

## Winter 2005-2006 - an update

**Ofgem monitors the energy markets to ensure there are no barriers to prevent the market delivering secure energy supplies to Great Britain.**

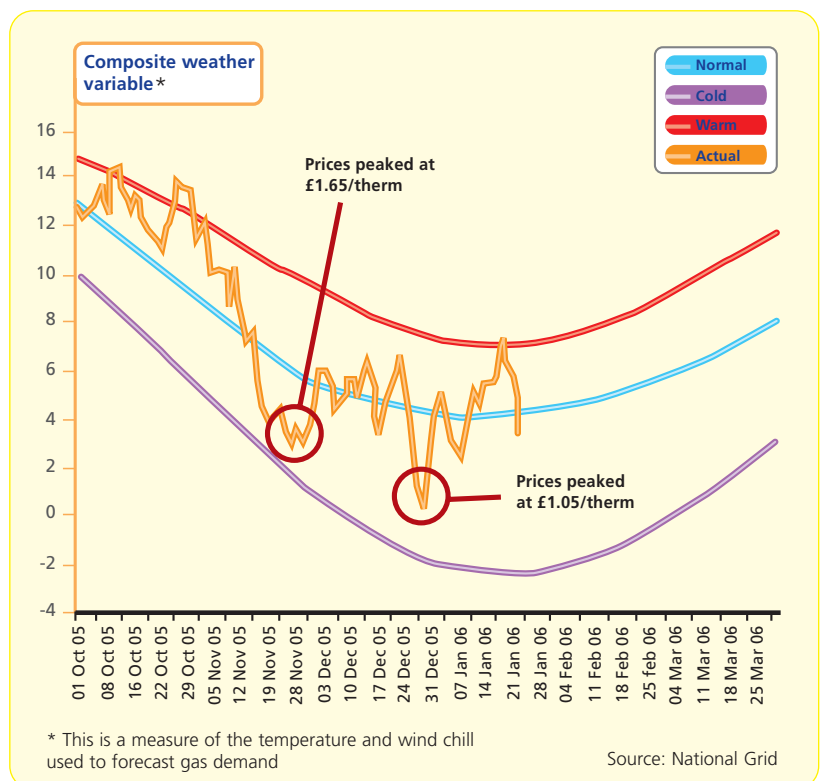
**As part of this role Ofgem works to ensure the market receives information on energy supplies well in advance of winter so that the industry can put in place the commercial and operational arrangements to prepare for all possible weather conditions.**

**This winter Ofgem has regularly updated the industry on its analysis of how the market has performed and will continue to do so looking ahead to winter 2006-2007.**

### Wholesale prices this winter

While January prices have fallen back, during late November and early December wholesale prices for gas and electricity rose sharply. There are several reasons why this happened:

- higher gas demand due to colder than average weather for that time of year
- less gas was available through the interconnector than was expected. An upgrade to the pipeline allowing it to import higher volumes had been completed, but only 60 to 75 per cent of the full capacity was being used. This occurred even though GB was experiencing the highest wholesale gas prices of anywhere in Europe during November, meaning that exporting gas to Britain through the pipeline would have been commercially attractive to European suppliers
- the Isle of Grain Liquefied Natural Gas (LNG) terminal in Kent did not receive as many shipments as expected. As with the interconnector, high wholesale prices in Britain should have attracted more LNG cargoes, and
- supplies of gas from the North Sea were less than expected due to maintenance work being carried out on certain fields.



Storage gas was used to make up the shortfall of supplies. The cost of withdrawing gas from storage earlier in the winter than usual increased prices as storage users will seek to sell their gas at, or above, the prices they would expect to get during periods of high gas demand, typically in January and February.

The graph above shows that during parts of November and December, temperatures were colder than average. However, for most of the winter the weather has been relatively mild.

## Ofgem's actions

Ofgem responded in several ways including:

- securing agreement by the European Commission (EC) to investigate why the interconnector was not importing gas into GB at the levels expected. Ofgem is currently in discussion with the EC on its investigation
- Ofgem has also asked the EC to investigate whether certain arrangements to secure LNG supplies in some European countries, such as Spain, could be distorting trade, and

- ensuring that there are transparent and effective arrangements at the Isle of Grain LNG terminal to enable other companies to land gas when spare capacity is available.

BP and Sonatrach, the companies contracted to use the terminal, have both confirmed that they intend to fully use the facility over the winter. Sonatrach have used all of their capacity, but BP has not. Ofgem is continuing to discuss potential improvements to the effectiveness of the 'use it or lose it' arrangements with the relevant parties. These arrangements ensure that both companies offer any un-used capacity for other companies to use.

