

27 December 2000

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UK Transco, Shippers and Other Interested Parties

Dear Colleague,

Network Modification 0407

'Removal of Nationally Diversified Load Factors in 2001'

Ofgem has considered the issues raised in modification proposal 0407 'Removal of Nationally Diversified Load Factors in 2001'. Ofgem has decided to accept the proposal on the basis that it better facilitates the relevant objectives of UK Transco's Network Code.

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

Background to the Proposal

The implementation of Modification Proposal 0236a in 1999 provided for a phased change in the Nationally Diversified Load Factor's (NDLFs) from the original values set out in the Network Code towards values more closely aligned with the actual national average load factors. The present arrangements for NDLFs are set out in the Network Code and they provide for a progressive change over a three-year period.

The NDLF values stated in the Network Code (for the three consumption ranges to which NDLFs apply) do not reflect the most recent unscaled national average load factors arising from the annual Non-Daily Metered (NDM) demand estimation process. In view of this and the introduction of model smoothing in the NDM demand estimation process, which is expected to increase stability in the derived load factors, there may no longer be a need for NDLFs.

Modification Proposal

The proposal removes NDLFs with effect from 01 October 2001 to be replaced by the then current national average load factors derived from the Spring NDM demand estimation process. These unscaled national average load factors would be derived on an annual basis and take effect from October each year.

Respondents' views

In total Transco received five responses to Modification Proposal 0407. Four of the respondents supported the proposal on the grounds that such a modification will improve

cost reflectivity. However, of these respondents, one suggested that the load factor for each EUC should be based upon statistically significant samples of each region. Another respondent believes that changes to NDLFs should be phased in.

In contrast one respondent did not support the implementation of the proposal, arguing that there is too much uncertainty regarding the relative effects that the proposal would have upon transportation charges for domestic and I & C sites and that removing NDLFs would create increased volatility.

Transco's opinion is that the proposed removal of NDLFs in October 2001 will ensure that the most up to date information is used in future to estimate the NDM load factors. This proposal should therefore improve cost-reflectivity in the setting of transportation charges, thereby promoting effective competition between users.

Ofgem's view

Ofgem agrees that NDLFs do not accurately reflect the values estimated each year, and that their removal should improve cost-reflectivity. There is expected to be a minor impact on transportation charges as a result of moving from the use of NDLFs to the use of unscaled national average load factors from October 2001 but analysis indicates that this is likely to be restricted to 2% or less. Hence, Ofgem does not believe that the removal of NDLFs should be phased in because the load factor change will be relatively small. In response to concerns over increased volatility, the NDM model smoothing approach is expected to reduce volatility in the year on year NDM load factors. In regard to concerns over the sample sizes used, we believe it is appropriate to discuss such concerns in the Demand Estimation Sub Committee.

Whilst we acknowledge that the impact of implementing this modification will differ between domestic and I&C sites, Ofgem is satisfied that using unscaled national average load factors will better facilitate the accurate reflection of consumption patterns. In Ofgem's view, improving cost reflectivity will lead to more efficient and economic operation by the licensee of its pipe-line system and will better facilitate competition between relevant shippers and suppliers.

Ofgem's Decision

Ofgem believes that the proposal will better facilitate:

1. the efficient and economic operation by Transco of its pipe-line system;
2. the securing of effective competition between relevant shippers and relevant suppliers, and
3. the provision of reasonable economic incentives for relevant suppliers to secure that the domestic supply security standards are satisfied as respects the availability of gas to their domestic customers.

Taking the above considerations into account, Ofgem has decided to direct Transco to implement this modification to its network code.

Further Information

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

Sonia Brown
Head of Market Surveillance