

Winter '07: Going to extremes?

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Introduction

- A winter retrospective
 - Winter '05 and Winter '06: Chalk and cheese
- Customer impact and reactions
 - From record high wholesale prices to record lows
- Looking ahead to Winter '07
 - Price responsiveness and supply guarantees
- The more things change, the more they stay the same
 - Still work to be done
- Conclusions



Who are EIC?

- Leading independent consultancy
 - Purchased by Broadfern in early 2007
- Main product areas:
 - Procurement
 - Risk Management
 - Carbon Management
 - Market Intelligence
- Procure energy spend worth £1,250 million per annum
- Represent approximately 1,300 clients
- Combined team of 110 people
- Long standing history in the energy sector
 - EIC established in 1975
 - Broadfern established in 1993



Winter '05 in overview

- Some harsh lessons learned by the end of March 2006
 - Winter '05 had been an exceptionally volatile period
 - Centrica's Rough facility offline after explosion and fire
 - UK had gone through its first Gas Balancing Alert
 - Interruptible supply clauses used for the first time in years
 - Imports from Europe had been highly unreliable
 - A mild winter, but with considerable extremes of cold
 - Russia-Ukraine gas dispute sent shockwaves across the EU
- Combination and coincidence of a range of events illustrated UK energy market's vulnerability to external shocks

Winter '05: What about the customer?

- What had the impact been for end users?
 - Highest prompt prices since December 1997
- Wide scale demand side response
 - Power generators provided the majority
 - Large scale industrial shutdowns
- Record increases in gas and power prices
 - Energy-induced profit warnings all too frequent
 - Job losses and plant closures became common
- Pipeline paranoia
 - How much gas would be delivered and when?
- How responsive were gas flows to price?

