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Dear Andrew

Winter 2007/8 Preliminary Consultation Report: March 2007

energywatch welcomes the opportunity to respond to the issues raised in the consultation. This response is non-confidential and we are happy for it to be published on the relevant website.

Consumers expect the delivery of safe, secure and reliable supplies of energy in an efficient and economic manner. They look to network operators, producers and suppliers of energy to take the necessary action to meet these expectations. Consumers can also contribute to increased energy efficiency and improved demand management. However, to achieve all of this requires a coordinated and effective approach which takes consumers' expectations fully into account. National Grid, as the System Operator for the gas and electricity grids, plays a pivotal role in meeting consumers' expectations and we welcome this consultation process as an open and transparent means of obtaining information which is critical to security of supply.

energywatch is not a producer or supplier of energy and so our comments are not specific to the questions asked in the report. We do, however, highlight some general issues which we believe must be addressed by producers and suppliers to ensure that consumers, particularly the most vulnerable, are best served by them.

Security of supply

We note the increase that there has been in infrastructure projects connecting new sources of gas supply as Great Britain has become a net gas importer. We also note that a number of projects are currently being planned and these may assist security of supply further. However, as Ofgem has often acknowledged, capacity does not equal commodity. The deliverability of sufficient gas is critical issue to meeting all consumers' needs and becomes more acute during times of system stress.

The supply/demand picture for gas also drives GB electricity prices as gas is a significant source of power generation. Consumers have faced penal rises in gas and electricity prices in recent years, even if suppliers claim that the full costs have not been passed on. Only over the last year have wholesale gas prices come down

significantly, although consumers await the full effect in lower retail prices. We are encouraged by the potential for increased supply but the report notes the real uncertainties that lie ahead. A number of factors can easily disrupt the picture of healthy capacity – unforeseen outages, extremes of weather, project planning difficulties and the vagaries of global markets.

Great Britain will increasingly source gas supplies from Europe and beyond, with all the potential pitfalls and bottlenecks in supply which that implies. Even with secure and reliable supplies from abroad, there are concerns that gas quality may create a barrier to imports, an issue which Ofgem and National Grid are currently addressing. We strongly believe that open and effective competitive markets, displaying the relevant characteristics, are required to best meet all consumers' expectations and ensure stable prices.

While the electricity plant margin tends to be healthier, the crucial role that gas plays in electricity supply means that, as was seen in winter 2005/06, gas prices dictate the level of power prices, and switching to alternative generating fuels may compromise environmental targets. There is therefore a similar requirement for open and effective competitive markets in electricity. We note that the recent transmission price controls have factored in network investment which is required to ensure that a diverse fuel mix for electricity supply is delivered.

Lessons from previous winters

We note the analysis provided regarding last winter (2006/07) and comparisons with the previous winter. The key points from our perspective are as follows:

- winter 2005/06 was not particularly cold overall yet wholesale gas prices rose to unprecedented levels. Winter 2006/07 was warmer and there was also additional infrastructure in place, causing the significant falls in wholesale gas prices and knock on impact of lower power prices;
- it is appropriate to conclude that winter 2005/06 represented a 'perfect storm' of an average winter punctuated by cold snaps at particular pinch points – a cold snap early in the winter (late November) did not prompt the rational supply response and there was inconsistent delivery of gas from less infrastructure than was available in winter 2006/07, which created significant moments of system stress and caused prices to peak;
- there was a demand-side response to high gas prices in winter 2005/06 but this amounted to switching to high carbon fuels and demand destruction. Large consumers were forced to reduce demand through closures to maintain the supply/demand balance rather than contribute through coordinated effective demand management measures which could have maintained the viability of some businesses; and
- the pattern of winter 2005/06 can be repeated at any time in the future, even with more available infrastructure, if there continues to be a lack of openness and effective competition in markets in Great Britain and across

Europe. Reliance upon LNG as a major future source of gas supply, for instance, could be fraught with difficulty as there is a global LNG market and supplies will depend on whether European and GB markets prove commercially attractive for delivery at peak demand times.

The last point will cause GB consumers the most concern because it reflects a situation where unstable prices can arise at any point throughout a winter with no assurance that markets will react rationally. If a significant source of supply also proves unreliable, GB consumers' expectations will be undermined.

Potential ways forward

We believe that reform of GB and European markets to produce openness and effective competition requires action in the following areas:

- we believe that Ofgem should support the European Commission's attempts to progress liberalisation of European energy markets while also scrutinising the behaviour of participants in the GB markets to ensure that open and effective competitive markets are operating. The recent experience of GB consumers regarding retail prices suggests there is scope for an investigation.
- information transparency – the hallmark of open and effective competitive markets is the level of information made available to all the market participants that need it. Improved access to information on a level playing field which is balanced against appropriate requirements for commercial confidentiality allows market participants to make informed and rational decisions about demand and supply which ought to stabilise prices. We have already taken action on behalf of consumers to secure equal access to better information for all market participants: -
 - we raised and obtained regulatory approval for UNC modification 006 to improve transparency in the gas market;
 - energywatch also raised modification UNC104 to increase information availability on 'gas in store' at LNG importation terminals. As LNG supply will become increasingly significant to meet GB demand, we believe that better information on the availability of LNG which balances commercial confidentiality with transparency will lead to more rational supply/demand decisions by market participants. We note that delivery to, and flows of, LNG from the Isle of Grain in winter 2006/07 were more reliable compared to winter 2005/06. We await the final regulatory decision on UNC104 and note Ofgem's provisional 'minded to' view that it should be approved.

We note that National Grid has raised a review proposal, UNC140, which seeks to define the information which should be made available by the System Operator. We will engage effectively with the review on behalf of consumers. We believe that an appropriate test for assessing which of the current data

set should continue to be made available needs to balance the cost of provision against a very clear requirement from market participants that the data adds value to, and assists in, rational decision-making.

- clarity around outage programmes – this issue is significant and is linked to improved information transparency. Market participants need to know at an early stage what profile these outages will take, as this will dictate supply/demand requirements going forward and clearly impacts on prices. With the increasing reliance on Norwegian imports and their ability to flow either to GB or Continental Europe as demand requires, early visibility of outage planning, particularly over the summer period, must be obtained. A similar approach needs to be adopted for the interconnectors to which the National Transmission System is connected, as well as GB-based (including UKCS) infrastructure. Summer demand may become volatile with variable weather patterns. High temperatures in summer can influence electricity demand during the main outage season. Early knowledge and profiling of outage plans is needed to assist the System Operator to balance both gas and electricity networks.
- demand management – National Grid should seek to engage more effectively with large consumers to coordinate and improve the management of demand reduction if this is required during the peak demand season. Although there is an interruptible regime for gas, attempts to offer controlled demand-side response in the electricity market have seemed less successful. We believe that improved communication and the offer of flexible products by suppliers to large consumers will assist National Grid in balancing the system. Appropriate incentives which do not amount to enforced demand reduction are required. A greater emphasis on energy efficiency is also necessary. We welcome the Short Term Operating Reserve product as a first step towards improved management of electricity demand.
- we note a number of current industry initiatives which are intended to improve access, management and efficiency of the gas and electricity networks. National Grid must be appropriately incentivised to manage the networks and not for activities such as providing quality information which it ought to undertake anyway. We look forward to contributing to the review of System Operator incentives that Ofgem will undertake later in 2007.

We will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers. We intend to engage further in National Grid's consultations on the Winter Outlook as these progress further.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs