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Dear Colleague

**Uniform Network Code (UNC) Modification Proposal 006 "3rd Party Proposal:
Publication of Near Real Time Data at UK sub-terminals"¹**

The Gas and Electricity Markets Authority (the "Authority")² has considered:

- (a) the issues raised in the Final Modification Report (FMR)³,
- (b) the responses to the Impact Assessments (IAs) that Ofgem published in May 2005⁴ and February 2006⁵; and
- (c) the responses to the consultations that Ofgem published in October 2005⁶ and January 2006⁷,

in respect of UNC Modification Proposal 006, "3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals" (the "Proposal"). Having regard to those issues and responses, the relevant objectives, and its principal objective and statutory duties,⁸ the Authority has decided to direct the implementation of the Proposal.

¹ The Proposal was originally raised as modification proposal 0727 under National Grid Transco's Network Code. Following the replacement of the Network Code by a Uniform Network Code (UNC) the Proposal was re-numbered as UNC modification proposal 006.

² Ofgem is the Office of the Gas and Electricity Markets, which supports the Authority, the regulator of the gas and electricity industries in Great Britain. The Authority was established by the Utilities Act 2000 and its powers are provided for under the Gas Act 1986, the Electricity Act 1989, the Competition Act 1998, the Utilities Act 2000, the Enterprise Act 2002 and the Energy Act 2004. The terms "Ofgem", "we" and "the Authority" are used interchangeably in this letter.

³ Modification report, 3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals, Modification Reference Number 0727, Version 2.0, 05.04.2005. This reference also incorporates the Draft Modification Report "3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals" Modification Reference Number 0727 – Version 3.0 – 09.02.2005 and associated responses.

⁴ 3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals, Modification Reference Number UNC 006 (0727), Impact Assessment, May 2005

⁵ 3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals, Modification Reference Number UNC 006, Impact Assessment, 03.02.06. This reference to the February IA includes responses to the letters sent to interested parties regarding the Proposal, on 24 October 2005 and 10 January 2006.

⁶ Uniform Network Code (UNC) Modification Proposal 006 "3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals", 24 October 2005.

⁷ Publication of Near Real Time Data at UK Sub-Terminals (UNC Modification Proposal 006), Ofgem Impact Assessment, Case Study, 10 January 2006.

⁸ Set out in sections 4AA to 4B of the Gas Act 1986 (as amended).

Ofgem considers that the Proposal would better facilitate the achievement of the relevant objectives of the UNC as set out in paragraph 1 of Standard Special Condition A11 of the relevant gas transporters' licences as compared with the existing provisions of the UNC, taking into account the information provided on a voluntary basis under the DTI information initiative relating to the release of sub-terminal information (the "DTI voluntary information initiative").

In this letter, Ofgem:

- (i) explains the background to the Proposal including the modification process to date;
- (ii) summarises the views of respondents regarding the Proposal; and
- (iii) outlines its views on the Proposal and the reasons for its decision.

This letter constitutes notice by the Authority under section 38A of the Gas Act 1986 in relation to the direction.

Background to the Proposal

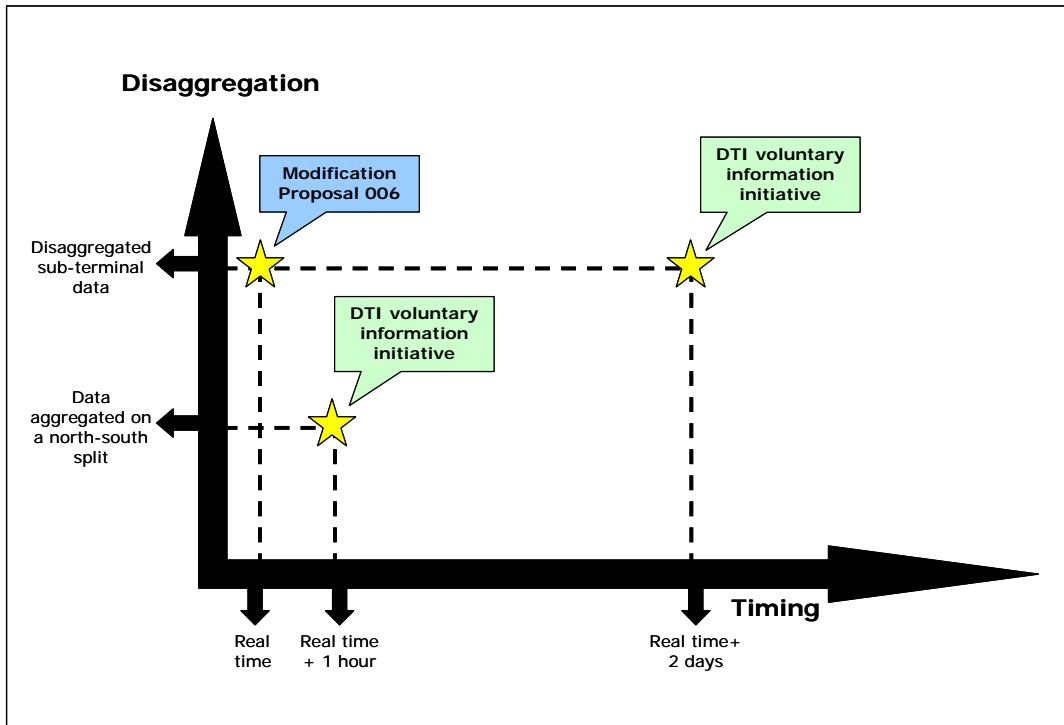
The Proposal was raised by energywatch in November 2004 and, if implemented, would require National Grid Gas NTS Plc (NGG NTS) to publish the volume of gas supplied to each eligible⁹ sub-terminal of NGG NTS' transportation network close to real time. The Proposal would therefore represent an increase in the granularity of data provided to the market, both in terms of the level of detail and the frequency of updates¹⁰, as compared with the current baseline.

The DTI, NGG NTS, the offshore industry and Ofgem, have engaged in discussions about releasing more information to the market regarding offshore gas production facilities and their flows. These discussions resulted in the development and implementation of the DTI voluntary information initiative. Whilst Ofgem welcomed these developments, it has, having regard to the principles of best regulatory practice, maintained a clear preference for a formal legislative route to secure the consistent and comprehensive release of this information. We think this is crucial to the efficient functioning of the market. We also think that a legislative requirement to provide this information would provide better long-term certainty about the level of information disclosure and avoid the potential for unilateral or collective withdrawal from providing the information that exists under any voluntary scheme.

