ofgem Promoting choice and value
for all gas and electricity customers

Winter Consultation 2007/8

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Outline

- Winter 2007/8
  - gas - supply outlook and prices
  - electricity – generation outlook and carbon prices
- Gas network capacity
- Norwegian flows
- Building integrated European markets
- GB Markets
- Beyond Winter Consultation

Winter 2007/8

Winter 2007/8 - summary

Increased focus on gas network issues – developments in transfer and trade

Gas supply outlook more positive than last winter

More positive outlook reflected in forward prices

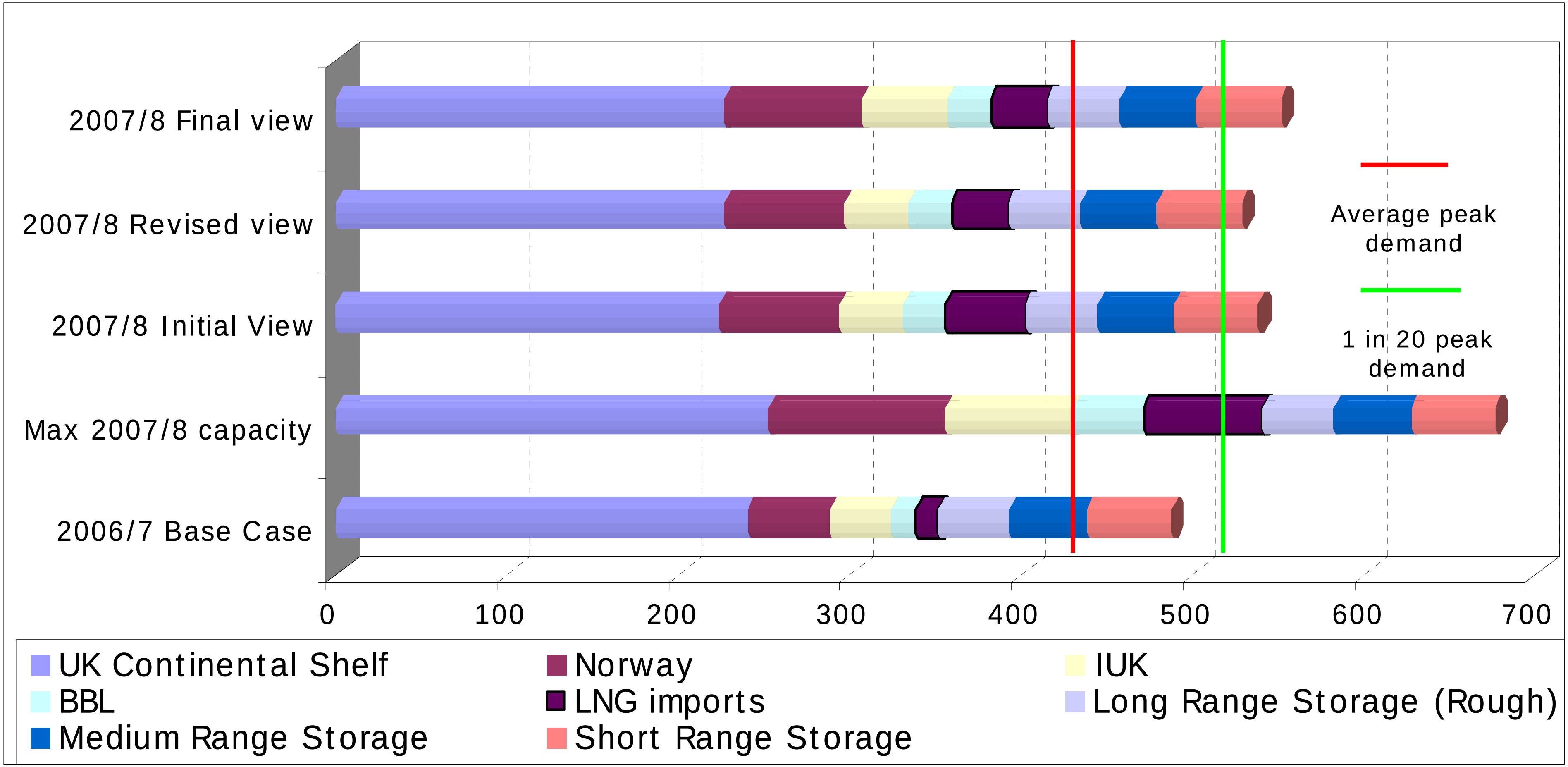
Key uncertainties remain for demand and supply

