

TRANSCO NETWORK CODE MODIFICATION PROPOSAL No. 0563

"Delay to removal of NDM Demand Forecast Deviation Tolerance"

Version 1.0

Date: 04/07/2002

Proposed Implementation Date:

Urgency: Non-Urgent

Justification

Network Code Modification Proposal 0511 "Removal of NDM Forecast Deviation from Imbalance Calculations" is due to be implemented with effect from 1 October 2002 and is intended to enhance Users' incentives to balance. Therefore from 1 October 2002 all Users' imbalances will be cashed out at System Marginal Prices.

As a consequence, it is expected that Users would have an increased incentive to achieve a closer daily supply/demand balance. Furthermore, it has been suggested that the proposal will decrease the role of Transco as residual balancer thereby improving the economic and efficient operation of the system.

However this change could only be expected to deliver improved operation if Users with NDM portfolios are better able to forecast their NDM demand and manage their imbalance exposures. To do this Users must have access to effective tools. Unless this is the case it is unlikely that the residual balancing role of Transco will be reduced. Indeed it has been suggested that the removal of the NDM Forecast Deviation before Users are better able to forecast NDM demand is likely to increase the number of residual balancing actions taken by Transco.

The industry had anticipated that the implementation of Modification Proposal 0496 "Improvements to NDM Demand Attribution" would generate significant improvements in the NDM attribution process. However at a recent industry meeting it has emerged that there has been a significant misunderstanding about the implications of implementing Modification Proposal 0496 and that the benefits of that proposal are unlikely to be as great as most Users had expected.

It has also become apparent that there is a considerable gap in the level of information provision to Users from Transco. This will hinder the development by Users of improved demand forecasts and risk management tools.

In addition, Users are currently unable to inform Transco via their AT Link NDM Output Nominations that they have decided **not** to track Transco's demand forecasts.

One key new risk management tool is that envisaged by Modification 0553 "Amendment of Imbalance Calculations to Enable Elective Aggregation of Demand Across One or More Shipper Ids". However, recent industry discussions indicate that there is insufficient time to develop this functionality in time for 1 October 2002.

It is clear that Users will not have access to the appropriate risk management tools and that there could be deterioration in the provision of information to Transco. It is therefore appropriate to

delay the removal of the NDM forecast deviation tolerance as there is insufficient time to address these concerns prior to 1 October 2002.

Nature of Proposal

To delay implementation of Modification Proposal 0511 until 1 October 2003.

This delay will enable a Network Code Review Group to be convened to investigate:

- whether the Demand Attribution process might be improved;
- what information might be released by Transco to better facilitate individual User NDM demand forecasting;
- how information from Users might be provided to Transco;
- how information from Users might be used by Transco;
- what further risk mitigation might be appropriate either within or outside of the Network Code to facilitate efficient risk management for Users whilst facilitating the economic and efficient operation of the system;
- whether it is appropriate for Users with NDM portfolios to be fully exposed to the risk of SMP cashout; and
- whether some form of error correction mechanism to address demand attribution processes before, during and after the day might be appropriate.

Purpose of Proposal

If implemented, this Modification Proposal would delay implementation of the removal of the NDM Forecast Deviation until 1 October 2003. In addition, it would facilitate competition in shipping and supply by ensuring that Users and their NDM customers are not exposed to inappropriate risks. Such risks arise from exposures that Users cannot reasonably be expected to manage.

Instead Users would continue to be incentivised to track Transco's NDM demand forecasts, rather than take ill-informed balancing decisions, thereby promoting the efficient and economic operation of the system as Transco has certainty over Users' behaviour.

In the meantime, a fundamental review of the NDM demand forecasting methodology and the basis and use of NDM demand projections could be undertaken. This could include consideration of the merits or otherwise of Users using their own demand forecasts, provision of information to shippers, implementation of the functionality to support additional risk management tools and introducing a mechanism for Users to inform Transco if they decide to track their own demand forecasts. A delay would also permit the community to assess the outcome of the changes introduced via Modification Proposal 0496.

Consequence of not making this change

Competition in shipping and supply would be jeopardised because Users will not have access to the necessary information and tools to manage the increased risk of SMP cashout and to improve the quality of NDM demand forecasting. The financial implications are such that to remove the NDM Forecast Deviation Tolerance without remedying the situation would unreasonably expose Users to inappropriate and unwarranted costs.

Users with NDM portfolios will be fully exposed to the errors associated with the current demand attribution process, over which individual Users have little, or no, control, and will be unable to efficiently manage their imbalance positions.

Users will not have the ability to make better-informed decisions about how to balance their portfolios. In fact, Users are more likely to make ill-informed balancing decisions, which could increase the likelihood of Transco taking corrective action to remedy the overall supply/demand balance.

Users will not be able to tell Transco about their intention to use their own forecasts. Transco could therefore be forced into taking unnecessary balancing actions. This could jeopardise the efficient and economic operation of the pipeline system as Transco will have heightened uncertainty within day when deciding whether to take system balancing actions, as it tries to second-guess Users' responses to NDM demand updates and assess the need to take system balancing actions.

The likelihood that Transco might take an increased number of system balancing actions could have a knock-on effect on cashout prices, thus unnecessarily increasing exposure to SMP cashout, particularly for Users with NDM demand. This in itself will have a redistributive effect via energy balancing neutrality, which may inefficiently redistribute the increasingly cash-generative balancing neutrality cash flows.

Such effects may distort competition in shipping and supply to NDM customers and thus act against the interests of those customers.

The increased risks and the associated costs of managing them means that Users will be forced into charging larger risk premiums resulting in higher prices to customers.

Area of Network Code Concerned

Section F2

Proposer's Representative

Katherine Befroy (Scottish And Southern Energy plc)

Proposer

Katherine Befroy (Scottish And Southern Energy plc)

Signature

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