At the time that the Proposal was raised the relevant sub-terminal data provided to market participants included daily flows from each sub-terminal provided with a two day delay (D+2). In addition, sub-terminal data aggregated to a north-south split and provided on an hourly basis was due to be made available from the end of June 2005 under the DTI voluntary information initiative.

⁹ The proposal includes all entry points that are owned and operated by NGG NTS, all entry points which are capable of accepting gas flows at rates greater than 10 mcm/day and all individual sub-terminals which are capable of accepting gas flows greater than 10 mcm/day.

¹⁰ For further details regarding the Proposal please see the May IA.



The Draft Modification Report (DMR)

Ofgem received the FMR and responses submitted to the DMR in respect of the Proposal on 5 April 2005. Following consideration of the issues raised in the report and associated responses, Ofgem considered it was appropriate to carry out a detailed IA in respect of the Proposal¹¹.

The May IA

In May 2005, Ofgem published, and invited responses to, its initial IA regarding the Proposal. The responses were broadly split between customers, customer representatives, traders and parties with downstream interests in favour of the Proposal and parties with upstream interests against the Proposal.

A number of respondents pointed out that increased information was to be made available to the market from the end of June 2005, under the final phase of the DTI voluntary information initiative. These respondents suggested that it would be appropriate to assess the Proposal against this new baseline.

Following consideration of respondents' views, Ofgem considered that there were significant benefits associated with implementation of the Proposal, as compared with the then-existing baseline, and was minded to direct its implementation. However, we agreed with those respondents who suggested that consideration of the effects arising from the release of the north-south data would enable a better evaluation of the incremental benefits (if any) that could be provided by implementation of the Proposal. Accordingly, the Authority decided to defer its decision on the Proposal to allow an assessment to be undertaken against the new baseline¹².

¹¹ Ofgem's revised guidance on Impact Assessments ("Guidance on impact assessments – Revised guidance", Ofgem, June 2005) sets out Ofgem's considerations in deciding whether an IA should be produced: <http://www.ofgem.gov.uk/ofgem/work/index.jsp?section=/areasofwork/corporateplanning>.

¹² Letter of 25 July 2005: Uniform Network Code (UNC) Modification Proposal 006 "3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals" 25 July 2005.

The Authority recommended that a further IA should be published at the end of January/beginning of February 2006 to assess the incremental value of the Proposal against the existing information available to market participants, including the final phase of the DTI voluntary information initiative.

The October consultation

In October 2005 Ofgem issued a letter to all parties that had previously responded to consultations regarding offshore information¹³. The letter invited views regarding the value of the current information released to the market under phase 3 of the voluntary scheme, and of the incremental value that publication of information under the Proposal may provide.

The January consultation

In January 2006 Ofgem issued a further letter to parties that had responded to the October consultation setting out two case studies that tried to simulate the effect that an offshore outage may have on observed line pack¹⁴ and price¹⁵. In the letter Ofgem invited the views of interested parties regarding the way they would react to an offshore outage with the current information available as compared with the information that would be available under the Proposal¹⁶.

The February IA

In the February IA, which took account of and summarised inter alia responses to the October and January consultations, we stated that we considered that the benefits identified in the May IA remained applicable¹⁷. In addition, we developed a model to quantitatively assess the potential benefits that would be achieved as a result of improved economic signals for market participants if the Proposal was approved. This analysis explored three scenarios in terms of the benefits that may be achieved and set out a range of high, medium and low potential benefits¹⁸. However, in the IA we recognised the inherent difficulties associated with modelling the potential benefits that may be achieved as a result of the release of near to real time sub-terminal information.

In terms of the costs of implementing the Proposal, following a request for clarification from Ofgem, NGG NTS estimated that these would be in the region of £1.4 million due to required IT system developments. However, following analysis of NGG NTS's cost

¹³ Letter from Sonia Brown re: Uniform Network Code (UNC) Modification Proposal 006 "3rd Party Proposal: Publication of Near Real Time Data at UK sub-terminals", 24.10.2005
http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/13735_October_Letter.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/wholesalemarketmonitoring

¹⁴ Line pack is the term used to describe the volume of gas in store in NGG NTS' transportation system.

¹⁵ Letter from Hannah Cook re: Publication of Near Real Time Data at UK sub-terminals (UNC Modification Proposal 006) – Ofgem Impact Assessment – Case Study, 10.01.2006
http://www.ofgem.gov.uk/temp/ofgem/cache/cmsattach/13767_Jan_letter_merged.pdf?wtfrom=/ofgem/work/index.jsp§ion=/areasofwork/wholesalemarketmonitoring

¹⁶ A number of respondents had concerns regarding the short time frames provided to respond to this consultation. We recognise that the timeframes for response were shorter than usual but views were invited regarding a specific element of the proposal and the consultation was undertaken to inform specific assumptions relating to the modelling. A number of respondents also commented on the select nature of the consultation. We considered it appropriate to circulate the letter to respondents to the October consultation as they had recently expressed an interest in the proposal. We would also note that the consultation was distributed more widely where requested and that it formed part of a wider consultation regarding the Proposal. As such, respondents were specifically invited to provide their views regarding this consultation in response to the February IA and it was open to parties to access the consultation letters from the Ofgem website. A large proportion of respondents stated that the information provided was a partial representation of existing data. We are aware that market participants may also use supporting data but consider that the graphs included provided a proxy for information currently available.

¹⁷ For further details regarding these benefits, please see the May IA and February IA.

¹⁸ For further details regarding the analysis carried out please see the February IA.

estimates, in the February IA we remained of the view that they represented the upper end of a range of potential costs as some of the stated system requirements may not be necessary given the volume of data flows that would be provided under the Proposal.

In the February IA we noted that the risk remained that parties with offshore production interests may choose to withdraw the information that they currently provide as part of the DTI voluntary information initiative as well as other sub-terminal information that is provided to NGG NTS. However, we remained of the view that the likelihood of this occurring would be low given the importance of this information for the secure and efficient operation of the gas system.

We also recognised that in a limited number of cases, NGG NTS may need to renegotiate contracts as a result of the Proposal, although NGG NTS had provided no detailed analysis of its contractual position and our own analysis suggested that in the vast majority (if not all) of cases, disclosure would not be contrary to existing contractual obligations.

Given the costs and benefits identified throughout the consultation process and presented in the February IA, we considered that there were potentially significant benefits associated with the Proposal. Ofgem’s assessment of the Proposal set out in the February IA is summarised in the table below¹⁹.

