

## Business customers and gas prices this winter

**Business customers in Great Britain are facing higher gas and electricity prices this year as the country makes the difficult transition from being self-sufficient in gas to becoming a net importer.**

However, over the last 14 years British businesses have paid less for their gas and electricity than most of their European competitors, thanks to the benefits of a fully competitive market.

### Between 1990-2004 British industry paid:

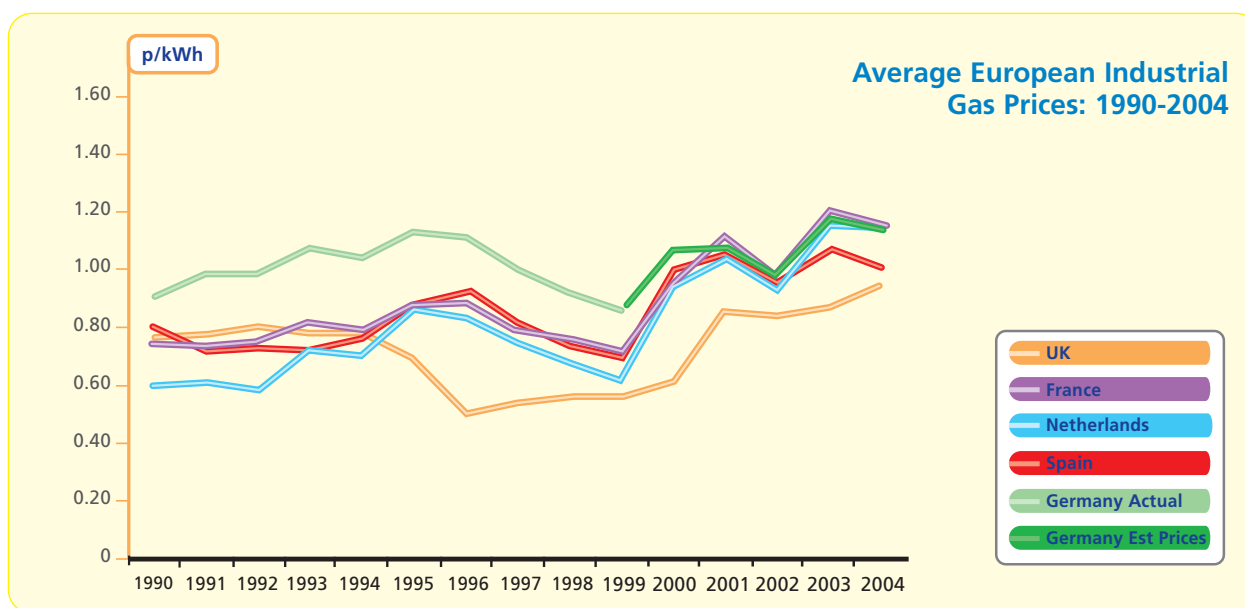
- £7.9 billion less than Germany
- £5.8 billion less than Italy
- £4.3 billion less than France
- £3.6 billion less than Spain, and
- £2.6 billion less than Holland

for their gas.

As Britain's own gas supplies are declining so more expensive gas has to be imported from further afield - this has driven the wholesale price of gas up as well as the wholesale price of electricity, where gas is a major fuel source for generation.

Britain is not alone as higher wholesale energy prices are a global issue, fuelled by rising oil prices and the impact of recent hurricanes on US gas and oil production. Events like the American hurricanes can have an impact on the world price of Liquefied Natural Gas (LNG) and this can affect gas prices in the UK, following the opening of Britain's first LNG import terminal.

As Britain still has some of the lowest transportation charges in Europe, thanks to effective regulation by Ofgem, prices for many industrial and commercial businesses were still below average European levels in July 2005 (the latest data available).



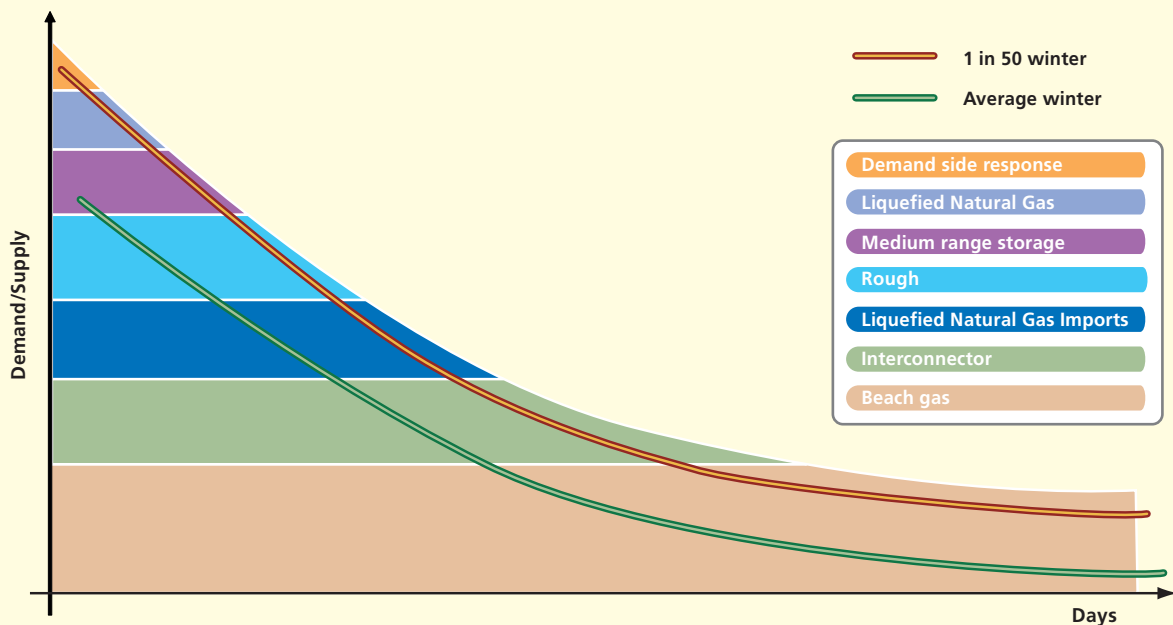
## Why has this happened?