## The current winter situation and Ofgem's analysis

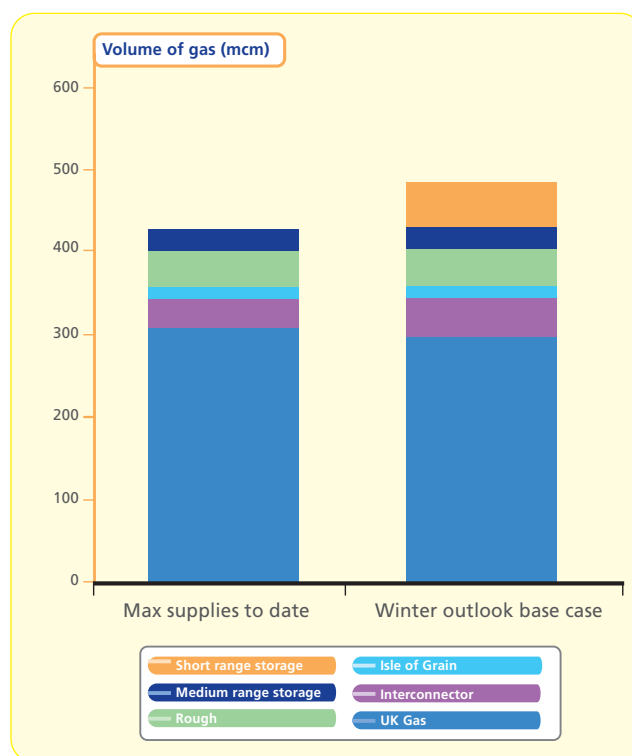
The graph opposite summarises the actual flows of gas against the basecase forecast in National Grid's Winter Outlook report (October 2005).

Since January, wholesale prices have fallen back to levels of between 40 to 65 pence per therm due to several factors:

- milder weather during December and January, leading to lower gas demand, and
- more gas availability from North Sea fields after maintenance work was completed.

These factors resulted in gas being put back into storage in preparation for colder weather during February and March.

Overall, gas flows from most storage facilities and from the North Sea have been in line with National Grid's expectations in its Winter Outlook report. However, a continuing **concern for Ofgem** for both this winter and the next is the performance of the Bacton–Zeebrugge interconnector. Despite the fact that gas prices in GB over much of this winter have been at higher levels than in Europe, and that the interconnector capacity has been available, this has not resulted in increased imports through the pipeline.



Further cold weather in February and March could lead to increased demand for gas, resulting in higher spot prices. Ofgem is continuing to monitor the performance of the interconnector, particularly as gas flows have not been consistent with the current price differentials between GB and Europe.

## Looking ahead: winter 2006-2007

Ofgem will be encouraging customers and market participants to respond early once National Grid's preliminary Winter Outlook report is published in May. This will give the energy industry and large industrial customers the chance to plan effectively for the winter ahead.

### Looking ahead to 2006-2007, there are similar issues to this winter in respect of GB's gas supplies:

- new import pipelines being completed on time
- the amount of gas being delivered to Britain through the new import facilities, and
- the degree of further decline of North sea gas production in winter.

As with all years, the weather is also a key factor affecting demand and gas prices.

## Import facilities

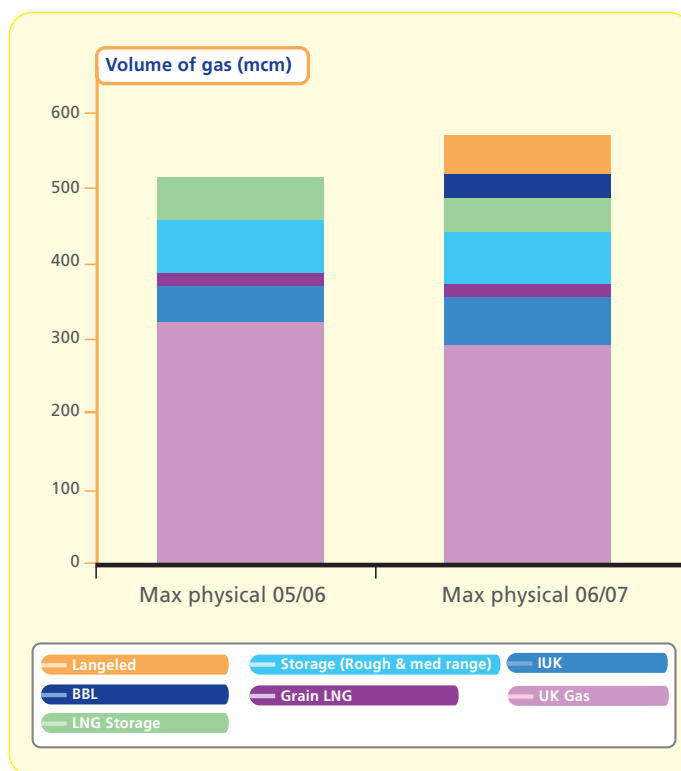
Around £6 billion is being invested in gas import infrastructure projects and several of these are scheduled for completion for winter 2006-2007:

- the second phase of the upgrade to the Bacton-Zeebrugge interconnector, which will give a total import capacity of 68 million cubic metres (mcm) per day from December 2006
- the new Bacton-Balgzand interconnector linking the UK with the Netherlands, bringing in 27 mcm per day of import capacity from December 2006, and
- the Langeled pipeline will be able to import 70 mcm per day of Norwegian gas. The majority of this capacity will be ready from Autumn 2006. Full capacity will be available from 2007-2008.