Estimated costs and benefits of the Proposal

Benefits		
Economy and efficiency		
Economic signals	£20.03 - £59.08 m	
System balancing	£25.03 m	
Market volatility	>£38.05 m	
Market perception and liquidity	✓	
Security of supply		
Short term	✓	
Long term	✓	
Impact on customers	-	
Environmental impact	-	
Costs		
IT costs	£1.4 m	
Contract renegotiation	XX	
Risks	Impact	Probability
Withdrawal of information	XXX	Low
Duplicate metering	XX	Low
Data accuracy	X	Low
Ownership of data	X	Low
Net benefits		
High case	£122.46m	
Medium case	£109.27m	
Low case	£82.87m	

Respondents’ views

This section provides an overview of the responses to:

¹⁹ The results of the qualitative assessment from the May IA are represented by ticks and crosses (rated on a scale from 1 - 4). One tick/cross represents an incremental benefit/cost compared with the base case and 4 ticks/crosses represent significant benefits/costs as compared with the base case.

- the Draft Modification Report (DMR) published in February 2005;
- Ofgem's initial IA regarding the Proposal, published in May 2005;
- the letter to interested parties in October 2005 (the October consultation);
- the letter to interested parties in January 2006 (the January consultation); and
- Ofgem's second IA regarding the Proposal published in February 2006.

This section is intended to summarise the principal themes of the respondents' views to these consultations and is not intended to provide a comprehensive overview of these responses. Appendix 1 to this letter provides a fuller overview of the responses raised in response to each of the consultations undertaken regarding the Proposal²⁰.

	Respondents in favour of the Proposal	Respondents opposed to the Proposal
General	Information transparency crucial to understand demand/supply balance and movements in price	Support principle of increased information if this creates benefits
	Release of this information will create a level playing field	Proposal will not provide significant benefits over DTI scheme
BENEFITS		
Economic signals	Reduced risk sentiment would help reduce prices	Information will not assist in making more informed purchasing decisions
Quantitative modelling analysis	A measured and reasonable attempt to quantify the benefits	Includes untested and erroneous assumptions and lacks transparency
System balancing	Parties better able to balance their positions will reduce NGG NTS's role	System balancing benefits largely theoretical
Market volatility	Volatility would be reduced as prices would reflect demand/supply fundamentals	Information may be inaccurate, misleading or misinterpreted and may lead to increased volatility
Market perception and liquidity	Reduce entry barriers and increase market confidence and liquidity.	Unlikely that liquidity would be increased - not properly assessed
Security of supply	Understanding of supply/demand balance will increase security of supply	Will reduce incentives to invest in the UK Continental Shelf (UKCS) and interconnector projects
COSTS		
To NGG NTS	Costs are high given that NGG NTS already collates relevant data	Assumptions seem reasonable - do not have any insight into costs
To market participants	Any costs incurred are voluntary reflecting the benefit of the data	Likely to incur costs from monitoring and analysis of the information

²⁰ Copies of all non-confidential responses are available on the Ofgem website <http://www.ofgem.gov.uk/ofgem/index.jsp>

Commercial sensitivity	10mcm/day threshold will protect parties' commercial interests	Threshold is arbitrary and will not protect all commercial sensitivities
	Parties will only be distressed buyers if contract position is also known	Potential for parties to become distressed buyers not assessed
Risk of liability to NGG NTS		May expose NGG NTS to claims for breach of confidentiality
Contract renegotiation	Confidentiality provisions would be unlikely to apply	Contractual arrangements would require time and cost to negotiate
RISKS		
Withdrawal of information	If parties withdraw data a regulated agreement should be put in place	If Proposal is approved parties may not wish to continue with existing levels of disclosure
	Withdrawal unlikely due to data importance and inconsistency with market principles	Approval of the Proposal inconsistent with previous Ofgem statements
Duplicate metering	Installation of duplicate metering would be inefficient	Duplicate metering may be required if contracts cannot be renegotiated
Data Accuracy		There may be inaccuracies in the data which may mislead customers
OTHER		
Gas and electricity comparisons	Nordpool: parties can't trade after an outage until market is notified	Comparisons between data levels in gas and electricity are inappropriate
North-south data	Welcome initiative and data has been a useful addition to portfolio	Appropriate to assess benefits of DTI scheme after a full year
	Further supply information needed to understand market	Benefits of Proposal above DTI scheme would only be marginal

The Authority's views

The Authority has carefully considered the views of respondents in relation to the Proposal, having regard to its principal objective and wider statutory duties and considers that the Proposal would better facilitate achievement of the relevant code objectives compared to the existing baseline and should be implemented.

That said, we recognise that there are some areas of the Proposal that the industry may wish to give further consideration to. It remains open to parties to raise further modification proposals in due course, if they consider it appropriate, to address any particular concerns. Any proposal will be considered by the Authority in accordance with its statutory and other public law duties.

We also recognise that, given our decision, this information will be released to the market just prior to the start of winter 2006-07 and some parties have highlighted concerns that the release of this information at this time could initially increase price volatility. We will continue our work with customers and other market participants to inform and highlight all aspects of this new information flow, particularly given its near to real time nature. As customers start to see this new data flow and make use of the information we think that any initial volatility will reduce and the identified benefits will be delivered.

This section sets out the reasons for the Authority's decision in the context of its assessment of the modification against the relevant objectives (in particular (a) and (d)²¹) and the Authority's wider statutory duties.

Relevant Objective (a) (Standard Special Condition A11(1)(a)) the efficient and economic operation of the pipe-line system to which this licence relates

NGG NTS as operator of the NTS has an obligation to ensure that the gas pipeline system is operated in an economic and efficient way. Operating the system requires NGG NTS to buy and sell gas to keep the system in balance over operational timescales. Competitive spot and forward gas markets are therefore an important tool in assisting NGG NTS to discharge this obligation as it allows them to buy and sell gas for balancing purposes at competitive prices.

Information transparency

In order for the market to operate efficiently, it is important that the arrangements in place are as transparent as possible. At the moment, some parties (notably producers) have access to information which other parties (notably downstream suppliers, traders and customers) do not have. By allowing all parties access to near to real time sub-terminal information this should permit the market to operate more efficiently.

The experience of this winter has highlighted the importance to all market participants of having access to timely, good quality information. A number of customers have outlined concerns that they have felt at a disadvantage to other market participants that have greater access to information regarding the operation of the gas market particularly in respect of their ability to respond to within day events or movements in prices. In taking this decision, we have noted that other parties have indicated that the release of this information will place them at a commercial disadvantage. These concerns are addressed below.

Economic modelling regarding improved economic signals

The modelling in the February IA sought to provide a quantitative assessment of the potential benefits of the Proposal in respect of improved economic signals. In carrying out this analysis it is necessary to use a number of assumptions regarding the way prices would change if the Proposal is implemented²². Making use of these assumptions, a simplified model was developed that we think is a reasonable proxy for the gas market²³. Having said this, some respondents did not consider that the modelling was sufficiently detailed to properly quantify the potential benefits of the Proposal. However, on the basis of the scale of the modelled potential benefits from improved economic signals²⁴, identified as being in the range of approximately £20 - £59 million, the value of carrying out further much more detailed analysis would be limited. This is particularly the case given that these benefits relate to the improved economic signals, and it is likely that the Proposal would accrue further benefits in respect of a reduced role in system balancing for NGG NTS, lower levels of volatility and improvements in market perception and liquidity.

²¹ The Authority has also assessed the Proposal against relevant objectives (b), (c), (e) and (f) of the UNC but did not consider that the Proposal would affect the achievement of these relevant objectives.

²² The assumptions used regarding the way in which prices would change if the Proposal were implemented were based upon the views expressed by respondents to previous consultations regarding the Proposal. Further details regarding these assumptions can be found in the February IA.

²³ A comparison of the prices obtained from the regression analysis contained within the February IA highlighted that the simplified model adopted was a reasonable proxy for the gas market given the similarity in prices observed as compared with those predicted through the modelling.

²⁴ Although the benefits illustrated through the modelling are not definitive, they reflect the likely benefits that the Proposal may provide through improved economic signals.

NGG NTS's role as residual balancer

We consider that NGG NTS's role as residual balancer would be likely to be reduced if the Proposal was implemented as market participants would be better able to balance their positions within day. We recognise that some respondents who were not supportive of the Proposal considered that any assessment of any such benefits was theoretical only. Although there are difficulties in assessing such benefits ex ante, we consider that the increased information available under the Proposal will allow market participants to develop a better understanding of the operation of the market, particularly over time. This will then allow parties to better balance their positions and hence lead to a reduction in system balancing costs, producing benefits for the market and ultimately consumers.

Market volatility

We note the views of some respondents who stated that inefficiencies may result from the release of information under the Proposal due to the volume of the information released and the potential for this to be either inaccurate or misinterpreted and hence result in market participants taking inappropriate action leading to increased volatility within the market.

As set out above, we recognise that following implementation of the Proposal there may initially be increased price volatility, particularly as the market first develops its understanding of the new information flows. We also recognise that given the timing for implementing this Proposal this initial volatility is likely to occur at the start of the winter period. However, we believe it is likely that as parties learn to make use of this new data, the effects of any initial volatility would reduce as prices would adjust to reflect supply and demand fundamentals (as opposed to rumours and market sentiment) and benefits would be delivered²⁵.

Ofgem is aware that some market participants currently undertake in-depth monitoring of the market and have made clear in their responses to the consultations that they would be keen to monitor carefully the increased information available under the Proposal in the event of implementation. We consider that it is likely that such parties will build up in-depth knowledge of this data to inform their trading decisions and, as such, will learn to understand the data released under the Proposal and to change their behaviour to respond to such information appropriately.

Further, we consider there is potential for companies to provide data management services to market participants. Such companies will be capable of sophisticated analysis of the data made available under the Proposal and will be able to provide this analysis as a service to market participants to inform their understanding regarding the operation of the gas market.

Market perception and liquidity

We are also of the view that market perception and liquidity would likely be improved as increased information will improve understanding and market confidence. This may in turn help to attract new entrants into the market, including on the demand side, increasing competition and improving trading activity and liquidity.

²⁵ This was demonstrated within Oxera's assessment of the costs and benefits of the Proposal which indicated that if the Proposal were implemented the spread of prices would likely be reduced during periods of uncertainty; '*What are the costs and benefits of near real-time gas information?*', Report prepared for UK Offshore Operators Association', Oxera, May 2005. The benefits that we have identified associated with this reduced volatility over time are consistent with the analysis carried out by Oxera.

A number of respondents disagreed with these points and argued that there was no real evidence that the Proposal would increase liquidity. As noted earlier, we consider that the provision of increased information under the Proposal will enable market participants to develop an improved understanding of the operation of the gas market. While we recognise that this information flow by itself is unlikely to be sufficient to attract new entrants to the market, by further enhancing the current arrangements to provide for an open and more transparent market with equal access to timely information, this will likely improve market perception more widely. As such, the Proposal may therefore also help to lead to a reduction in entry barriers and a corresponding increase in liquidity.

DTI Voluntary information initiative

Following consideration of responses to its May IA, the Authority decided to delay its decision in respect of the Proposal in order to give the market time to consider the value of the new north-south flow information (which was released as part of the DTI voluntary information initiative at the end of June 2005).

It is clear that the release of the north-south flow information has been beneficial to market participants to better their understanding of the day to day operation of the gas market. In responses to consultations regarding the Proposal, parties have indicated that information made available under the final phase of the DTI voluntary information initiative has provided an incremental benefit, over and above the spectrum of information already available to the market, in understanding the flows of gas onto the NTS.

The near to real time sub-terminal flow information that would be made available under the Proposal would provide market participants with increased granularity of this flow data and also more frequent publication of updates. We consider that when compared with the baseline of north-south flow information, the Proposal would provide market participants with an improved understanding of the gas market allowing them to make better informed trading decisions.

Some respondents have noted concern that Ofgem should allow for a longer period for the market to consider the north-south flow information, in order to fully understand whether the information that would be made available under the Proposal represents a benefit as opposed to the current baseline.

Market participants have had the opportunity to make use of the north-south flow information, and therefore develop an understanding of its value, over what has turned out to be a particularly difficult winter with very high and volatile gas prices. Given the number of days over this period where there were difficulties experienced and where information regarding gas flows was particularly important to enable market participants to take better informed within day trading decisions, we consider that there has been a sufficient period within which to allow the market to understand the value of the existing baseline of information. As such, given the potential incremental benefits that could be achieved by releasing flow information at enhanced granularity and on a more timely basis, as per the Proposal, we consider that it is important not to further delay implementation of the Proposal in order to ensure that it will be implemented in time for these benefits to be realised over the coming winter.