Generation margin manageable even in severe winter

EU ETS Phase II not change NG assumption that coal generation preferred to gas

Winter 2007/8 - gas

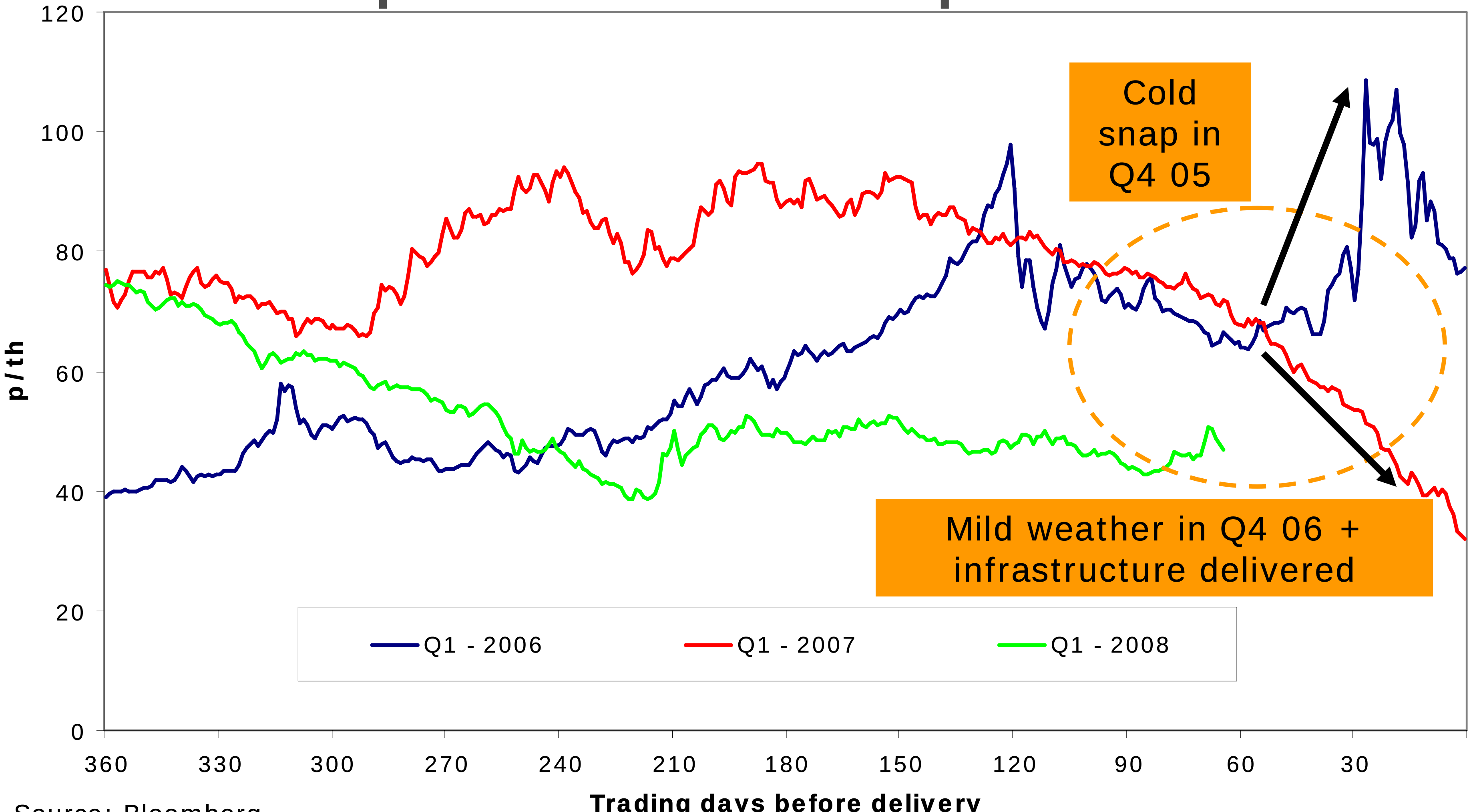
Gas supply outlook