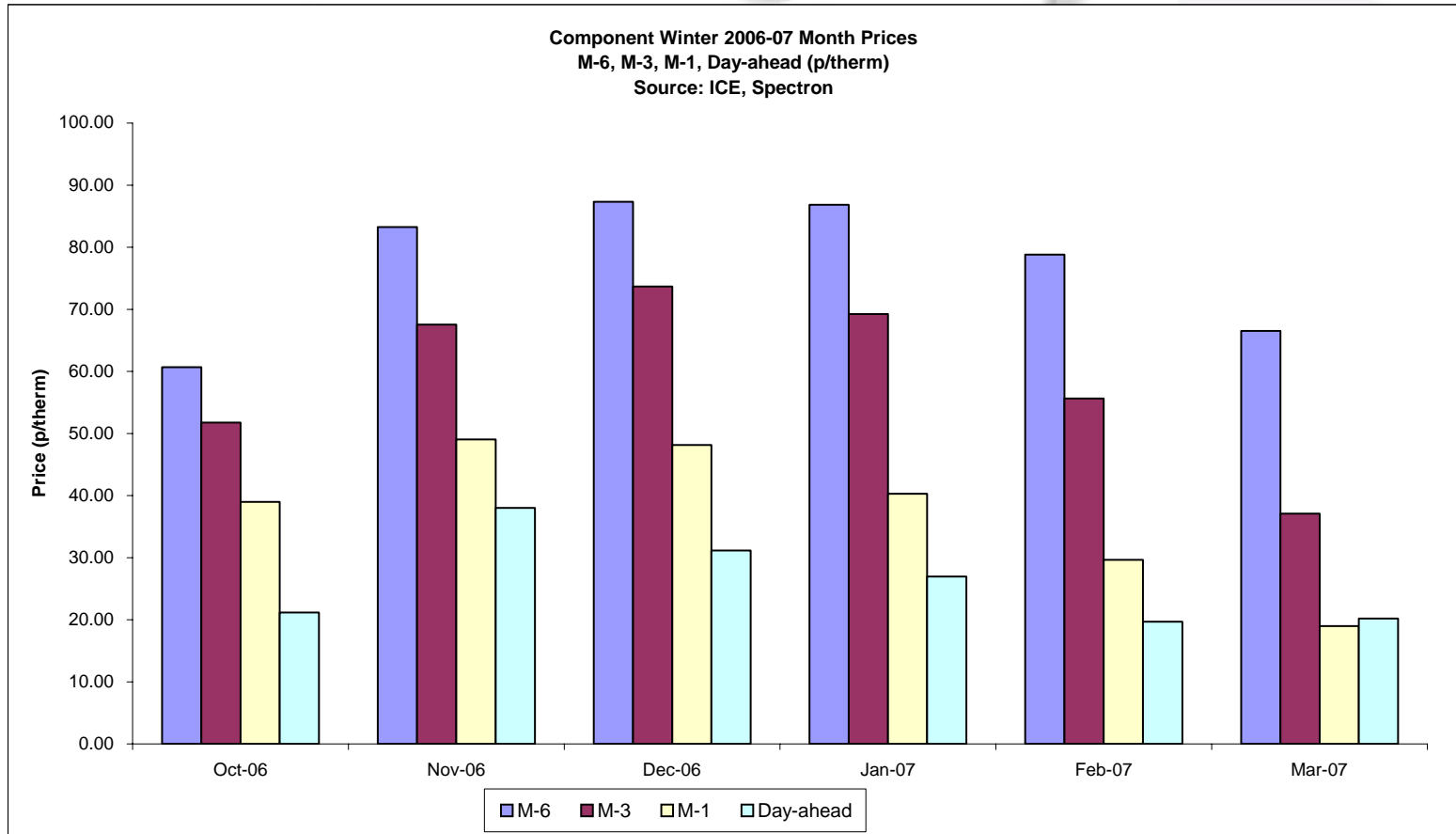


Winter '06 in overview

- From one extreme to the other
 - Negative prompt prices for first time since March 1997
- New import capacity online and heavily utilised
- Absence of British Energy units failed to have an impact
- Russia-Belarus gas dispute averted at the eleventh hour
- How real were the risks that were present earlier in the year?
 - Would Norwegian gas arrive?
 - Would Rough come back on line?
 - How bad would the weather be?
- How responsive were gas flows to price?

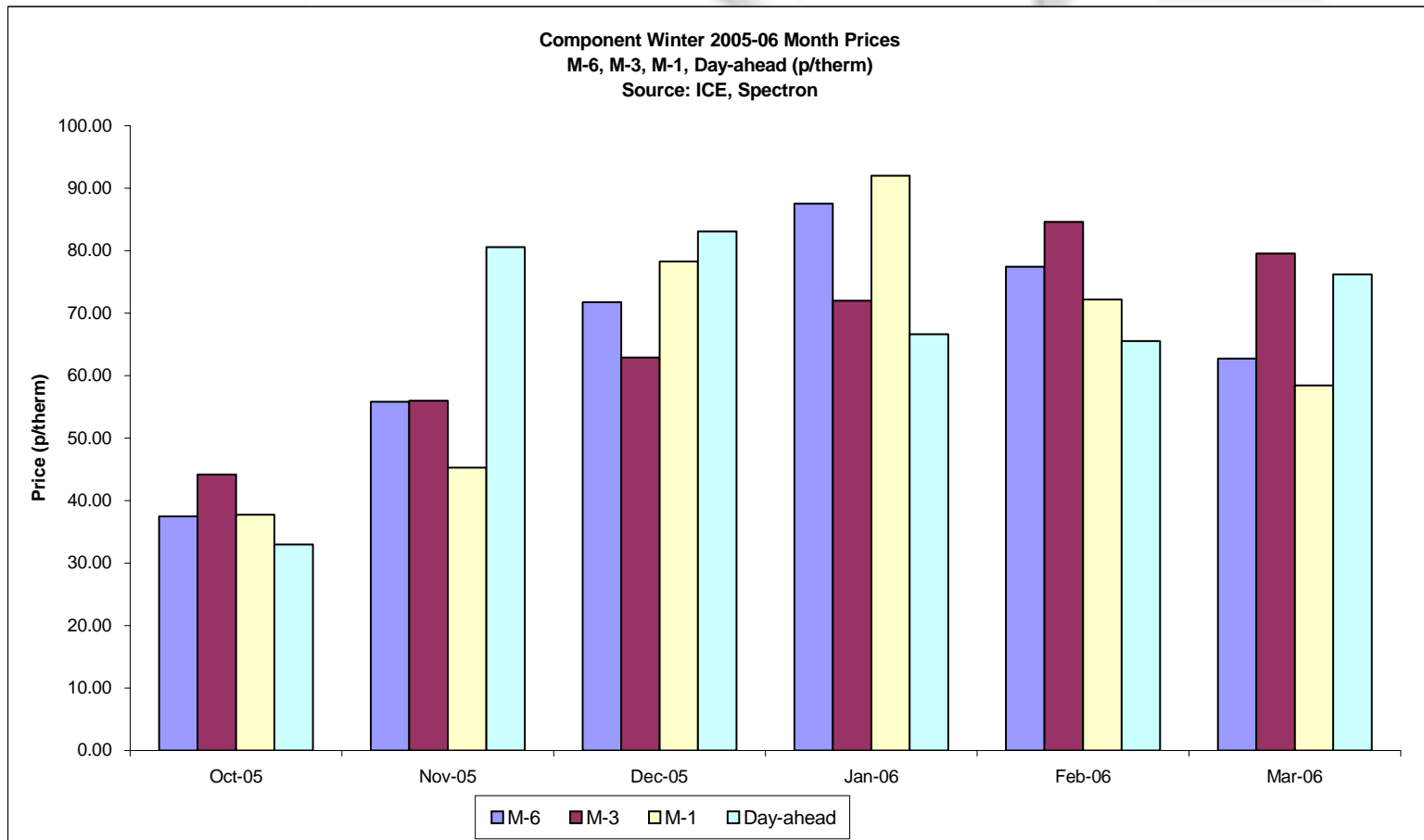


Winter '06: What about the customer?