We are also of the view that the release of the increased flow information would further promote the economic and efficient operation of NGG NTS's pipeline system by enabling parties to make better informed trading decisions. This will allow parties to seek to avoid purchasing gas during periods of high prices, aiding their purchasing strategies and allowing them to compete more effectively within the markets that they operate. A number of respondents to the February IA consultation concurred with this view; with parties outlining that the release of information under the Proposal at the time of the

February Rough outage would have enabled them to see whether it would be possible for the loss of gas from the storage facility to be made up from other supply sources.

Contract renegotiation and liability

Some parties have raised concerns about the possibility of NGG NTS being liable for any disclosure of commercially sensitive information under the terms of its existing contracts, and the costs of renegotiating any such contracts.

As we understand, NGG NTS has not undertaken any detailed analysis of its contractual position. However, Ofgem has endeavoured to carry out its own analysis. In light of this analysis, we consider that the number of contracts where the issue of any liability for the disclosure of information arises is likely to be small and, in those cases where it does arise, it is arguable that the legal disclosure requirement imposed on NGG NTS by the Proposal would suffice to protect it from liability for such disclosure both at common law and under contract.

In the February IA we noted that, apart from a small number of legacy agreements, the majority of the contracts in place would permit the disclosure of information by NGG NTS to third parties where required by law and that this would mean that the disclosure required by the Proposal would not be in breach of NGG NTS' contractual obligations under these contracts.

We considered that even where legacy agreements did not explicitly allow the disclosure of information to third parties it could be argued that the confidentiality provisions would be rendered ineffective or unenforceable as regards the relevant information by the imposition on NGG NTS of a licence obligation to disclose the information, as per the Proposal, which could constitute a supervening event. As such, we consider that it is likely that in the vast majority of cases (if not all), NGG NTS would be able to disclose the information in accordance with its licence obligations without being in breach of its contractual obligations.

A number of respondents were of the view that Ofgem had not given due consideration to the costs that would be incurred as a result of contract renegotiation. Notwithstanding our view that disclosure may be possible even under the legacy contracts, we recognise that there may be costs associated with the renegotiation by NGG NTS of some contracts. However, if, and to the extent that, any renegotiation of contracts is required, we do not believe that the costs of such renegotiation would outweigh the substantial overall benefits of the Proposal, particularly given the small number of contracts likely to be involved.

A further issue raised by some respondents was the potential for NGG NTS to incur liabilities associated with the release of potentially inaccurate information. We recognise that there may be occasions where meters or associated data transmission equipment do fail and may provide false or misleading information. However, we still think that as long as users are made fully aware of the estimated level of confidence in the published information, the relevant information should continue to be released. This could be addressed by NGG NTS placing suitable caveats on its website regarding the information flows, in much the same way that it does for other information it publishes to the market.

Withdrawal of information

A number of respondents have stated that if the Proposal is approved they may need to reconsider the continued provision of information under the DTI voluntary information initiative. Ofgem remains of the view that it is unlikely that gas producers would seek to withdraw their information if the Proposal were to be approved. We consider that given the obvious value of sub-terminal information for ensuring the secure and efficient

operation of the gas system to both NGG NTS in its role as SO and market participants more widely, which has been particularly highlighted over this winter, it would be highly unlikely that parties with gas production interests would seek to withdraw this information.

In response to the February IA, Gassco (the Norwegian System Operator) raised concern regarding the level of transparency that would be required if the Proposal were approved and indicated that it has been provided with some comfort by government that disaggregated information regarding sub-terminal flows would not be disclosed under the UK regulatory regime. As such, Gassco stated that if the Proposal was to be approved it would not be willing to comply with the obligation to provide real time information to NGG NTS.

Given the relative tightness in gas supplies over the last winter, and forecast for the next winter, GB gas prices have been trading at a considerable margin to other European markets. We consider it would be unlikely for commercial companies that have an opportunity to sell their gas to what is currently a highly profitable market for gas producers to withdraw information and therefore limit their ability to trade in this market.

Finally, a number of respondents stated that approval of the Proposal would be inconsistent with previous Ofgem statements regarding information release²⁶.

In relation to Network Code Modification Proposal 593, the Authority reached the decision to reject this proposal to allow the benefits of the voluntary scheme to be more fully assessed and ensure that any further proposal in this area was considered against a clear and appropriate baseline. The Authority deferred its decision on the Proposal to allow the effect of the new information (in particular the north-south flows) provided under the DTI voluntary information initiative to be assessed prior to taking this decision. As such, the Authority's decision is entirely consistent with the position it took in relation to Network Code Modification Proposal 593.

Ofgem published clear guidance on the issue of modifications seeking to release information in June 2005 which built on a number of statements that we have made regarding offshore information release in past decision letters²⁷. In response to the February IA, a number of parties argued that approval of the Proposal would be inconsistent with previous statements issued by Ofgem and, in particular, this guidance. The guidance refers specifically to the release of ex-ante company-specific information. Whilst we accept that it is possible that in a small number of cases information relating to a specific company could be released as a result of the Proposal, that information would not be released on an ex-ante basis (i.e. in advance of real time) and does not therefore fall within the ambit of the guidance. Ofgem's guidance continues to apply and it remains open for parties to raise potential issues or amendments for consideration.

Duplicate metering

In the May IA, Ofgem outlined that it considered the cost of installing duplicate metering to be a risk to the achievement of the potential benefits of the Proposal. We noted that

²⁶ In rejecting Modification Proposal 593 Ofgem outlined that the costs of disrupting the DTI voluntary information initiative on the release of offshore information would outweigh the potential benefits associated with the Proposal. Since rejection of Modification Proposal 593, market participants and Ofgem have been provided with sufficient time to assess the benefits of the DTI voluntary information initiative and Ofgem remains of the view that there are significant benefits associated with implementation of the Proposal over and above the DTI voluntary information initiative. In addition, the risks of disrupting the DTI voluntary information initiative are low and are therefore outweighed by the potential benefits of the Proposal.

²⁷ This guidance was published for consultation, although effective and in place at that time, in June 2005. A final version of the guidance was published in November 2005; Information release under Gas Transporters Licence Standard Special Condition A7, Guidance Document: Version 2.0, November 2005
<http://www.ofgem.gov.uk/ofgem/index.jsp>

installation of duplicate metering would be necessary where NGG NTS was not able to successfully renegotiate its contracts. However, as explained in the February IA and above, we consider think it is likely that no renegotiation will be necessary in light of the legal obligation on NGG NTS to disclose the information and, in any event, the number of cases (if any) in which contract renegotiation is necessary is likely to be small. Therefore any costs to NGG NTS of installing duplicate metering in order to comply with the Proposal should be minimal.