Source: Table 6 in Winter Consultation Report 2007/8

NG have reiterated their view that outlook is more positive than last year

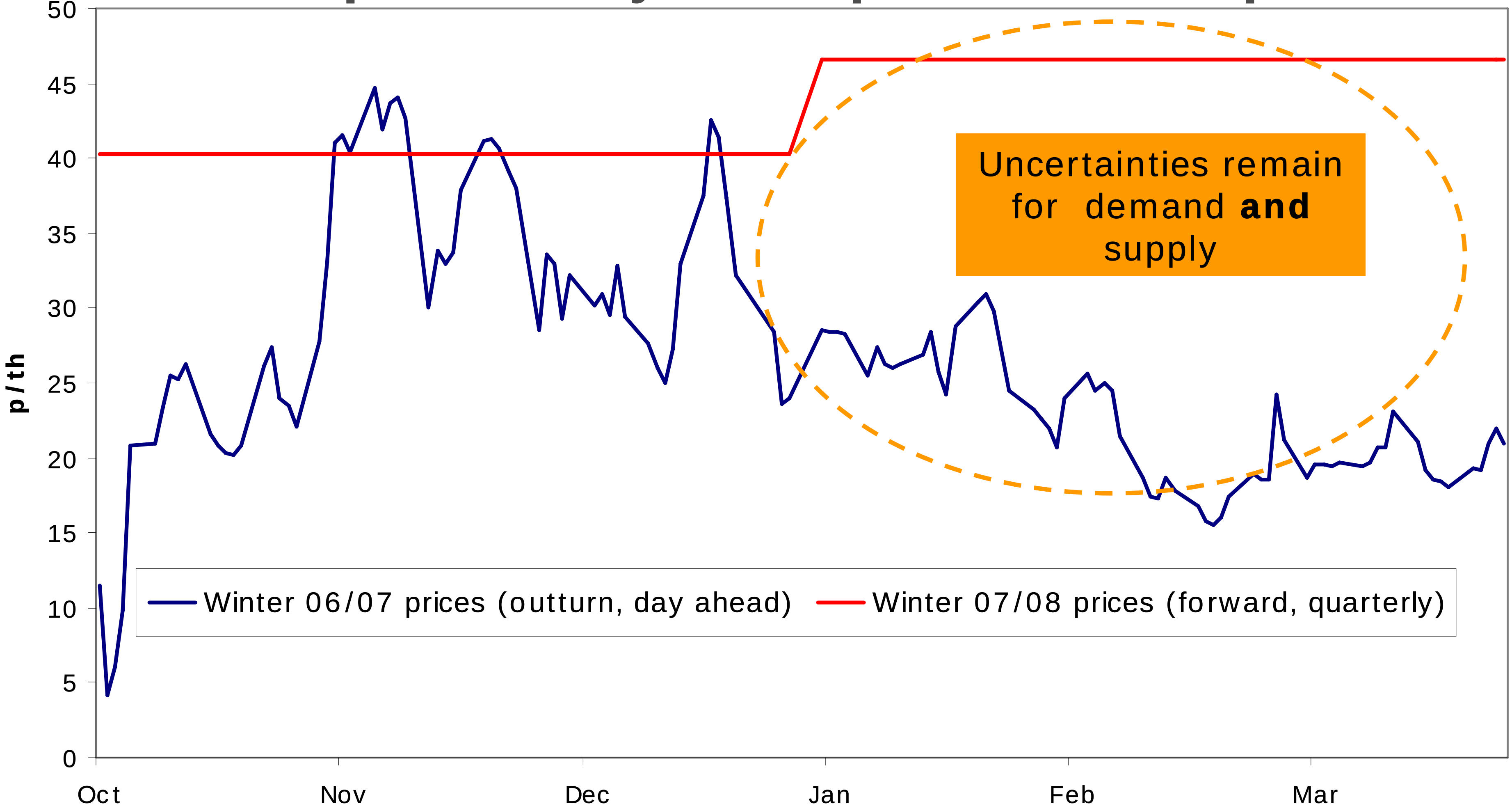
Forward prices reflect more positive outlook