Well it could be worse...

Take Winter '05 for example



The impact on the bottom line

- Between Winter '04 and Winter '05
 - The average delivered price for an end user contract for **power** as seen by EIC **rose** by **44.1 per cent**
 - The average delivered price for an end user contract for **gas** as seen by EIC **rose** by **90.1 per cent**
- Between Winter '05 and Winter '06
 - The average delivered price for an end user contract for **power** as seen by EIC **fell** by **15.7 per cent**
 - The average delivered price for an end user contract for **gas** as seen by EIC **fell** by **24.4 per cent**
- End user prices still well above historic levels



* As based upon contracts negotiated by EIC commencing within the period under review
(i.e. Winter '05 and Winter '06 start contracts)

Figures are based upon volume weighted averages

Delivered power prices include BSUoS, transmission losses and suppliers' RO charges, etc, but exclude all other losses and DUoS, TUoS, CCL and VAT

Delivered gas prices include transportation, metering, swing and supplier's margin, but exclude CCL and VAT

Customer reactions to winter uncertainty

- What has been the response from suppliers?
 - Blend and extend products
 - Interruption and DSR-based products
 - Regime change is still on the way (due 2010)
- More and more customers demanding flexibility
- Customers willing to take on managed procurement risk
 - Seeking greater market interaction
- The view that high prompt prices affect only large users is a myth
 - Flexible products for smaller customers
 - EIC's portfolio offerings provide an aggregated procurement service



Winter '07: Import pipelines

- Pipeline interaction is key
- Ormen Lange and Langeled
 - Gas can be diverted to several countries
 - Saw price response when UK gas at c. 15.00 p/therm
- Bacton-Zeebrugge Interconnector
 - Uncertainty is the only certainty
 - How much gas can we expect given public service commitments?
- Bacton-Balgzand Link (BBL)
 - Little correlation between deliveries and market price differentials
 - Governed by contractual nominations and associated obligations



Winter '07: Liquefied Natural Gas (LNG)

- Will LNG be baseload or marginal supply?
- Teesport, Milford Haven and Grain
 - Rights of capacity holders are key
- LNG should flow to highest price market
 - Global LNG market still evolving, but...
- Mixed experience for the UK so far
 - Grain Winter 06 deliveries defied price arbitrage
 - Teesport facility lost its commissioning cargo a number of times before first delivery
- If LNG is a global market, then what about Japan?
 - Rise in deliveries due to summer heatwave and earthquake damage to nuclear capacity
 - Echoes 2002-2003 Tokyo Electric plant shutdown



Winter '07: The more things change...

- Suppliers have become less rigid in their product offerings
- Greater UK market transparency through Mod 006, etc
 - Even if there is a "shoot first and ask questions later" approach on intra-day flows
- UKCS continues to surprise its critics with sustained healthy production
- Grain partners to auction off berthing capacity slots
 - Should encourage market approach to third party access
- Transfer and trade of SEC opens new windows of opportunity
- Power market coping well in run-up to LCPD compliance



Winter '07: The more things stay the same

- Poor wholesale market liquidity is a major problem
 - Where will be the marginal unit of energy come from?
- Market volatility is no less damaging than high prices
- DBERR and Ofgem have made in-roads into EU market transparency
 - But this still remains poor
- In theory, we have a competitive EU energy market
 - The reality is far from this ideal
- UK consumers still getting a raw deal via the wholesale market and European interactions
- Billing accuracy still leaves a lot to be desired



How have the last two winters been for consumers?

- What has changed for consumers?
 - Energy procurement increasingly a board level area
 - Greater desire for purchasing flexibility
- Risk and reward being weighed appropriately
- Consumers have switched focus away from solely how much energy costs
 - Energy efficiency and carbon management
 - Bill accuracy, checking and validation
- Greater need to for information about the energy market
 - Accurate market intelligence essential



Conclusions

- Last two winters have gone from one extreme to the other
 - "Goldilocks" approach - will Winter 07 be "just right"?
- How well has the UK actually managed?
 - Gas import dependency and market interaction the key factors
 - Power market has managed last two winters despite a few scares
 - "In my experience, there's no such thing as luck"
- Wholesale energy market volatility shows no sign of abating
- Consumers of all sizes doing more to interact with the energy market



Thank you

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