IT system costs

Ofgem considers that any investment made into sophisticated IT systems by different market participants to capture, retain and/or analyse the additional data flows released under the Proposal would reflect the value that those parties place on capturing the additional data. The extent of any such investment is clearly a commercial decision for individual parties to make. Ofgem is also aware that the potential exists for third parties to collate and analyse the information released under the Proposal and provide the analysis, as a service, to market participants that would value it. Therefore, Ofgem considers that any costs associated with monitoring of the data would be incurred voluntarily by market participants as they sought to better understand market fundamentals and therefore make more informed trading decisions to reduce associated costs.

We have set out on a number of occasions that we consider NGG NTS's IT systems costs to be at the higher end of what may be expected. However, given the significantly greater overall benefits that this Proposal will deliver we do not consider this to be a significant issue.

Ofgem's view against relevant objective (a)

We therefore consider that the Proposal would better facilitate the achievement of relevant objective (a) of the UNC and assist in the efficient and economic operation of the pipe-line system by allowing market participants to better understand the operation of the gas market and to make more informed purchasing decisions.

Relevant Objective (d) (Standard Special Condition A11(1)(d)) the securing of effective competition between relevant shippers, between relevant suppliers and/or between DN operators and relevant shippers

Creation of a level playing field

We think that the provision of near to real time sub-terminal information under the Proposal will promote effective competition by providing all market participants with equal access to this information and will therefore help to create a level playing field. In this respect, improved access to information will allow all market participants to make more informed purchasing decisions and therefore permit them to compete more effectively within the market.

Commercial sensitivities

While some parties have argued that the Proposal would help to create a level playing field for all market participants, others considered that it would be necessary for them to have an information advantage within the market where their commercial position would otherwise be exposed to allow them to cover their commercial positions. Where parties consider their positions are affected by the release of this information, we consider they would be able to mitigate any associated risk.

It is open to parties to adopt strategies to ensure that their position is covered in the event of an offshore outage. As such, parties could contract for gas within the market or manage their portfolio to ensure that they have sufficient reserves available if they were to experience an offshore outage. In this way, parties could adopt the most efficient option available to limit potential exposure as a distressed buyer in the event of a supply disruption. In the event that the party did not experience an outage, it would be open to them to sell this gas to the market.

As such it would only be plausible for a producer to hold back production where the risk of its field suffering an outage was so high that this risk would offset any potential revenue from the sale of the gas in reserve. We do not therefore consider that strategies of this nature would have implications for security of supply as parties would have the option of selling the gas back to the market and may even be able to profit from the sale of this gas if it is sold during a period of high prices. We also do not consider that such strategies would be inconsistent with the principle of effective market operation but that they would simply represent insurance strategies against potential exposure. We also note that in electricity there is no evidence that parties choose to hold back generation from the market even where real time information is released for each individual generation unit.

Further to this, we note that the 10mcm/day threshold on flow information was designed to provide most parties with sufficient protection from exposure of their commercial position. However we recognise that a small number of parties may face potential exposure where they suffer an offshore outage in specific circumstances once this information is released. We recognise that the 10mcm/d threshold is somewhat arbitrary, however we view that any potential costs associated with this are small in comparison with the overall benefits of enhanced transparency to the gas market.

Comparisons between gas and electricity

A number of respondents have stated that comparisons made between the levels of information available in the gas and electricity markets are inappropriate given the fundamental differences between the two commodities. They have stated that the current level of exposure in electricity, following an outage, is far lower than the exposure that offshore gas producers would experience in the event that an outage was to occur and near to real time sub-terminal information were available. In particular, respondents considered that there was no equivalent risk in electricity to that faced by gas producers in respect of the performance of gas reservoirs. One respondent pointed out that the differences between the market operation rules in gas and electricity made the risk for producers resulting from offshore outages greater than the risk of generation failure in electricity. In particular, this respondent considered that the lack of gate closure in gas, along with the differences in balancing periods and trading meant that it was inappropriate to draw parallels between the two markets in respect of this issue.

We recognise that there are differences in the market operation between the gas and electricity markets, but disagree that the level of exposure in electricity is lower than the exposure that would be experienced by gas producers under the Proposal. Clearly, there are risks in respect of the performance of gas reservoirs but there are also risks in respect of the operation of generation plant (some types more than others). Ofgem notes that in the electricity market, information is made available in real time regarding unit performance and, as such, where an outage occurs the commercial positions of affected parties will be exposed. In the event of an offshore outage in gas, where near to real time sub-terminal information were available, market participants would be able to discern that there were physical problems associated with the flows of gas from a particular sub-terminal but would not have information on the contractual position of the affected party. As such, they would not be able to discern how much (if any) additional gas the producer would need to buy in order to meet its contractual obligations. As

noted previously, we recognise that the 10mcm/d threshold is some what arbitrary, however we view that any potential costs associated with this are small in comparison with the overall benefits of enhanced transparency to the gas market.

Finally, we note that electricity market analogies are useful for the purpose of comparison in this context, but for the avoidance of doubt, Ofgem has not formed its decision on the basis of these comparisons.

Ofgem's view against relevant objective (d)

We therefore consider that the Proposal would better facilitate the achievement of relevant objective (d) of the UNC and assist in securing effective competition between players by allowing parties to make more informed purchasing decisions and therefore to compete more effectively within the market.

The Authority's decision

The Authority therefore considers that the Proposal will better facilitate the achievement of:

- relevant objective (a) - the efficient and economic operation of the pipe-line system to which this licence relates; and
- relevant objective (d) - the securing of effective competition between relevant shippers, between relevant suppliers and/or between DN operators and relevant shippers;

Having regard to the above and its principal objective and wider statutory duties, the Authority has decided to accept the Proposal and hereby directs the relevant transporters to implement the Proposal.

Implementation of this modification shall be in accordance with the Proposal as set out in the final modification report. Therefore implementation of this modification of the UNC shall come into effect on and from 1 October 2006.

If you have any questions concerning this letter please feel free to contact Sonia Brown on 0207 901 7172 or Hannah Cook on 020 7901 7444 who would be happy to help.

