some of the schemes is also prohibitively expensive.'

Policy-makers and influencers

'The Climate Change Levy is a cost that is borne by UK businesses which is not repeated in other countries. This has pushed up prices and will lead to increasing disparity with competitors.'

'I think that there is a moderately higher cost element here although it is probably one of those areas that is over-played by companies. The Enhanced Capital Allowances Scheme could be made to work a lot better than it does by extending the list a bit.'

How has being involved in the EU ETS affected your business?

Selected comments from MEUs

'It has affected our business at almost every level; there is incredibly complex data recognition, and a high level of complexity.'

'The ETS has not had a major impact, and we are managing to achieve the targets.'

'...we are panicking rather as we have only been given two-thirds of the allocation that we asked for. I have no idea how I reduce emissions by two-thirds... People say there was a cock-up, and that they didn't ask... industry in the beginning.'

'The positive element is that the different companies are communicating to share best practice; there is an awareness that we can't work in isolation. In the same group, one of us may be in surplus and one may be in deficit, and we can sort this out.'

'This is a complete cock-up by government. We had spent a good amount of time on the process for CCA and had lots of experience for it all to be thrown away to start again with [the] ETS. The first phase hasn't completed so its hard to say how it will work in the long-term.'

'Purely and simply it has pushed up wholesale power prices.'

npower Commentary – future fuels for power generation

Renewable energy has a major role to play in delivering environmental targets. To keep costs down we have to ensure that we develop the lowest cost options to their full potential. The Renewables Obligation does this effectively and has led to a rapid growth phase in wind power.

Whether and how new nuclear power becomes a part of the UK's generation portfolio is a hotly debated issue. The gradual but steady reduction in our generating capacity certainly supports the need to reassess the nuclear option but there are a number of caveats. Safety, waste and proliferation of nuclear materials are all issues that must be debated and resolved ahead of time or the process of new-build will never get off the ground.

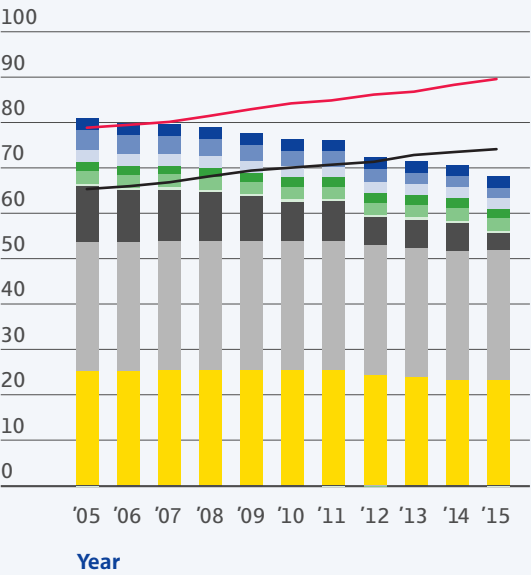
Realistically, the Government will need to take responsibility for waste disposal and the final decommissioning of nuclear power stations, possibly charging developers an annual fee for this; otherwise the financial risks will be too great for companies to commit investment. Conversely, nuclear must not be overly favoured. Removing barriers that would stop new nuclear competing on level terms is acceptable but any policy aimed at picking nuclear as a 'winning' technology and forcing it into the energy mix would be wrong. Energy markets are most successful when participants are allowed to make investment decisions within a high-level framework.

Finally though, we cannot rely on zero CO₂ emitting technologies alone to meet predicted system needs. Even with all other issues resolved, new nuclear power could not begin to contribute until after 2015. Wind power is vital but must tackle planning issues as well as technical and cost constraints regarding connections to the grid, especially for large-scale offshore developments.

With declining coal-fired generation capacity after 2015, due to environmental regulation, this leaves modern gas-fired power stations as the likely short- to medium-term solution. Clean-coal technologies and carbon sequestration projects can be implemented but they will take some time to be fully developed. High gas prices currently make the commissioning of new CCGTs unlikely in the short term. However, it is not only market prices that govern this decision. There still remains uncertainty regarding environmental regulation in the UK which is discouraging much-needed investment.

What is certain, however, is that maintaining a 20% capacity margin will require 20GW of new plant by 2015. With increasingly tight generation margins the market will respond by adding in a risk premium to prices further out, and any small changes to the supply demand balance are likely to have an increasingly significant impact.

Power generation capacity (GW)



Renewables
CHP
Pumped storage
Interconnectors
Oil
OCGT
Nuclear
Coal
CCGT
20% demand margin
Peak demand

Source: RWE npower

npower Viewpoint

Perhaps surprisingly, the overwhelming majority of businesses surveyed expressed strong support for the Government's policy of reducing CO₂ emissions. This was tempered, however, by pessimism regarding the likelihood of meeting the target set out in the Kyoto Protocol. Subsequently, the Government has restated its environmental targets that go beyond the Kyoto Protocol; it is looking to reduce CO₂ emissions by 20% (from 1990 levels) by 2010, compared to the Protocol's target of 12.5% reduction in 'greenhouse gases' for the period 2008–2012.