Source: Bloomberg

Q1 08 gas price <u>currently</u> trading below Q1 07 price this time last year

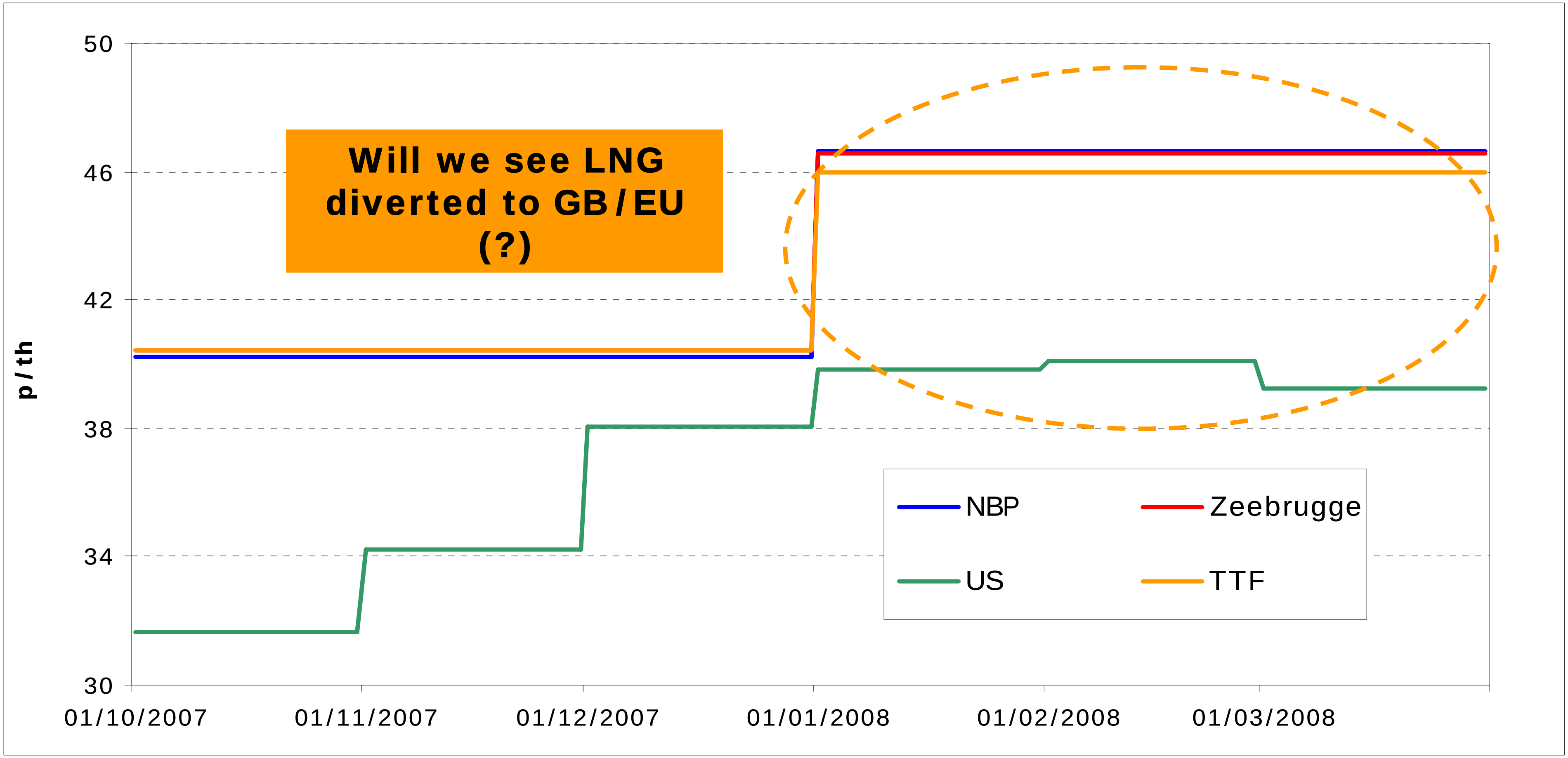
Forward prices may not equal out-turn prices



