Alistair Buchanan
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Promoting choice and value for all customers

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Dear Colleague

NG's Winter 2006/07 Consultation Document

Ofgem has published today National Grid's (NG) Winter 2006/07 Consultation Document[1]. This signals the start of the consultation process to develop gas and electricity supply-demand outlooks for winter 2006/07. As in previous years, the consultation process is designed to help the market to assess the risks to supplies and put in place appropriate commercial and operational arrangements to mitigate them. This year we have asked NG to take forward further enhancements to its consultation process and we welcome the changes that have been made to enable maximum opportunity for parties to inform the outlook for winter 2006/07. Under this improved process, NG will publish a second consultation in July and a third document in September.

At this stage, NG's initial assessment is that the gas supply and demand position for the winter period will be as tight, if not tighter than last winter. This assessment appears to be shared by the market as forward prices for next winter are higher than last winter's forward prices at the same point in the year.

Below we have identified a number of the key issues and uncertainties highlighted in NG's report. Given these uncertainties, NG needs accurate information from the market to produce a robust outlook. We would therefore encourage all major gas producers, suppliers and other market participants and interested parties to participate fully in the consultation process.

Key issues identified

With the continuing decline of North Sea production the UK will increasingly rely on gas imports to meet its gas supplies. Investment is clearly on the way to meet these changing needs in the form of new import infrastructure and storage facilities. The key issues that NG has identified that could affect gas supplies next winter are:

- **the timely completion of new import infrastructure:** there are four new potential sources of gas supply (the BBL interconnector from the Netherlands, the Langeled pipeline from the Norwegian Continental Shelf, the second enhancement to the Belgian interconnector and the proposed new LNG deliveries at Teesside). Construction delays in these projects would impact on supply assumptions for the coming winter;

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[1] 'Winter 2006/07 Consultation Document', NG, May 2006 available on Ofgem's website: www.ofgem.gov.uk.

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- **utilisation of new infrastructure:** last winter we experienced periods of low utilisation of new import capacity both at the Isle of Grain and the Belgian interconnector. If we saw similar patterns of low use of all of the new infrastructure this could see much tighter supplies than last winter although the Langeled and BBL pipelines are different to Grain and IUK as they are backed by long term supply contracts;

- **availability of Rough storage facility**: while we welcome Centrica Storage Limited's Friday announcement that the return of the Rough facility is still scheduled for 1 June there remains the risk of delay and/or further problems over the course of the summer that could limit the time available to fill the facility ahead of this winter. There is a risk that Rough may not be full as we head into November;

- **availability of UK North Sea gas supplies**: the incident at Rough has highlighted potential safety issues with equipment that may be used on other UK gas fields. This could impact on UK gas supplies this winter. As this issue has only just come to light we are liaising closely with DTI, HSE and UKOOA to assess the extent of the problem and its potential impact on winter supplies

Given the experience of last winter, the planned start up dates for some of the new import infrastructure and the issues at Rough, we think that there are particular risks in November if we have a very cold snap like last year. With limited new supplies and European suppliers wanting to maintain storage stocks in Europe – this could see heavy draw down of UK storage and price spikes as we saw last year. As the winter progresses, the supply situation should ease if all of the new import projects are completed on time and European suppliers release more gas from storage to flow through the Belgian interconnector.

Some of these uncertainties will resolve themselves over the course of the summer and through the consultation process. We will have a better view on Rough and the completion of new infrastructure projects as we head in to the winter. We hope that companies in the UK, Norway and continental Europe will respond to NG's consultation and provide us with a more accurate assessment of how much gas may flow through all of the import facilities. We are currently conducting meetings with all of the major supply companies in Norway and Continental Europe to improve our understanding and to encourage them to respond.

In the electricity market, National Grid's assessment is that margins remain healthy even under severe weather conditions. But given the importance of gas as a fuel source for generation there remains the prospect that significant problems in the gas market could spill over into the electricity market if, for example, there were major unplanned outages with nuclear plant at the same time as high gas demand and lower supplies.