Completing these projects on time will be a key factor in determining prices next winter. The other crucial issue is how much of this new capacity will actually be used to bring gas into GB. At the moment Ofgem cannot explain why imports into GB through the interconnector have not increased. Prices in GB have been higher than in Germany, the Netherlands and France so more gas should have been exported to Britain. This is why the EC investigations are of crucial importance. The Commission is due to publish its next report on 16th February.

## Decline in UK Gas reserves

The graph below shows that the decline in North Sea supplies for winter 2006-2007 may be offset by new gas imports, provided they are built on time and are used at full capacity, resulting in an overall increase in the amount of gas available for next winter compared with this winter.



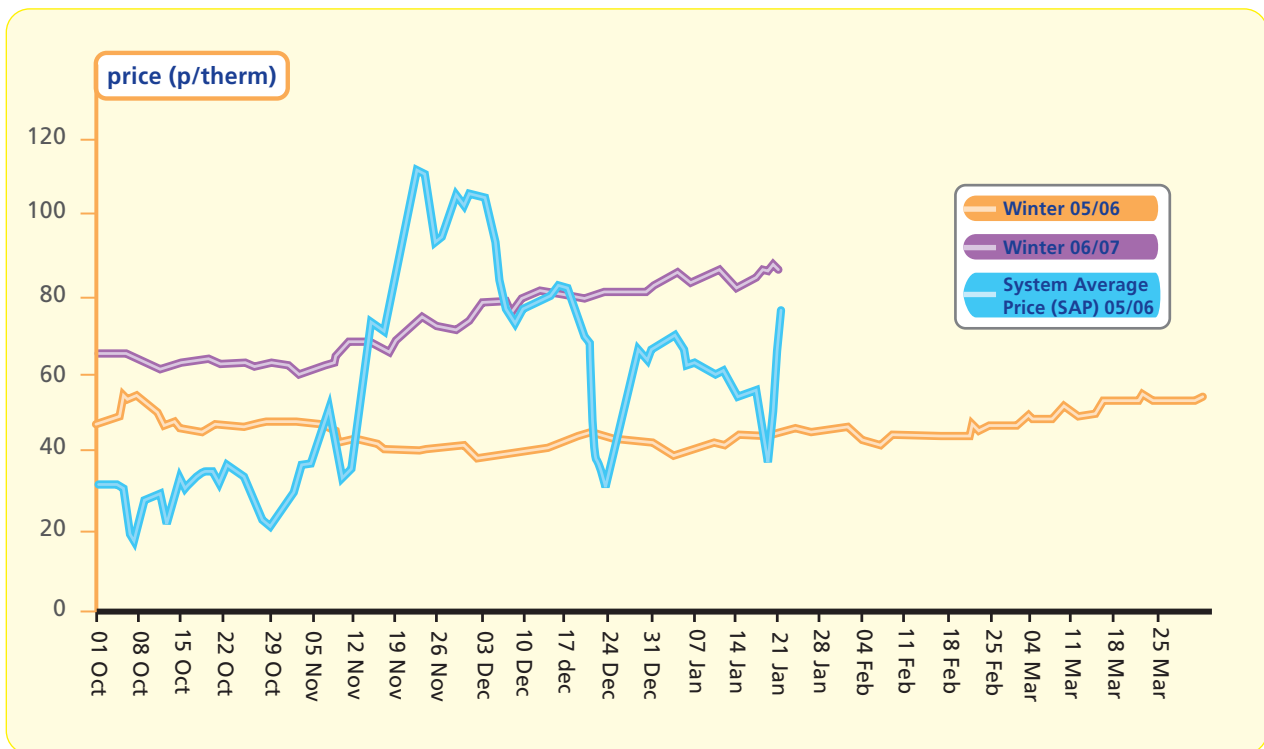
## Forward gas prices for winter 2006-2007

The graph below shows that gas traders and suppliers are less certain that gas supplies will increase next year. Generally forward gas prices for next winter (2006-2007) have been trading at higher levels than forward prices traded for this winter a year ago. This could reflect market fears that the new import facilities will not be ready in time or may not be used to their full capacity to import gas into Britain.

However, a different picture is emerging in the Netherlands where gas forward prices for 2006-2007 have increased, bringing their prices more in line with Britain. This may be an indication that the Dutch market believes that the new interconnector pipeline

between the Netherlands and Britain will be built in time for next winter and that companies are planning to use it to export gas to Britain. Higher prices in the Netherlands suggest that Dutch companies expect to export gas to Britain.

At present the developers of all three projects have confirmed that they are on schedule to be completed in time for winter 2006-2007.



### 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)