Source: Heren Energy

Gas prices for this winter above the DA gas prices seen during last winter

Price movements beyond GB market

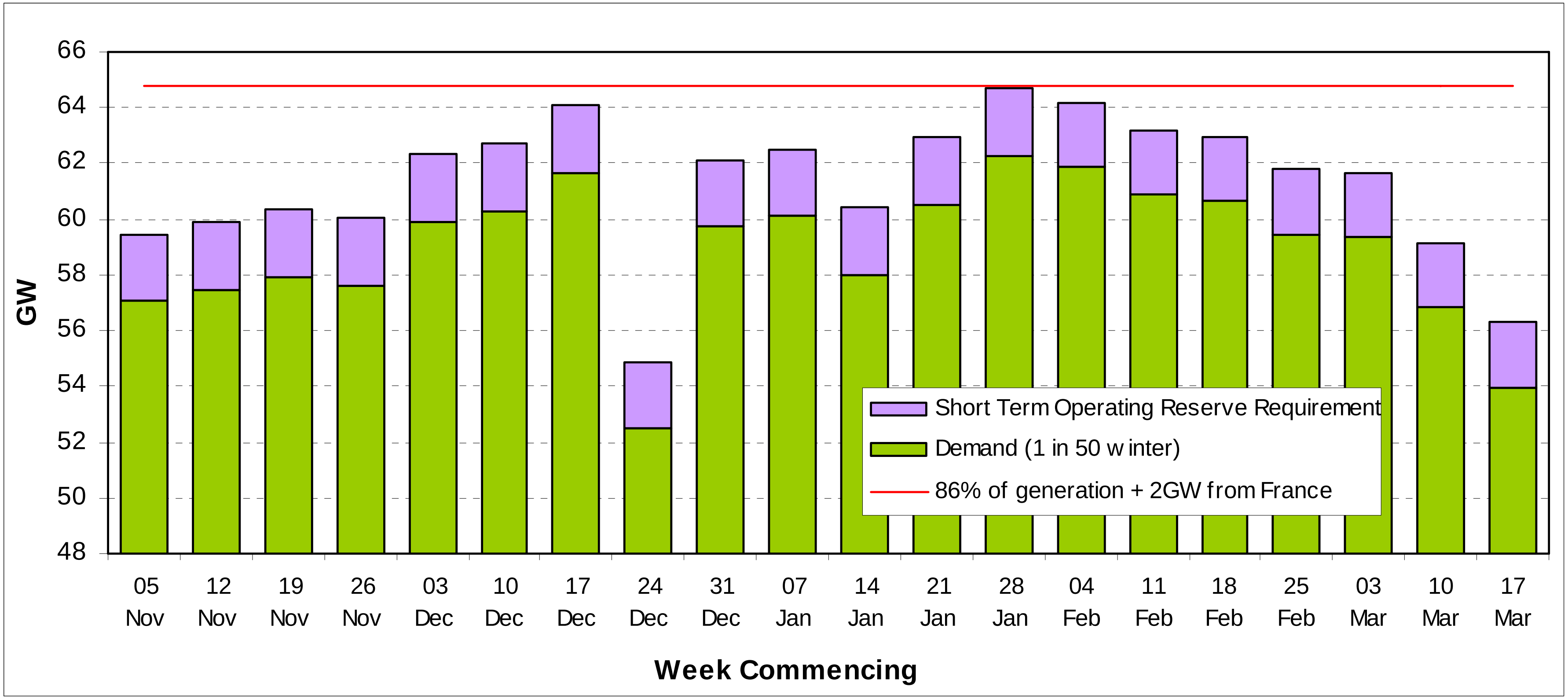


Source: Heren Energy/www.energywindow.com

Price differentials between EU and US for this winter reversed since June

Electricity supply

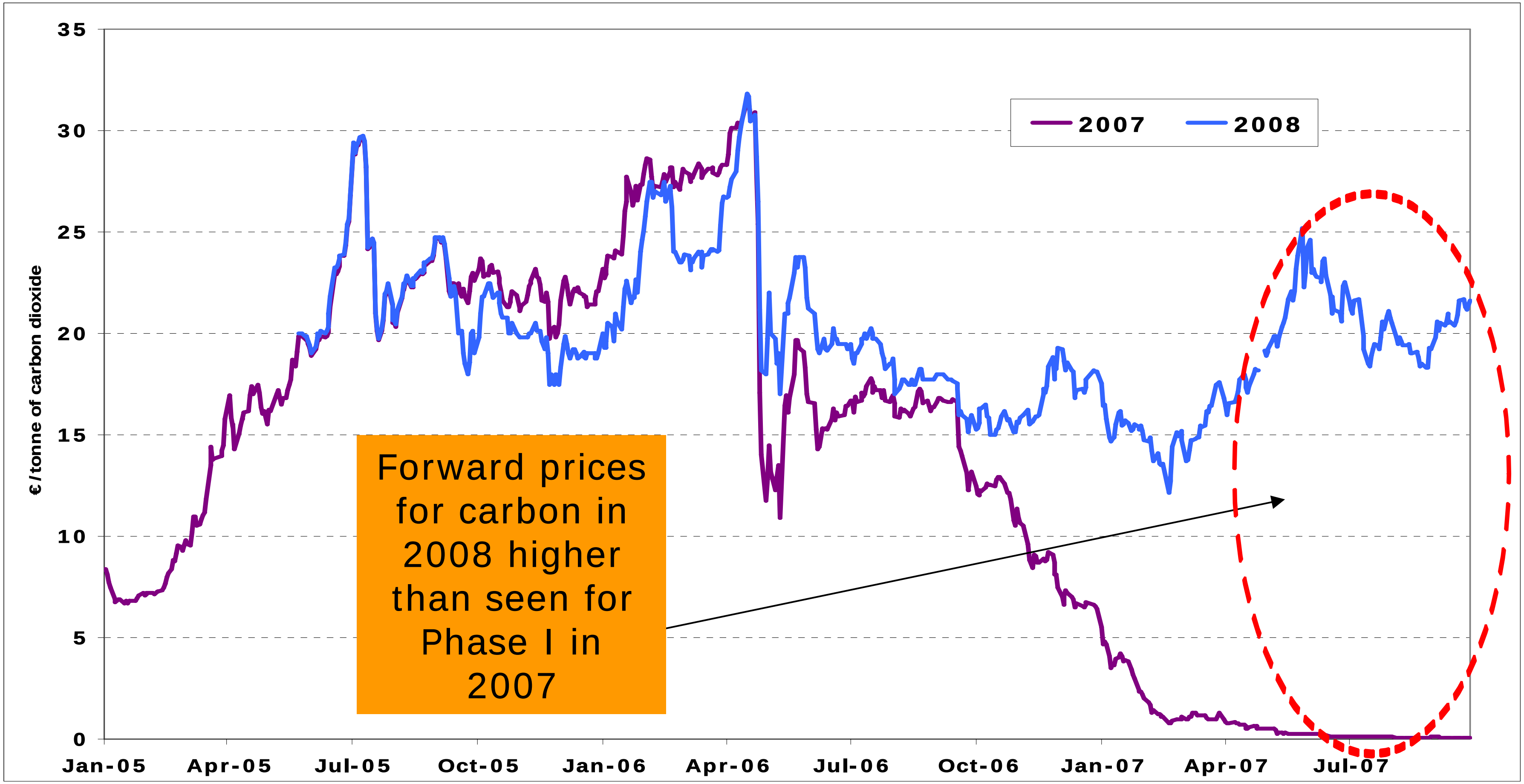
Elec margin manageable in severe conditions



