

Direct Dial: 020-7901-7303

19 January 2001

Transco, Shippers and Other Interested Parties

Your Ref:
Our Ref: Net/Cod/Mod/0396

Dear Colleague,

Modification Proposal 0396 'Proposal to allow for RBD Adjustment to be processed consequent to the recalculation of LDZ Specific Shrinkage Factors for revised temperature data for the period from the implementation of RBD to the start of current Supply Year 1999/2000'

Ofgem has considered the issues raised in Modification Proposal 0396 '*Proposal to allow for RBD Adjustment to be processed consequent to the recalculation of LDZ Specific Shrinkage Factors for revised temperature data for the period from the implementation of RBD to the start of current Supply Year 1999/2000*'. Ofgem has decided to direct Transco to implement the modification, because we believe that this proposal will better facilitate the relevant objectives of Transco's Network Code.

In this letter, we explain the background to the modification proposal and give the reasons for making our decision.

Background to the proposal

Shrinkage is gas in the system which is used by Transco in connection with the operation of, or which is unaccounted for as offtaken from the system. The constituent parts of shrinkage are as follows:

- a) Leakage
- b) Own Use Gas: Gas used for the operation of the system
- c) Theft of Gas

Reconciliation by Difference (RBD) was introduced on 1 February 1998. Under RBD, supply points in the domestic market do not have their consumption reconciled to a meter reading but are reconciled in aggregate by Local Distribution Zone (LDZ). Therefore, any error in shrinkage will be borne by RBD (domestic) shippers, whereas before it was spread across all NDM (non daily metered) shippers (i.e. all sites excluding the large daily-metered sites and the very large daily-metered sites.)

With the implementation of RBD in 1998, LDZ specific shrinkage factors were derived to accommodate variations in pressure and temperature between the LDZs. The shrinkage factors since 1998 have been determined using Industrial and Commercial (I&C) temperature data only, as no domestic temperature data was available. The first survey of domestic meter gas temperatures was undertaken in April 1999. Shippers raised a number of questions about the methodology and a series of workshops were held throughout 1999/2000 to look at the issues. At the request of shippers a further survey was carried out. This was completed in May 2000. A detailed report was provided to the industry in July 2000

for consideration. The revised factor for 2000/01 was adjusted to account for both domestic and I&C temperatures. One participant raised concerns about the robustness of this survey on the grounds that the linkages between weather conditions and metered gas temperatures was not sufficiently explored. As a result Transco has agreed to do more analysis which will culminate in a new domestic temperature survey for 2001. As part of this analysis Transco is installing additional meters in various LDZs. Ofgem has participated in the domestic temperature survey debate and is satisfied with the conduct of the survey.

Each year there is a reconciliation of the LDZ shrinkage factor, whereby Transco will in respect of the preceding year review the estimate of the LDZ shrinkage factor for each LDZ, and the aggregate shrinkage factor for each LDZ and where appropriate undertake a reconciliation. To apply the results of the domestic temperature survey for the period from RBD implementation, it is necessary to permit a further reconciliation, as the annual LDZ shrinkage adjustment has already been processed. It is also necessary to amend the network code to allow for any future adjustments that may be required as a result of the 2000/2001 domestic temperature survey.

The modification proposal

It is proposed to allow more than one reconciliation of the LDZ shrinkage for the gas year, to enable the results of the 1999/2000 Domestic Temperature Survey to apply from 1 February 1998, and to allow for prospective adjustments following the results of the 2000/2001 Domestic Temperature survey.

Respondents' views

Of the five responses to the modification, three were in support of the proposal. Those that supported the modification did so on the grounds that it was fulfilling a commitment given at the time of the implementation of RBD, to adjust for domestic temperatures once a domestic survey had been carried out.

The two respondents that opposed the modification proposal supported the principle behind it, however they had concerns about the modification itself. One respondent was concerned about the prospective element of the modification, as it would create some uncertainty with regard to the period of liability. It was suggested that there should only be a single adjustment period in order to keep uncertainty and administrative costs to a minimum. Another suggested that the shrinkage period should be closed out in the same way that invoices are closed out. There was concern about the robustness of the domestic temperature data. One respondent believed that these concerns should be dealt with before any financial adjustment is made. One respondent expressed concerns about the cash flow implications of such an adjustment(s).

Ofgem's View

With the introduction of RBD on 1 February 1998, it was recognised by all parties, including Ofgem, that the use of Industrial and Commercial temperature data to adjust the LDZ shrinkage factor would only be an interim measure until such time as a domestic temperature survey was carried out. It was also recognised that once domestic temperature data became available, there would be need for a retrospective adjustment back to 1 February 1998.

Ofgem believes that it is inappropriate that there should continue to be a cross-subsidisation between LDZ's, since more accurate data is now available. This is not cost-reflective and neither is it conducive to the securing of 'effective competition between relevant shippers and

suppliers'. Any anomalies created as a result of the application of I&C temperatures should be corrected in a timely manner.

Whilst we empathise with respondent's concerns about the impact on cash-flows, we have been assured by Transco that further work will be carried out on the adjustment principles to mitigate any adverse results on a company's cash flows. It is worth noting that with the ending of the domestic temperature survey programme in 2001, any further adjustments will only pertain to the preceding year, thereby, giving shippers comfort that they will not be exposed to an unlimited volume of adjustments. This will enable better financial planning for shippers.

Ofgem's Decision

Taking all the considerations above in to account, we have decided to direct Transco to implement this modification, as we believe that it will better facilitate the achievement of the relevant objectives of Transco's network code, in particular; the securing of effective competition between relevant shippers and relevant suppliers. The LDZ shrinkage factor was hitherto based on I & C temperatures and therefore, was not wholly reflective of the charges that would have been levied if domestic temperature data had been available.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

John Kennedy
Trading Arrangements