Britain's supplies of gas have declined quicker than forecast by the offshore industry and the market has reflected this tightening of supply with increases in the price of gas.

Higher gas prices, while painful for UK industry, are attracting over £6 billion of new investment to build more pipelines, LNG import facilities and storage facilities as well as extending the life of the UK's gas fields. As these new supply sources come on stream, the pressure on gas prices is expected to ease.

Britain is not alone in seeing higher gas prices for businesses as European gas prices, most of which are still linked to oil, have followed the upward trend in oil prices. In countries with less liberalised market arrangements, this increase may take longer to feed through to the prices paid by businesses, as they are supplied on long-term gas contracts.

## Gas prices this winter



To meet winter gas demand, suppliers use the cheapest source of gas first, which is the UK's own supplies from the North and Irish seas – known as beach gas. Then more expensive sources of gas are used, such as imports from the interconnector and LNG imports. Next to be used would be the long-term gas storage facility at Rough, which can

provide gas for over 70 days during the winter. For colder weather, medium range gas storage and LNG storage is used to respond to rapid increases in gas demand. When all these sources of gas are being fully used then a response from large energy users to turn down their energy demand would be required. This is called demand-side response.

*\*This graph is schematic to give a clear representation of Britain's gas supply sources*

## (Gas prices this winter continued)

As gas supplies are tighter this year than previous years, it is more likely that a demand-side response will be required. National Grid's forecast for this winter say only a modest demand-side response would be required in an average winter and this can be met by gas-fired power stations.

An extreme 1:50 winter – one so severe it only happens twice a century - would require significant demand-side response. National Grid estimates that half of this response would come from large gas-fired power stations without threatening security of electricity supplies. Generators will run coal-fired

plants ahead of gas and switch from gas-fired plants to back-up fuels. The response required from business would be around 16 per cent of total business demand over the coldest 60 days in winter and would probably involve only very large industrial users reducing their demand.

This is not just a feature of the GB market. In France, industrial and commercial customers were interrupted last February and March when France had very cold weather. Earlier this year large users in Spain were interrupted when Spanish gas demand was very high.

## Demand-side response

### Demand-side response can take the following forms:

- **Commercial interruption** – companies can sign contracts with gas shippers allowing their supply to be interrupted for a number of days each year in return for lower gas prices.
- **Balancing services** – this is similar to a commercial interruption contract except that the interruption only occurs when the gas network is short of gas.
- **Response to prices** – companies buying gas on the spot market may decide not to take gas if it becomes very expensive, eg during a cold weather snap a manufacturer may shut their plant to avoid paying higher prices for their gas.
- **Transportation interruption** – If there is a lack of capacity on the gas pipeline system, for example emergency work on the high pressure gas network has reduced supplies in a particular area, National Grid (NG) can interrupt larger customers in order to ensure supplies to domestic customers. Customers receive substantial discounts from National Grid on their transportation bills in return for agreeing to be interrupted.

## Ofgem's role

Ofgem has worked with industry to tackle barriers which might prevent an effective demand-side response. This includes:

- Improving the quality and transparency of the information available to customers. Daily information is now available on gas storage and a new website will now give businesses easy-to-understand information on the gas market this winter.
- Gas balancing alerts - these will give large gas users advance warning that National Grid needs a demand-side response to help keep the gas network in balance.
- Ofgem recently approved a rule change proposed by National Grid to improve commercial incentives on gas shippers to ensure they have enough gas to meet their customer's demand.

**ofgem**

## Is the gas market working?

As part of its work in monitoring the energy markets, Ofgem conducted an investigation into the gas market which found that higher gas prices were a result of the decline in UK reserves and high oil prices feeding into GB prices via the interconnector gas pipeline.

While it found no evidence of market manipulation, it did highlight a number of concerns, such as:

- questions about why continental gas was not made available for the UK market, and
- lack of offshore information.

Since Ofgem published its findings, the European Commission has announced an investigation into the European Gas market, looking at many of the issues highlighted in Ofgem's report. Ofgem is also working closely with the Council of European Energy Regulators (CEER) to promote greater liberalisation of Europe's gas markets.

The Department of Trade and Industry (DTI) and the UK Offshore Operators Association (UKOOA) has brought in a voluntary agreement to increase the amount of information the gas market receives about offshore production. Ofgem is monitoring the success of this agreement.

### **However, competitive energy markets do deliver benefits to businesses, such as:**

- ensuring that the price customers pay efficiently reflects market conditions. It does not guarantee that prices will always be low
- giving customers choice to seek a contract that suits their individual needs, and
- attracting investment. Over £6 billion is currently being invested in expanding gas storage and importation facilities and over £30 billion has been invested in the gas and electricity networks since privatisation.

Ofgem's role is to ensure the UK sees the benefits of competitive energy markets by monitoring them to make sure there are no barriers to effective competition. Ofgem also approves changes to market rules to ensure markets work efficiently.

### **For further information please contact:**

Mark Wiltsher, Head of Media Relations  
Chris Lock, Communications Officer

020 7901 7006  
020 7901 7225

email [mark.wiltsher@ofgem.gov.uk](mailto:mark.wiltsher@ofgem.gov.uk)  
email [chris.lock@ofgem.gov.uk](mailto:chris.lock@ofgem.gov.uk)