Source: Figure 18 in Winter Consultation Report 2007/8 (National Grid)

Coal plant expected to provide baseload generation

Phase II of EU ETS (from 1 Jan 2008)



Source: Bloomberg

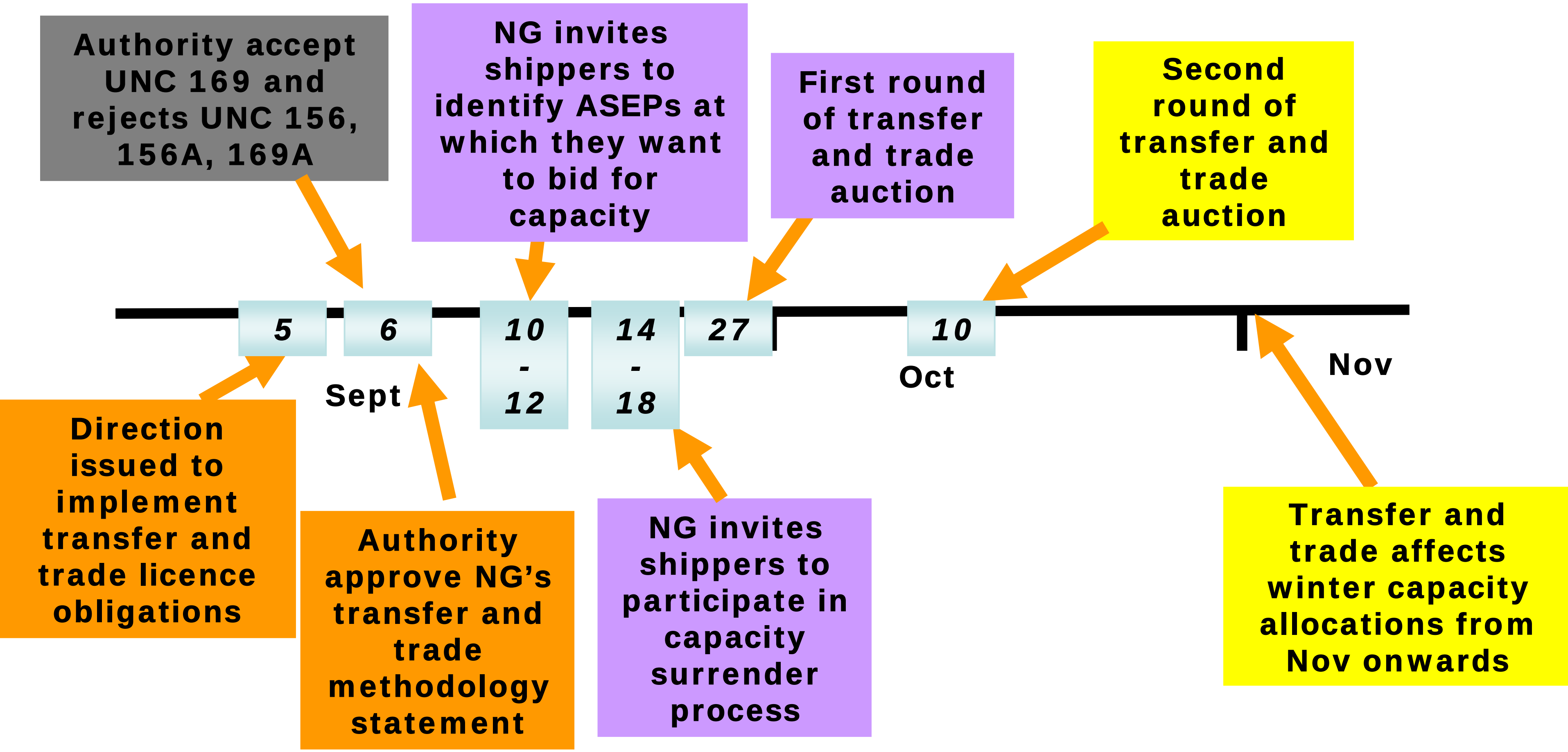
Carbon prices not high enough to drive switching from coal to gas

