ofgem

Promoting choice and value for all gas and electricity customers

Update Ofgem's gas probe findings

Ofgem's probe into high wholesale prices has concluded the main causes of rising prices are:

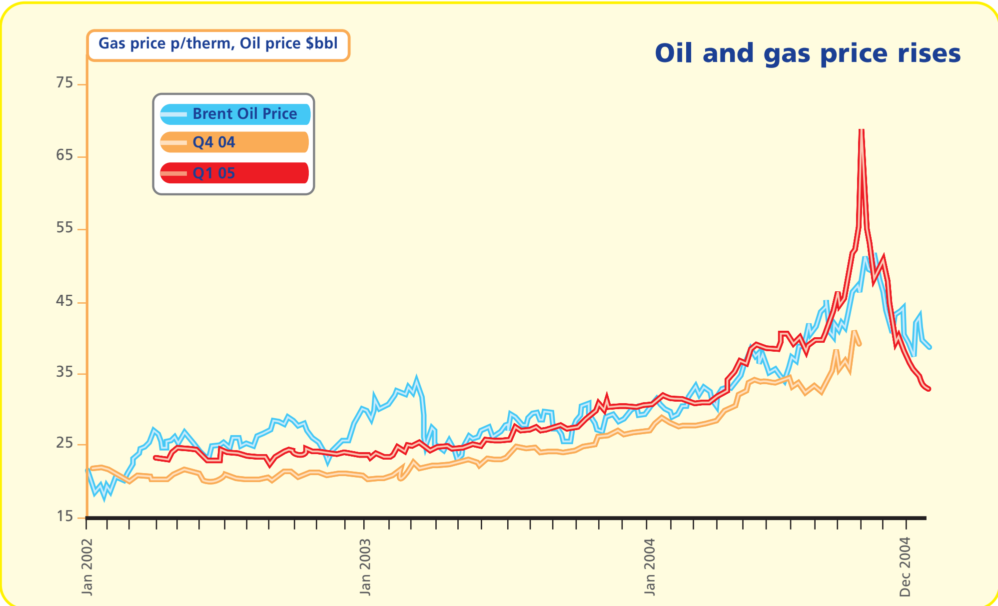
- **High oil prices feeding into GB prices via pipeline link to Europe**
- **Declining UK gas supplies**

Ofgem is working with the Commission and national regulators on specific issues relating to the supply of gas from other European markets. Ofgem is examining why some North Sea gas supplies did not reach the market.

Impact of high oil prices

Most long-term gas supply contracts in the rest of Europe are linked to oil prices.

This used to be the case in Britain before competition was established. However, there are still a few residual long-term contacts for offshore supply which continue to maintain the oil price link.



How do oil prices affect UK gas prices?

The effect of high oil prices feeds through to UK gas prices through the interconnector pipeline between Britain and Belgium. This affects UK prices in two ways:

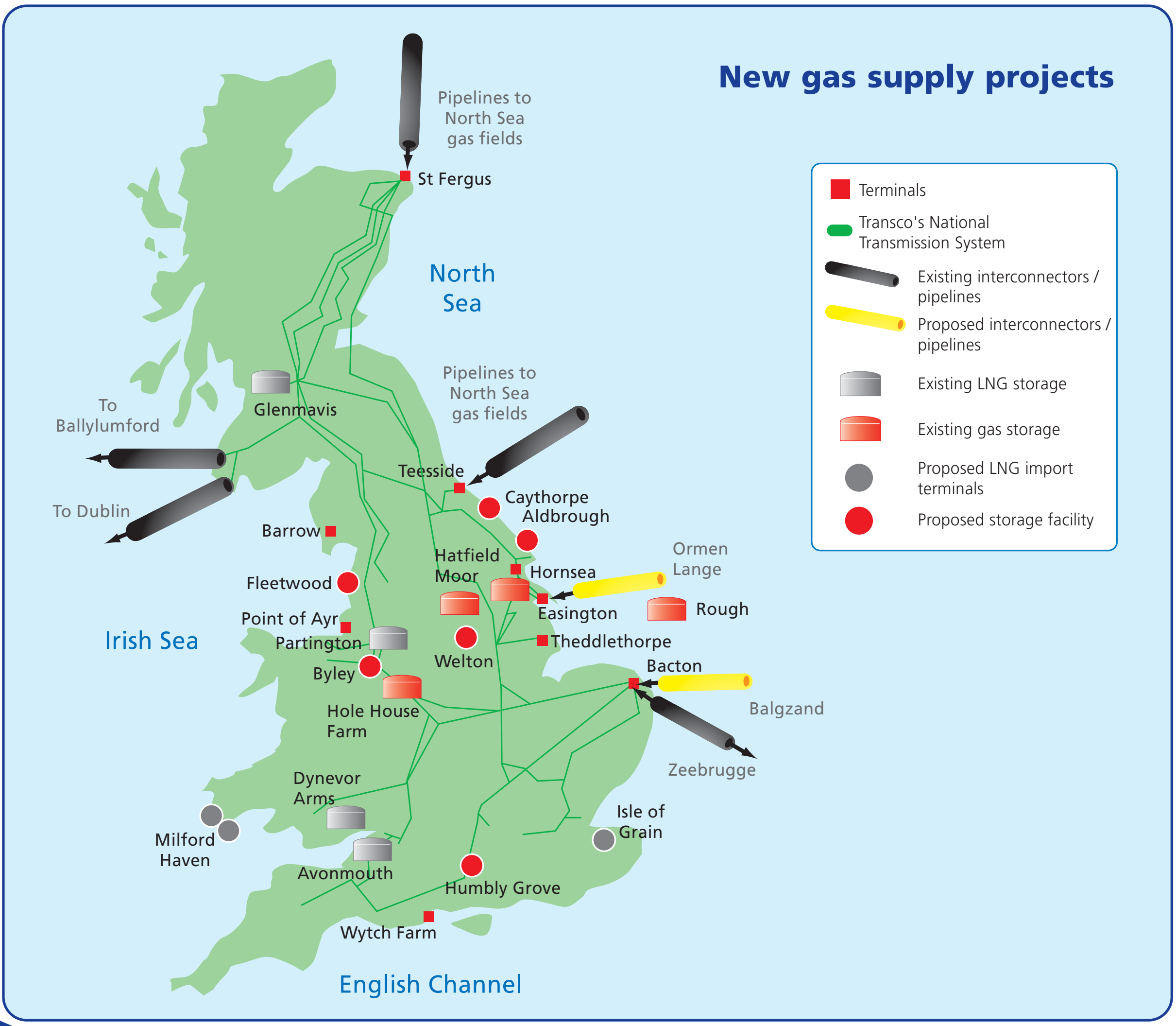
- **During winter**, Britain imports gas through the interconnector so the oil linked price of European gas directly affects GB gas prices.
- **During Summer,** higher European gas prices mean higher prices in GB as gas is exported to Europe. This also increases the cost of putting gas into storage for the coming winter. So the oil price rises affect winter prices too through higher storage costs.

Declining UK supplies

In May 2004 Transco revised its forecasts showing Winter gas supplies had fallen more quickly that the market was expecting. This does not undermine security of supply, even in an extreme winter, but it does require more expensive alternatives such as gas from other European markets to replace UK supplies.

In the long term, Britain is shifting its supply routes to meet the shortfall of supplies from the UK Continental Shelf (UKCS) and projects are under development to bring new supplies of gas to GB.

Rising prices caused by declining supplies help signal the need for new investment in gas production, storage, Liquefied Natural Gas (LNG) imports and new pipeline schemes to continental Europe and gas fields like the Norwegian Ormen Lange field.



Supplies from the North Sea

In October and November 2003, gas prices rose to peak at 34p therm. In response to concerns expressed by customers Ofgem's preliminary analysis concluded that the price rises could not easily be explained. Ofgem therefore launched its probe to find out why prices had risen.

Ofgem's analysis of the increase in wholesale prices shows that the price rises were largely caused by a combination of **planned and unplanned maintenance** for the offshore gas fields.

Ofgem has identified some **5 per cent** of UK gas supplies that were **physically available, but did not reach the market** under existing contractual arrangements despite the high prices.

Ofgem is continuing to look at the structure of existing contracts that affects the supply of gas that flows onshore through two sub-terminals at Bacton in Norfolk.

In November Ofgem announced it had secured agreement from Centrica, Shell, ExxonMobil and BP to provide more information on the operation of the Sean gas field. This information was provided in January.

The Sean field is capable of producing around 17 million cubic meters (mcm) of gas a day. This equates to around five per cent of National Grid Transco's forecasted North Sea Supplies of 350 mcm.

Ofgem has not reached any firm conclusions at this stage on the Sean contracts.

European supplies and the interconnector

Ofgem's analysis concluded that the interconnector pipeline between GB and Belgium that connects our gas market to Europe appeared to operate as it would be expected to given reported prices in the two markets.

However, Ofgem analysis has led to three further questions relating to European gas supplies which Ofgem has not been able to answer given the information available.

These questions are:

- was any surplus gas which was contractually available to European gas companies offered to companies to import into Great Britain,
- was the decision by several European gas companies to continue to put gas in store, rather than sell it to companies to import to Great Britain, reasonable, and
- was surplus capacity on the European gas pipeline networks made available to allow any surplus gas to be transported to the interconnector so that it could be imported to Great Britain?

Ofgem has presented these issues to the European Commission and is working with its Competition Directorate and other national regulators to identify, and as necessary pursue, any potential breaches of competition law.

