

URGENT MODIFICATION PROPOSAL No: 0492

TITLE: Proposal to fix the national LDZ Shrinkage factor from 1 October 2001 pending validation of the 1992 NLT leakage rates.

DATE: 11 September 2001

PROPOSED IMPLEMENTATION DATE: 1 October 2001

URGENCY: Urgent Procedures Requested

JUSTIFICATION

The current national LDZ shrinkage factor is based mainly on a Transco model for leakage, which is driven by leakage rate data from the last detailed leakage survey (NLT) carried out in 1992. At that time, the survey was subject to independent verification by Newcastle University and Warren Springs, and is claimed by Transco to have been the most comprehensive such survey ever undertaken in the world. However, the results were derived in a very different commercial environment and are now around ten years old. There has been no work since 1992 to review and update the figures, and thereby confirm or otherwise the continuing validity of the assumptions in the current leakage model.

Although Transco have undertaken greater consultation with Shippers on shrinkage matters through the LDZ Shrinkage Forum in recent years and have provided additional information in a number of related areas, they have not been willing to date to validate the leakage rates established in the NLT. Throughout the consultation process, Shippers have made very clear that this was their highest priority, given the very high degree of statistical uncertainty identified in the original exercise.

Transco have now indicated in their recently published document 'Final LDZ Shrinkage Factors Proposal for Gas Year 2001/02' that they intend **'to undertake a NLT in 2002, provided appropriate funding is allowed in the next price control period'**. However, they admit that results from this proposed 2002 NLT will not be available for inclusion in the LDZ Shrinkage Factor proposal until Gas Year 2003/04 - at the earliest.

As a consequence of the implementation of the RbD process for small site reconciliation in February 1998, any 'error' in LDZ shrinkage estimates is borne by the RbD Shippers only, whereas under the previous methodology it was effectively spread across all NDM Shippers through the reconciliation neutrality smearing process. This increased risk was identified in the pre-RbD discussions, and strong representations were made by Shippers at the time that shrinkage rates should be held fixed pending 'proof' from Transco to substantiate any further reductions. Unfortunately, this did not translate through to an absolute requirement for action by Transco, the obligation on them being limited to consultation on their annual proposals for change.

Post-RbD implementation, Ofgem was given the power in the annual review process of LDZ shrinkage factors to disallow a proposed change from Transco for the next gas supply year, so leaving the factors unchanged from the prior year. This power was exercised for the first time two years ago, after representations from Shippers linked to concerns about the robustness of the underlying estimates, and in particular the continuing reliance on the leakage rates. As Transco did not propose any change in the overall factor last year, despite their models pointing to a reduction of 0.02%, Ofgem was not called upon to exercise its power of disallowance.

Transco's final proposal for the next gas supply year (2001/2002) is for a reduction of 0.05% from 0.91% to 0.86%. This significant reduction is explained as being mainly driven by an 'asset data enhancement exercise' which has led to the re-classification of a number of pipe material types, particularly from pit cast to spun iron which has a lower estimated leakage rate from the NLT.

Shipper members of the LDZ Shrinkage Forum were very disappointed that this major 'data cleaning' exercise was only mentioned to them after its completion, and that they were not given any opportunity at all to input to either its design or quality control. Whilst Transco have provided significant amounts of information and responded to Shippers queries through the LDZ Shrinkage Forum meetings, they have not been willing until recently to commit to any plans to undertake a new NLT exercise or similar which all Shipper members have identified as the top priority. The time has therefore arrived to apply commercial incentives to Transco to commit to validation of the NLT leakage rates, or restrict their use in estimating LDZ shrinkage factors.

The LDZ demand deeming process currently has two major areas of estimate that interact through the LDZ shrinkage process: the assumptions on leakage rates and the assumed levels of overall Theft of Gas (ToG). Both of these quantities are through necessity based on estimates that are difficult to confirm accurately, but commercially are costs that should be controlled and hence borne by different parties – leakage being a cost to Transco and ToG being mainly the responsibility of Shippers. ToG levels may well be higher than the assumed levels and so lead to Shippers experiencing a net imbalance between deemed demands and their sales to end customers. However any underestimate in leakage estimates will have the same effect. Therefore it is important to ensure that the information used to derive both or at least one of the estimates is as accurate as possible to minimise the overall imbalance, and ensure the correct allocation of costs so as to drive appropriate remedial action.

Actual ToG levels are by their nature very difficult to estimate. Once theft is identified, then it can be addressed by Shippers or Transco according to the division of responsibility, but extrapolation from the levels of detected ToG to undetected and hence total ToG is not straightforward. Leakage estimates on the other hand can be estimated through the derivation of leakage rates by appropriate sub-division of plant type and associated statistics. Greater certainty about the level of leakage would then lead to more certainty about the levels of ToG and then drive action to address this major issue for the Industry.

It is therefore proposed that:

- The national LDZ shrinkage factor be fixed at 1% until such time that Transco carries out an exercise to validate the NLT leakage rates, with appropriate input from Ofgem Technical Directorate and Shippers on the design of that exercise.
- No annual re-assessment and reconciliation process be undertaken as currently allowed for by Section N of Code until this validation is complete as this also relies on the same underlying model and leakage assumptions, and the issues with the existing rules for this process are resolved.
- Transco to embody the impact of new leakage rates (be they higher or lower than the 1992 NLT estimates) when determined to the current gas year only i.e. no retrospective application beyond the start of the current year.
- LDZ shrinkage rates be adjusted annually only for the latest available temperature data

FURTHERING RELEVANT OBJECTIVES

This proposal provides the commercial incentive to Transco to undertake an early review of current leakage rate estimates. This will lead to greater certainty of their costs through LDZ shrinkage and hence better economics signals as to where their resources should be employed. It will also lead to a better understanding of the levels of Theft of Gas and hence direct appropriate Shipper resources to address these hidden costs. The current uncertainty in both of these areas could act as a potential barrier to entry to new domestic Shippers.

Therefore this modification would further the Code relevant objectives of both 'the efficient and economic operation by the Licensee of its pipeline system' and also 'the securing of effective competition between relevant shippers and relevant suppliers'.

CONSEQUENCE OF NOT MAKING THIS CHANGE

The true costs of operations for both Transco and Shippers and potential cross-subsidisation will continue to be uncertain and lead to economic misallocation of resources.

AREA OF NETWORK CODE CONCERNED

Section N.

NATURE OF PROPOSAL

The national LDZ shrinkage factor should be reset from October 2001 to a fixed rate until such time as the leakage rates derived from the 1992 NLT can be validated by an appropriate exercise. Transco should design and progress this exercise, with appropriate input from the Ofgem Technical Directorate and Shippers. Once the exercise is completed, the new leakage rates should be implemented for the current gas supply year without any retrospective adjustments to prior gas years. The fixing of the leakage rates and limit of the retrospective application of the new rates are designed to provide Transco with the commercial incentive to carry out the work as soon as possible, if they are confident that the underlying level of leakage is lower than inherent in the fixed rate.

PURPOSE OF PROPOSAL

This proposal is designed to give greater certainty to the levels of leakage within LDZs, and at the same time allowing more understanding of the levels of Theft of Gas. Both of these developments will then allow the parties involved to direct appropriate resources to tackle these problems.

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MODIFICATION PANEL SECRETARY'S USE ONLY

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