Yours sincerely



Stephen Smith

Managing Director, Wholesale Markets

Signed on behalf of the Authority and authorised for that purpose by the Authority

Appendix 1 – respondents' views

The section provides an overview of the responses to:

- the Draft Modification Report (DMR) published in February 2005;
- Ofgem's initial IA regarding the Proposal published in May 2005;
- the letter to interested parties in October 2005 (the October consultation);
- the letter to interested parties in January 2006 (the January consultation); and
- Ofgem's second IA regarding the Proposal published in February 2006.

This section is intended to summarise the principal themes of the respondents' views to the DMR, Ofgem's May IA, the letters issued to interested parties in October 2005 and January 2006, as well as responses to the February IA to outline the reasoning for our decision and is not intended to provide a comprehensive overview of these responses. In this regard, where points raised in response to consultations are substantively similar to those outlined in response to previous consultations, we have not duplicated these to avoid repetition²⁸.

DMR – respondents' views

NGG NTS received thirty one responses to its DMR. Twelve parties provided full support to the Proposal, three provided qualified support, fourteen were opposed to the Proposal and two parties provided only comments. Those respondents that supported the Proposal were shippers, traders, customers or those representing customers' interests, whilst those opposed to the Proposal mainly had production interests.

Respondents in favour of the Proposal

The majority of respondents supported the principle of increased provision of information to the GB gas market and several respondents considered that the Proposal would reduce barriers to entry, creating a level playing field, improving market confidence and allowing the market to operate more efficiently. Respondents considered that over time market participants would develop a better understanding of the gas market and movements in price and that this should make it easier for new parties to enter the market. A number of respondents also considered that NGG NTS's actions would be more efficient as they would be able to more reasonably expect market participants to balance their position.

Several respondents did not consider that confidentiality clauses would likely apply at a number of the terminals, given that flows would be aggregated and would not therefore disclose any single party's commercial position. Respondents also considered that the inclusion of the 10 mcm/d threshold for information disclosure was a pragmatic step that would preserve the commercial interests of market players at small entry points. However, respondents noted that the contract positions of certain shippers at particular entry points are widely known and that near to real time sub-terminal information would provide the wider market with information on the position of such shippers.

A number of respondents considered that if the offshore community were to withdraw from the DTI voluntary information initiative as a result of the Proposal, it should be replaced by a suitable regulated agreement. Some respondents considered that threats to withhold information were inconsistent with an efficient and competitive market.

²⁸ For a full account of responses please see the Ofgem website <http://www.ofgem.gov.uk/ofgem/index.jsp>

Respondents against or raising objections to the Proposal

A number of respondents considered that the information to be released might be misleading and misinterpreted by the market and therefore may lead to increased volatility in gas prices and the introduction of inefficiencies within the market.

Several respondents considered it would be appropriate to review the benefits of the DTI voluntary information initiative before considering further changes. Such respondents stated that if the Proposal were approved, they would have to consider whether to recall information previously disclosed or refuse to supply similar or other information in future and to re-consider whether appropriate safeguards were in place in relation to this data.

Some respondents noted the complexity of contractual arrangements in place which would need to be renegotiated if the Proposal were to be implemented. A number of respondents also considered that it would potentially expose NGG NTS and others to claims for breaches of confidentiality and liability risks relating to accuracy of the data.

A number of respondents had concerns that NGG NTS may need to install duplicate metering to provide the required information and raised concerns regarding the cost and timing implications this might have.

Some respondents highlighted the significant physical differences between gas and electricity and therefore stated that comparisons between the levels of information available in the two markets were inappropriate.

May IA – respondents' views

There were 32 responses to the May IA, of which 16 supported implementation of the Proposal, one offered qualified support and 15 were against its implementation. The responses remained broadly split between customers and customer representatives, traders and shippers without production interests as compared with NGG NTS, the DTI and those companies with production interests and producer representatives.

Respondents in favour of the Proposal

A number of respondents considered that information regarding supply and demand was essential for market participants to understand price movements and for this to inform their commercial decisions. Further respondents stated that the Proposal would reduce volatility by ensuring that prices were more reflective of supply and demand fundamentals as parties learnt to interpret the data. Several respondents stated that this would also increase market liquidity. Some respondents considered that if market participants were able to better understand supply demand fundamentals this would incrementally increase long term security of supply. One respondent also stated that the provision of near to real time sub-terminal information would help to facilitate demand side response.

A number of respondents welcomed the final phase of the DTI voluntary information initiative but did not consider that the initiative went far enough in respect of the information made available while further respondents set out that a legislative approach to the release of this information was required.

Several respondents stated that the costs estimated by NGG NTS were excessive given that it already collates and aggregates the information as part of the DTI voluntary information initiative. A number of respondents also considered that the structure of contracts between NGG NTS and parties with offshore interests would allow the release of information under the Proposal. A further respondent stated that even if confidentiality issues were apparent there was plenty of time to renegotiate contracts that are in place,

prior to implementation. Several respondents considered that the installation of duplicate metering would be inefficient.

Seven respondents stated that near to real time information should be made available given that some parties in the market have access to this. Several respondents stated concern that parties may withdraw all offshore information and a further two stated that this would be unreasonable in view of safety issues associated with the provision of this information to NGG NTS. A number of respondents considered that the risk of withdrawal was relatively low.

Respondents against or raising objections to the Proposal

Several respondents did not consider the Proposal would assist parties in making more informed purchasing decisions while one stated that system balancing benefits were largely theoretical. Some respondents did not consider that volatility would be reduced as a result of the Proposal while others stated that volatility would likely be increased. Some respondents considered that there had not been sufficient analysis of the effect of the Proposal on volatility while others stated that such benefits had been overestimated. One party stated that the effect of the Proposal on liquidity had not been assessed while another set out that it was unlikely that liquidity would be increased.

A number of respondents stated that it was unclear how the release of near to real time sub-terminal data would increase security of supply while further respondents considered that this would disincentivise investment in the UKCS and interconnector projects.

Several respondents considered that implementation of the Proposal would provide only marginal benefits over and above those achieved from the DTI voluntary information initiative. In addition, a large number of respondents stated that the initiative needed to be fully implemented to allow an assessment of the Proposal to be made.

Respondents highlighted that the potential for producers and sub-terminal operators to be placed in the position of distressed buyers in the event of a supply disruption had not been fully taken into account. One respondent considered that the 10mcm/day threshold was arbitrary and would discriminate against large supply points while others set out that the limit would not protect all parties from commercial exposure. A respondent set out that storage sites would be captured and this would appear an unintended effect.