Gas prices and their effect on electricity prices

Wholesale electricity prices have risen by 62 per cent in the last year. Higher gas prices have been an important factor in this increase as gas accounts for nearly 40 per cent of all generation. Higher prices for coal, due to rising global demand, have also increased the cost of coal-fired generation.

Impact of wholesale gas price rises on customers bills

Domestic customers

Even with recent price increases, domestic energy prices are £200 cheaper than they were before privatisation.

Today domestic customers who have not switched their gas or electricity supplier can make savings of **at least £90** a year.

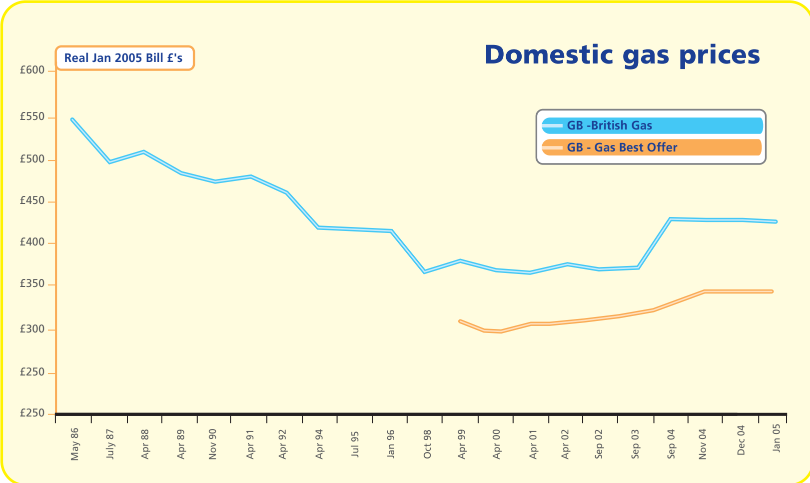
There are also significant savings from energy efficiency measures.

Industrial and commercial customers

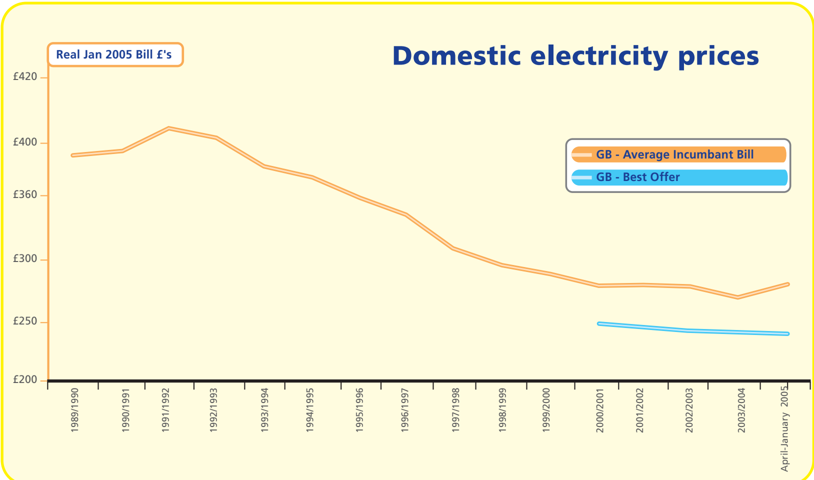
The industrial and commercial (I&C) market accounts for 2/3 of all UK gas consumption. These customers have borne the brunt of recent increases in gas prices.

This is because wholesale costs make up a greater proportion of I&C customers bills and their prices are often indexed directly to movements in wholesale prices.

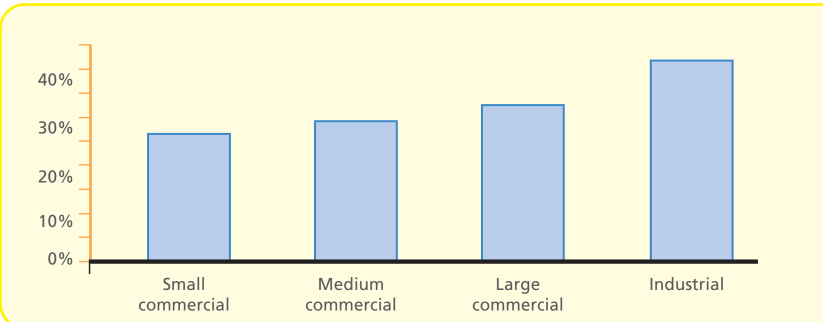
The impact of higher electricity prices has also had a greater impact on I&C customers



Domestic gas prices



Domestic electricity prices



Gas price rises for business customers Oct 03 - Oct 04

For further information please contact:

Richard Hunt 020 7901 7158 email richard.hunt@ofgem.gov.uk

Mark Wiltsher 020 7901 7006 email mark.wiltsher@ofgem.gov.uk