Gas network capacity

Gas entry capacity for this winter - overview

Transfer & trade arrangements in place for this winter

Gas entry capacity– implementation of transfer and trade arrangements for this winter



Gas entry capacity – beyond this winter

Transfer and trade
need for improved and enduring arrangements to be in place ahead of next winter

NG has obligations to develop, maintain and operate a safe, efficient and economical network

Capacity substitution
facilitate permanent transfer of unsold entry capacity

Capacity baselines
Ofgem reconsulting on price control baselines to apply from 1 Apr 08

Gas network capacity - exit

- **Competition Commission upheld EON appeal in part**
  - key area of concern on flexibility product
- **Decision to be retaken by Authority**

- **Next steps**
  - Ofgem to consider scope of re-decision – NGG and EON proposal or broader?
  - **Ofgem to publish open letter on scope of re-decision**
  - UNC Review Group 166 considering way forward

Any reforms to exit regime will not be implemented during this winter

Norwegian flows

Norwegian flows

- **Concerns raised by industry about the impact of Langeled flow pattern on WD and DA gas prices**
  - is Langeled price-setting or price-responsive?
- **Constraints on ability of Norwegian producers to respond to NBP prompt prices**
  - supply (eg upstream flexibility and availability, annual production permits)
  - demand (NCS also directly connected to 3 other European countries)
- **Constrained optimisation muddies the link between flows and WD gas prices**
- **Higher prices in mid-summer also coincided with number of factors**
  - CATS, IUK exports, unseasonably high demand, UKCS maintenance

Ofgem continues to monitor the market and will act where it has concerns

Building integrated European markets

"3rd Package" - Timetable

Jan 2007 – Commission publish Sector Inquiry and "Strategic Energy Review":
Blueprint for future EU energy policy to achieve "sustainability, security, competitiveness"

March – Spring European Council
Heads of Government endorse Commission plans, including 3rd package and 2020 targets

19 Sept – Commission publish 3rd package proposals

October – formal negotiations between European Parliament/Council begin
No fixed time limit. Crunch points in Member State discussions expected in December 07 and June 08

June 2009 – Final agreement before European Parliamentary elections/end of Commission mandate?

Highlights of the “3rd package”

Unbundling
full ownership unbundling, with possible derogations for ‘deep’ ISO model

EU Regulation
Establishment of ACER (Agency for Cooperation of Energy Regulators)

Transparency
Binding requirements on storage and LNG operators

TSO co-ordination
establish formal networks to improve cooperation on operations and investment

Power/independence of NRAs
enhanced powers and independence alongside new duties

Kick-starts negotiations between European Parliament and European Council

GB Markets

GB Markets work on wholesale issues

System Operator (SO) Review
- Full review of electricity and gas SO functions and incentives
- New scheme must be in place from April 2008
- **Dec 2007** - Initial Proposals (and thoughts on long-term scheme)

Distributed Energy (DE)
- Gain a better understanding of difficulties faced by DE and look into potential solutions
- Aim to publish consultation document in **November 2007**

GB Markets

Gas Quality
- Reviewing industry responses

Cash out Review
- Wide ranging review to simplify current arrangements
- Mod proposals in latter stages of industry assessment process

Infrastructure
- Exemptions
- Anti-hoarding

Next Steps

What happens after today?

Winter 2007/8
NG publish regular information and commentary on key trends and developments in winter so far

May 08 – NG publish initial Winter Consultation 2008/9 WCR (alongside a summer outlook?) Supported by Ofgem seminar

Summer 08 – Ofgem/NG workshop focusing on responses and areas for further discussion