Predictably, business also voiced the caveat that environmental objectives must not compromise international competitiveness. Cost increases were assumed to be an inevitable result of taking the lead on environmental protection, but the complex processes and what is perceived to be the voluntary handicapping of British business were seen as unacceptable.

In this final section of the Report, businesses leant their support to both wind and nuclear power as the most desirable sources of future power generation. This response is consistent with the acceptance of CO₂ emissions as a priority.

We believe the Kyoto targets *are* achievable and that we can go some way towards meeting the Government's more ambitious objectives, but this will not be easy.

The EU Emissions Trading Scheme (ETS) and the Renewables Obligation (RO) are the most effective policy instruments because they create a market value for each unit of CO₂ emissions reduced and each unit of renewable energy produced respectively, and business operates best under market conditions.

npower Concluding Viewpoint

What is clear from the first npower Business Energy Index is that UK companies are concerned by rising energy costs and the potential loss of international competitiveness. In this Report we have explained how and why energy costs have risen – because of strong upward pressures from fuel prices and the introduction of new regulatory instruments. We have also provided end users with the opportunity to investigate how these costs can be mitigated.

There is already strong support for energy efficiency measures in the UK and the survey demonstrates the willingness of small, medium and major energy users to adapt to rising wholesale energy costs. Many businesses have expressed the view that some form of support is required from Government to encourage innovation. We believe it would be counter-productive to the progress already made in this area to instigate strict regulatory rules. Instead, businesses and energy suppliers should continue to work together in a market environment to improve energy efficiency. New energy efficiency solutions are now becoming available in both the residential and business energy markets.

Respondents views are that the variety of energy schemes under which they operate has adversely affected their business because of increased bureaucracy.

However, environmental protection measures will remain a central plank of EU energy policy which will be enforceable in the UK. These can be managed with careful planning but we believe that the Government must do more to clarify long-term issues to create the right conditions for vital investment in power generation. This will reduce the price volatility that is unhelpful to business energy customers.

Specifically, the rules of engagement in the second phase of the EU Emissions Trading Scheme must be set now to avoid damaging uncertainty. The ETS is an example of excellent regulatory theory, incentivising all qualifying CO₂-emitting organisations to make lowest cost reductions in their emissions.

However, political and regulatory arrangements are uncertain from 2008. Because CO₂ allocations are such a significant part of power generation costs and because the second compliance period of the ETS (from 2008–2012) is a completely unknown quantity, there is no clear market for UK power beyond 2007. This means that essential new capital investment in the industry will be slow to arrive and could arrive late.

The opinions expressed in the first npower Business Energy Index point to challenges ahead for the industry and its regulators and policy-makers. The biggest challenge is in meeting the twin objectives of maintaining secure power supplies and reducing CO₂ emissions, without imposing unnecessary cost and bureaucracy on UK business.

We believe this is achievable provided clear policy objectives are set and a coordinated and simplified regulatory regime flows from those objectives. The raft of energy policy instruments currently in place have been created over time to fulfil a range of different political, social and environmental objectives which are not always aligned.

npower believes a light touch, but consistent, regulatory framework will give the energy supply chain, from generators right through to end users, the clarity that business thrives on. In the meantime, we believe the role of energy suppliers is to help customers understand the options open to them in energy purchasing and use. This includes improving energy efficiency and adopting new, flexible and innovative buying habits to prevent unnecessary costs at a time of increasing energy prices.

Disclaimer

1 Availability of information

The npower Business Energy Index is issued by RWE Npower plc ('npower') free of charge and is provided on an 'as is' basis for general informational purposes only. The information provided by the npower Business Energy Index is of a general nature, not intended to address specific circumstances of any individual or entity and does not contain professional or legal advice. While npower undertakes every effort to provide accurate and complete information, the npower Business Energy Index may not necessarily contain comprehensive, complete, accurate or up to date information. The npower Business Energy Index is not intended to constitute and should not be relied upon as advice as to the merits of commercial decisions to be taken in respect of any commodity, market, contract or other product and may not be used for advertisement or product endorsement purposes.

2 Limitation of liability

npower makes no representations and disclaims all express, implied, and statutory warranties of any kind to the recipient, and/or any third party including warranties as to its accuracy, completeness, usefulness or fitness for any particular purpose. npower disclaims all liability for any loss of any nature howsoever arising as a consequence of reliance upon any of the material published in the npower Business Energy Index.

3 Copyrights

The layout of the npower Business Energy Index, graphics and pictures used and the collection of third party contributions are protected by copyright. npower reserves all rights in respect thereof. The reproduction of pictures, graphics, layout, information, texts and extracts of the npower Business Energy Index shall be allowed upon prior consent of npower only.

4 Third party contributions and opinions

Npower plc has no influence on the contents or reliability of information or opinions contributed by third parties. Such third party contributions do not necessarily express opinions of or information generated by npower. npower disclaims all express, implied or statutory liability for third party contributions and provides such information or opinions for general informational purposes only.

© RWE Npower plc 2005. All rights reserved.

RWE npower

Windmill Hill Business Park
Whitehill Way
Swindon
Wiltshire
SN5 6PB

T +44 (0)1793/87 77 77
F +44 (0)1793/89 38 61
I www.rwenpower.com