Consultation process

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Developing realistic scenarios ahead of winter 2006/07 is a very important part of preparations for the winter. To increase the involvement of market participants, customers and interested parties in the process, Ofgem is holding four seminars during the process. These aim to give these parties additional opportunities to participate in the winter 2006/07 outlook process. The timetable for the winter outlook process is as follows:

Date	Event	Location
16-May	Winter 06/07 first consultation	Available on the Ofgem website
24-May	Winter 06/07 seminar	London
2-Jun	Winter 06/07 seminar	Edinburgh
Late June	Winter 06/07 second consultation	Available on the Ofgem website
20-Jul	Winter 06/07 seminar	Ferrybridge power station
Late September	Winter 06/07 final report	Available on the Ofgem website
27-Sep	Winter 06/07 seminar	Birmingham

Could requests to attend Ofgem's winter 06/07 seminars please be sent to wholesale.markets@ofgem.gov.uk.

Initiatives ahead of winter 2006/07

There was some criticism last winter about the number of changes to the gas market rules that were raised and implemented shortly before winter began. Ofgem cannot raise modifications and can only consider them when they come to us for decision. We would therefore urge market participants who are considering raising modification proposals to raise them as early as possible to allow as much time as possible for the industry to analyse and debate them and for Ofgem to consider whether to approve or reject them.

To date, there has been one new modification proposal raised with a view to implementation ahead of winter 2006/07[2]. This proposal was raised on 10 May 2006 by Gaz de France and seeks to increase the level of demand side response that can be provided ahead of winter 2006/07 by enabling NG to tender for and utilise gas reserve contracts.

We are also continuing to take forward our own initiatives ahead of winter 2006/07. These are set out below:

[2] In highlighting these initiatives, Ofgem is in no way fettering its discretion concerning any future decisions in these areas.

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- **Working with government, customers and market participants:** We will continue to work to ensure that the government, customers and market participants are kept fully briefed on developments of the work undertaken ahead of winter 2006/07 and progress during next winter for example via steering groups and our next 'Winter to Date' seminar series.

- **Demand Side Working Group (DSWG):** We will continue to chair the work of the DSWG to identify and develop further ways in which potential barriers to providing demand side response can be removed. We are currently working with the group to identify other 'quick wins' that could be progressed ahead of the winter months.

- **Customer and Supplier seminars:** We have started the next round of our 'Options for Energy Buyers' seminars which are designed to help customers gain a better understanding of the commercial options available to them through a series of supplier presentations.

- **Information issues**: Further to the developments over winter 2005/06, where we saw enhancements to daily information on NG's website and increased information flows regarding storage stocks, there will also be greater information available to the wider market as of this winter in respect of sub terminal gas flows following Ofgem's decision on UNC Modification Proposal 006. We will continue to seek greater transparency in relation to information flows in European markets (e.g. European gas flows and storage stock information) and in the UK where appropriate (e.g. distillate stocks at gas fired power stations, stocks at Grain LNG/Medium Range Storage).

- **New incentives on NG:** We are working with NG and consulting with the industry on new incentives we are developing for NG. These incentives cover the following areas;

    - Improved website performance in respect of key market information; and
    - Improved gas demand forecasting.

- **Gas safety reserve**: We are continuing our work with the Gas Safety Review Group to consider whether any improvements can be made to the existing safety monitor arrangements. Some of the options being discussed by this group will be considered over a longer period than the lead up to this coming winter. We consider that it is important that these longer term options continue to be progressed quickly to ensure any changes required can be implemented early ahead of the winter 2007/08 period.

Gas quality: technical study into blending opportunities

As well as the initiatives identified above, we have also requested NG to undertake a technical feasibility study into the opportunities for blending at Bacton with a view to assessing options that could be implemented ahead of winter 2006/07. NG has identified significant challenges to the delivery of such a service for 2006/07 but has confirmed that it is acutely aware of the importance of this issue and, accordingly, is making every effort to try to secure such a service for the coming winter.

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Way forward

I would like to end by once again urging all market participants to provide as much information as possible to this consultation process to inform NG's understanding of the position for this coming winter.

It is therefore clearly very important that all market participants respond to the consultation and provide as much information as possible. I would also like to thank all of the companies, customers and other organisations that have contributed to and participated in our seminars to date. I hope that despite the busy time facing us all that you will all be able to continue to find the time to contribute to this process.

Yours sincerely

Alistair Buchanan
Chief Executive