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Dear Colleague

National Grid's Winter 2007/08 Consultation Document March 2007

Ofgem has published today National Grid's (NG) first Winter 2007/08 Consultation Document¹. This signals the start of the consultation process to develop gas and electricity supply-demand outlooks for winter 2007/08. As in previous years, the consultation process is designed to help the market assess the risks to supplies and put in place appropriate commercial and operational arrangements to mitigate them. Similar to last year, NG will be publishing three documents as part of the Winter Outlook process, with this year's earlier March publication intended to allow greater time for parties to feed their views into the process.

I strongly encourage everyone to respond to this early consultation to assist NG in developing a robust outlook for winter 2007/08. NG will be building on feedback received as part of this consultation in order to publish in June a range of supply scenarios for the winter ahead. The final outlook report will again be published ahead of the winter in September.

Outlook for energy supply

Higher than forecast gas supplies and low demand (due to a very warm winter) led to a much healthier supply/demand balance and much lower prices in winter 2006/07 than during the previous winter. On the supply side, we would like to congratulate the industry for delivering a number of complex, major new gas import infrastructure projects on or ahead of time. Combined, these new pieces of import infrastructure delivered significantly more gas than forecast during the recent winter – particularly from the Norwegian continental shelf and also through the new Bacton-Balgzand interconnector (BBL). In the power market, while there were unplanned outages at a number of stations early on in the winter, the plentiful supply of gas meant that the electricity system margin remained healthy (given the share of gas fired generation on the system), which, on the whole, was reflected in the wholesale electricity prices.

On the demand side, Great Britain (GB) enjoyed its warmest winter (September-February) since records began in 1914, which contributed to lower energy demand, particularly for gas. In addition, mild weather in Europe meant that there was a low demand for gas on the continent.

¹ 'Winter 2007/08 Preliminary Consultation Report', NG, March 2007 available on Ofgem's website: www.ofgem.gov.uk

The combination of these factors meant that over the lead up to and during this winter wholesale energy prices fell significantly from the levels seen during winter 2005/06. To put this in context, average wholesale gas prices (SAP) during winter 2006/07 have been nearly 60% lower than the average for winter 2005/06. Similarly, due to gas being an input fuel for around one-third of the GB generation mix, day-ahead baseload power prices have fallen approximately 50% year on year.

Following the new investment that has come on line this year, at this stage, NG's assessment of the winter 2007/08 gas supply outlook is that the 'infrastructure' risk is lower than in previous years. While there are still further import infrastructure projects likely to be commissioned during winter 2007/08 (specifically at Milford Haven), these new projects will therefore be adding to the overall diversity of GB import infrastructure and gas supply mix.

Nonetheless, uncertainties remain about the extent to which the new and existing import infrastructure will be used to actually deliver gas to GB. It is unclear to what extent we can rely on the gas import pattern seen this winter being repeated in future years, particularly against different gas demand conditions in Continental Europe. The new import infrastructure highlights the fact that the GB market will increasingly be linked through imports to the emerging global LNG market and the Continental European gas market. If there are supply or demand shocks in other markets that lead to higher prices, gas prices in the UK market will have to rise to continue to attract imported gas.

One of the other risks this winter relates to network capacity on National Grid's system. National Grid has a key role to play in delivering new network capacity on time to allow the new import facilities at Milford Haven to deliver gas to the UK market. National Grid also has an important role to play in making as much capacity available as possible at existing entry terminals where shippers want to import more gas such as Easington, Bacton and Teesside.

Together, these various challenges highlight the importance for GB of the work of the European Commission to increase transparency and competition in continental energy markets. Greater transparency will help us to understand how much gas might be available to flow to the UK under different demand conditions in Europe. Liberalisation will ensure that gas supplies respond quickly to shocks and flow to the highest priced markets – this will enhance security of supply for all Member States. We continue to support the work of the Commission in these areas and will continue to support these efforts as a priority.

Given these ongoing risks and uncertainties, it remains vital that companies in GB, Norway and Continental Europe participate in NG's consultation process ahead of the publication of the second consultation document in June.

Energy Demand

During winter 2006/07, levels of gas demand from non daily metered customers were lower than expected, even allowing for the mild weather conditions in GB. The weather-corrected level of electricity consumption in 2006/7 was below the comparable figure for 2005/6. It is currently unclear as to the extent to which any reduction in the level or growth of energy consumption reflects the response of customers to higher bills or to greater interest in energy efficiency in response to the challenge of climate change. Developing a better understanding of these drivers of demand will help industry to contribute to meeting the emissions targets committed to both in GB and in Europe.

We would encourage energy suppliers to respond to NG's questions on whether its demand forecasts and assumptions are reasonable particularly in a very cold winter. Suppliers should have the best information on how their customers' demand will be affected by rising prices under different weather conditions.

Consultation process

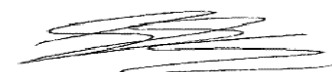
As in previous years, we will support this consultation process by holding seminars to coincide with the publication of each document. The proposed timetable is as follows. Full details of the seminar programme will be published on the Ofgem website in due course, as will the presentation materials from each seminar.

Date	Event	Location
27-March	Winter 2007/08 first consultation	Available on Ofgem's website
28-March	Winter to date seminar	London
2-April	Winter to date seminar	Glasgow
June	Winter 2007/08 second consultation	Will be published on the Ofgem website
June	Winter 2007/08 seminar	TBC
Late September	Winter 2007/08 final report	Will be published on the Ofgem website
September	Winter 2007/08 seminar	TBC

Way forward

Despite the significant fall in wholesale prices seen in recent months, there are clearly a number of risks and challenges in the outlook for the winter ahead. As a result it remains important that market participants respond as part of this consultation process. I would therefore like to thank in advance all those companies, customers and other key stakeholders who will find the time to participate in the first stage of NG's Winter 2007/08 consultation process - by either responding to the document or attending our seminar programme.

Yours sincerely



Stephen Smith
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