Oct 07 | Dec 07 | Mar 08 | Jun 08 | Sept 08

Oct 2 – Ofgem seminar

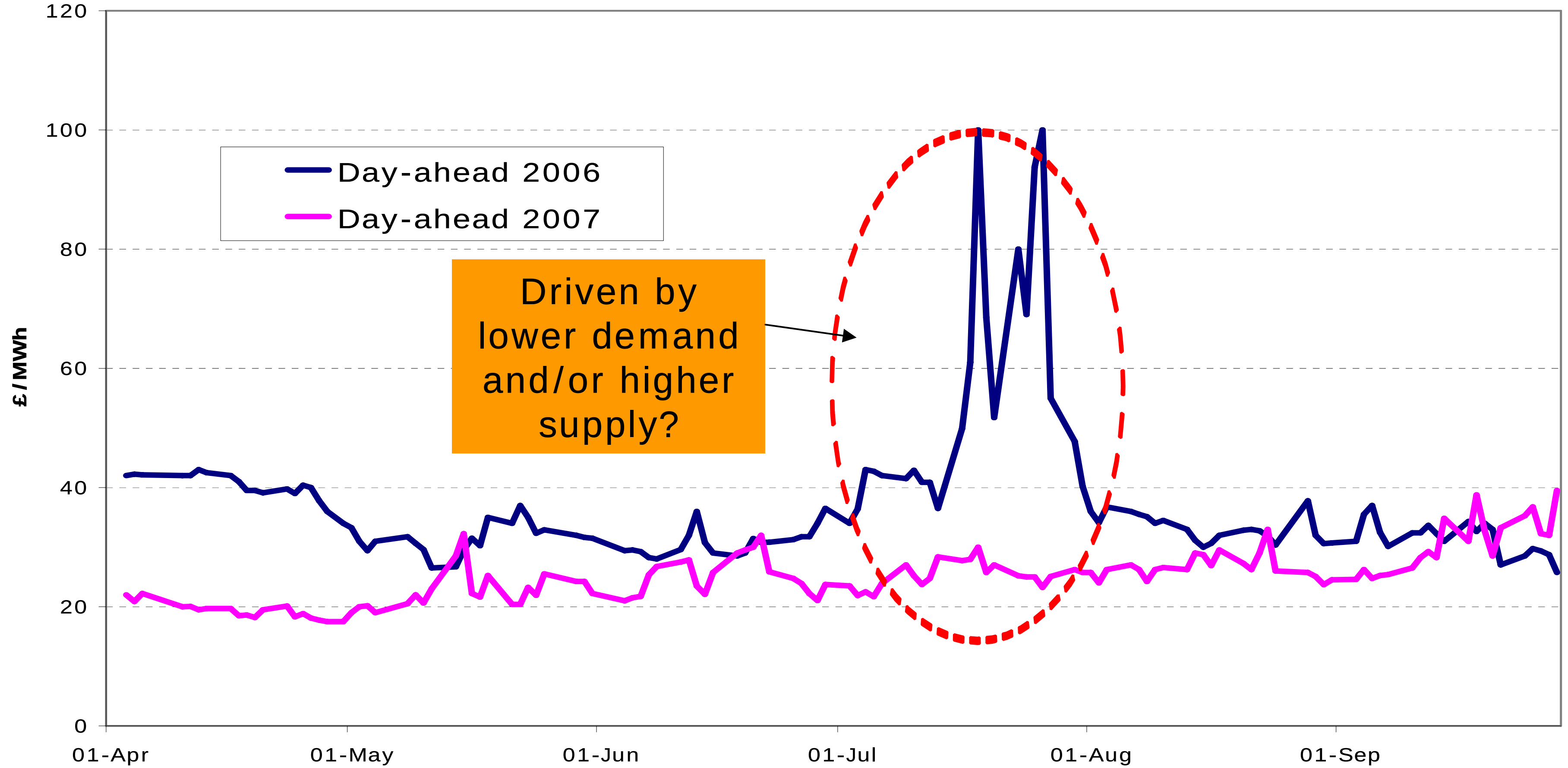
Apr 08 – NG publish final summary of events of winter 2007/8

July 08 – consultation responses due (8 week consultation)

Late Sept 08 – NG publish Winter Consultation Report 2008/9 accompanied by Ofgem seminar

Important that you let NG know what you would like to see from this process

Calmer summer for electricity prices



Source: Heren Energy

Would a summer consultation report be helpful?

Energy Markets Outlook (EMO)

Energy White Paper commitment to

"a new energy market information and analysis service from this autumn" that "will be jointly run by DTI and Ofgem"

- Analyse potential developments in gas and electricity markets over next 15 years
- Provide industry participants with credible long term market scenarios

- **First annual report to be launched in the autumn**

EMO should provide long-term complement to Winter Consultation process

Summary

Summary

- **Gas supply-demand outlook for this winter appears more positive than in previous years**
  – big challenges surround network capacity this winter and beyond
- **Elec margin looks manageable even in severe winter**
  – EU ETS Phase II and LCPD both kick in from 1 Jan 08
- **Significant developments expected in Europe**
  – EC have adopted 3rd Package of liberalisation legislation
- **Going beyond Winter Consultation**
  – what do you want from the Winter Consultation process?
  – first Energy Markets Outlook report to be published next month

Your engagement is key in a successful Winter Consultation process

ofgem

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for all gas and electricity customers