Several respondents stated that the issue of liability for the publication of sub-terminal flow information needed to be considered and others set out that this issue had not been appropriately assessed. A number of respondents stated that contract renegotiation would involve significant time and resource and that this had been underestimated. One respondent also expressed concern that technical and legal problems, outlined in the FMR, had not yet been adequately considered. Some respondents also had concerns regarding any potential inaccuracies that may be present within the data.

October consultation – respondents' views

There were 22 responses to the October consultation, of which ten were in favour of the Proposal, one provided qualified support and 11 were against its implementation. The responses remained split between those with upstream production interests and customers and unaffiliated shippers and suppliers.

Respondents in favour of the Proposal

A number of respondents considered that the information would increase transparency, permitting parties to construct a more accurate picture of the system and allowing purchasing decisions to be reached based upon market fundamentals. Some respondents

outlined that reduced risk sentiment would also help to reduce prices. One respondent stated that provision of near to real time sub-terminal flow information would allow detailed analysis of the gas supply curve. Some respondents highlighted that while it might take time to learn to understand the data provided, this skill would likely be developed quickly.

Some parties outlined that benefits of information were almost entirely attributed to the release of disaggregated sub-terminal data. Another respondent stated that the Proposal would allow an understanding of the supply demand balance in real time while presently information is only available 2-3 days after the event. Several respondents set out that security of supply would improve due to increased understanding of market operation.

A large number of respondents outlined that the north-south data had provided an incremental benefit and highlighted that they use the information as part of their overall portfolio of tools. However such parties also stated that associated benefits were limited and that the DTI voluntary information initiative had not gone far enough in terms of the required information. A number of respondents stated that the level of aggregation of the information tended to disguise the reasons underlying any changes in gas flows. Several respondents set out that the north-south information had not proved useful.

Respondents stated that market participants should have equal access to data and highlighted that in many markets acting on "inside information" is unlawful. One respondent outlined that parties would only be placed in distressed buyer positions if the market were aware of its commercial contracts on the day ahead.

Respondents against or raising objections to the Proposal

A number of respondents set out that they did not see any benefit from the release of locational flow data given that trading is generally carried out at the NBP. A number of respondents stated that release of information under the Proposal would mislead interested parties due to a lack of understanding as well as inaccuracies within the data and that this would lead to increased volatility. In addition, one respondent stated that there had not been a reduction in bid-offer spreads since publication of information under the DTI voluntary information initiative in July.

Several respondents considered that the information provided under the DTI voluntary information initiative provided the required level of information in relation to sub-terminal flows and stated that the information had not been available for a sufficient period of time to allow a full assessment of the associated benefits. Some respondents stated that they would likely incur costs associated with monitoring and analysis of the data although one highlighted that any such costs encountered were entirely voluntary.

A number of respondents stated that the Proposal may place NGG NTS in breach of confidentiality provisions and suggested that it would be appropriate for Ofgem to address issues of this nature as part of its IA. Some respondents outlined that substantial time and resources would be required to negotiate amendments to existing contracts.

January consultation – respondents' views

There were 16 responses to the letter that was sent in January 2006 regarding the Proposal. Of these respondents, 2 were large users, 5 were shippers, 8 had upstream production interests and 2 were consumer representatives²⁹.

²⁹ A number of respondents expressed concern regarding the short timescales provided to reply to the consultation, the select nature of the consultation and the representation of information in the consultation.

Respondents in favour of the Proposal

Five respondents considered that if the data were published this would permit market participants to obtain an understanding of the underlying reason for a disruption in supply and affect decisions regarding the purchase of gas.

Respondents against or raising objections to the Proposal

Four respondents stated that the release of near to real time sub-terminal flow data would not change their behaviour as the cause of the reduction in supply would not be known nor would market participants have an indication of the likely duration of the disruption.

February IA – respondents' views

There were 21 responses to the February IA. Six were in favour of the Proposal, one offered qualified support and fourteen were against its implementation. The responses remained broadly split between those with offshore production interests and large customers, traders and customer groups. Shippers and storage operators remained divided on the Proposal. A further response was also received a month after the deadline for responses and the respondent was not in favour of the proposal.

Respondents in favour of the Proposal

Several respondents stated that the quantitative assessment of the potential benefits resulting from improved market signals was measured and reasonable especially given difficulties associated with measuring benefits ex ante.

One respondent considered that the price implications of the incident at Rough would have been less severe if the Proposal had been in place while a further respondent highlighted that winter 2005/06 had been a prime example of a market that had reacted to fears and rumours over security of supply due to insufficient information.

One respondent stated that producer concern regarding an increase in costs as a result of the Proposal suggested that they currently enjoy an undue advantage over others and highlighted that in Nordpool, producers are prevented from trading following an outage until they have notified the market.

A number of respondents stated that if the threat of withdrawal of data provided under the DTI voluntary information initiative continued to exist, Ofgem and DTI should change the regulatory framework to underwrite this data and eliminate this risk.

Respondents against or raising objections to the Proposal

A number of respondents stated that the modelling contained too many untested and erroneous assumptions and that there was a lack of transparency in the approach adopted. As such, they considered that the modelling was inadequate to substantiate the changes required if the Proposal were approved. One respondent suggested that the benefits identified in the modelling analysis would simply be a transfer from producers.

Several respondents considered that the consequences for upstream producers had not been properly assessed and that the risk of parties becoming distressed buyers had been largely ignored. Further respondents stated that the Proposal would provide the market with visibility on how storage sites were performing against their contractual positions and a number of respondents suggested that the Proposal should be amended to remove certain parties. Some respondents outlined that Ofgem's guide on offshore information

had suggested that real time, potentially company specific, information would not be released and that approval of the Proposal would be inconsistent with this.

Several respondents stated that if producers held back gas to sell on the day to protect their position from commercial exposure in the event of an offshore outage this would reduce liquidity on forward markets and may have implications for security of supply. A number of respondents stated that the February IA had not included analysis of the costs associated with contract renegotiation. These respondents considered that costs of contract renegotiation should have been assessed further as part of the IA given the likely magnitude of the costs. In addition, further respondents considered that the Proposal could have implications for investment in the UKCS as well as in relation to interconnector projects, bringing gas to Great Britain, that are currently underway.

Several respondents stated that the assessment of the hourly north-south information provided as part of the voluntary DTI voluntary information initiative should have taken place after the information had been in place for a full year. A further respondent stated that it would be appropriate for Ofgem to analyse bid/offer spreads, volatility and liquidity changes since the release of the north-south information in July 2005 and, on the basis of this analysis, assess the impact the Proposal may have.