Quarterly Market Letter
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I am pleased to forward 5's first quarterly overview of the energy market. This letter covers notable trends and developments in the market over the past few months. We hope that these quarterly reports serve as a natural complement to our weekly market reports (which focus on energy prices), as well as the specific client-based recommendations issued by our advisors.

Coal's grip on US generation continues to weaken. According to the EIA (the US Government's Energy Information Administration), natural gas fired generation and coal fired generation each provided 32% of the nation's power generation in April. This is the first time that gas fired generation has equaled coal fired generation. Later in July, EIA reported that owners of coal fired generation units plan to retire 175 plants with an aggregate capacity of 27 GWs over the next 5 years. This amounts to 8.5% of 2011's total coal fired capacity. Of this amount, 9 GWs will retire in 2012. Modest demand growth, low natural gas prices, excess generation capacity, aging coal fired units, and the cost of current and anticipated state and federal environmental regulations drive this seismic shift in fuel used for power generation. We expect this trend to continue.

The historically low price of electricity that has persisted for the last year or so has also made it very difficult for developers to finance new power plants without a long term power purchase agreement. Notwithstanding these market signals that new generation is not needed, regulators are increasingly concerned about a potential energy shortage. In response to these concerns, New Jersey and Maryland have both mandated the construction of new generation and backed up these mandates with long term power purchase agreements or other guaranteed sources of revenue. While these state mandates are being challenged on various State and Federal grounds, the movement is picking up steam. Texas, the strongest deregulated market, is exploring various ways to address a perceived capacity shortfall. In June, the Texas regulators voted to increase the bid cap (the maximum price that can be bid by generators) by 50%. Also in June, the Brattle Group released a report authored at the request of the Texas energy system operator, ERCOT, which echoed the conclusions reached by regulators in Maryland and New Jersey. The report suggested various ways to effectively mandate new generation in Texas. We will closely monitor these new generation projects and the impact of these projects on the energy market.

Another factor contributing to the lack of new generation in deregulated markets is the growth of demand response. A demand response resource is created when an existing load – a consumer of energy – agrees to be paid to reduce that load whenever the electricity grid has a shortage. This is a significant new source of low cost capacity. Over the past 8 years, in the Mid-Atlantic region, the net amount of new generation bid into energy auctions was only 5,400 MWs (20,700 MWs of new generation was added and 15,300 MWs of generation was retired). Over the same period, the amount of demand response bid into the auctions increased from 715 MWs initially to 19,956 MWs in the auction which closed in May 2012. The growth of this new resource is a good example of how competitive markets can foster innovative and efficient ways of managing energy demand.

High temperatures continue, with volatile weather in many deregulated regions. Six New England states have seen the warmest seven months in record and two others, Pennsylvania and West Virginia, have had the second warmest in record.

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A hot summer does not make good science, but it can influence public opinion. Republican governors John Kasich of Ohio and Chris Christie of NJ have spoken out about the reality of climate change. In a recent University of Texas poll, 70% of Americans and 53% of Republicans accepted the reality of climate change. An evolving consensus on climate change will put additional focus on retiring existing coal plants, push greater use of natural gas, and create additional upward pressure on energy prices.

As always, our approach to the energy market focuses on strategies that manage risk. We continue to work with our customers to design products that will protect their businesses in the event of adverse market conditions. Please let us know if your objectives or circumstances have changed such that a further review of your energy management strategy may be necessary, or if you have any specific questions about how your account is managed.

Jonathan Moore
Chief Strategy Officer

Jon Moore is the Chief Strategy Officer at 5. In 2006, he co-founded Juice Energy and served as its CEO. In 1999, he co-led The AES Corporation's acquisition of NewEnergy Ventures, one of the first independent retail energy suppliers. NewEnergy was sold by AES to Constellation in 2002, and Mr. Moore joined Constellation as Chief Operating Officer of NewEnergy. In addition, he served as an independent Director of MX Energy, a national retailer of gas and electricity, until its sale to Constellation in 2011. Mr. Moore received a J.D. from Yale Law School. He received an A.B., from Princeton University and was a Fulbright Scholar.