

Draft Modification Report
Delay to removal of NDM Demand Forecast Deviation Tolerance
Modification Reference Number 0563
Version 1.0

This Draft Modification Report is made pursuant to Rule 8.9 of the Modification Rules and follows the format required under Rule 8.9.3.

1. The Modification 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.

2. Transco's Opinion

Transco notes that the Proposal is designed to achieve two objectives. Firstly to permit Users with more time to prepare for the implementation of Modification Proposal 0511 and secondly, to enable a Review Group to consider the broader issues associated with NDM nominations, forecasting and incentive arrangements to facilitate economic and efficient operation of the system and shipper on shipper competition.

Provisions in the Network Code relating to NDM Forecast Deviation currently reduce Users' exposure to SMP cashout prices up to the difference between the final NDM nominations and NDM allocations. Modification Proposal 0511 'Removal of NDM Forecast Deviation from Imbalance Calculations' will remove this tolerance from 1st October 2002. In its decision letter on this Proposal Ofgem decided to direct Transco to implement on the grounds that the Proposal increases Users' exposure to marginal cashout prices, improving *"the incentives to balance, thereby reducing the size of overall system imbalances, and Transco's balancing role."* Ofgem therefore considered it would better facilitate the Relevant Objectives to *"facilitate the economic and efficient operation of Transco's pipeline system and the securing of effective competition between shippers and between suppliers"*

In its decision letter Ofgem also recognised that Users may need time to prepare for the implementation of the Modification Proposal 0511. Ofgem chose to direct implementation from 1st October 2002. Ofgem stated that *"This date takes account of the time shippers have had since the Modification was proposed in December 2001 to consider the effects of its possible implementation."*

As stated in the final Modification Proposal 0511 Report Users may require better forecasting services and/or risk mitigation tools to manage the risks arising from implementation of Modification Proposal 0511. Despite the fact that the possibility of the removal of the NDM Forecast Deviation has been known since the raising of Modification Proposal 0511, Users may not be adequately prepared for the implementation of Modification Proposal 0511. Additionally there has been confusion among Users about the effect of Modification 0496 "Improvements to NDM Demand Attribution". Generally, Transco would not recommend delay for such reasons. However, in regard to this Proposal, Transco believes there are additional reasons why a delay might be appropriate.

Recent workstream discussions have indicated that implementation of the Proposal might generate operational issues for Transco since Users might no longer be appropriately incentivised to track NDM demand nominations. This may have implications for operational balancing efficiency and Transco would welcome views on this interpretation of the impact of Modification Proposal 0511 as part of consultation responses.

Transco is also mindful that Modification Proposal 0479 "Incentivised Nominations Scheme" will be introduced which has been designed to enhance the system balancing action decision making process. Implementing INS on 1st October 2002 with the removal of the NDM Forecast Deviation at a later date may, therefore, better enable an assessment of the efficacy of both regime changes.

Transco, therefore, believes that there may be merit in considering a delayed implementation date for Modification Proposal 0511 that would allow individual Users time to assess the demand information recently released by Transco to support and potentially enhance User NDM demand risk management capabilities. Additionally, such delay might enable the Review Group to consider a range of issues that might be considered to assist regime operation when Modification Proposal 0511 is implemented. These might include means by which Users could advise Transco of their NDM demand forecasts, whether additional NDM Demand Attribution runs might be helpful to Users and the manner in which Transco might be able to use such information to inform its balancing action decisions. As such, Transco believes that a short delay to the implementation of Modification Proposal 0511 may be worthy of consideration.

3. Extent to which the proposed modification would better facilitate the relevant objectives

Given the level of concern expressed by Users regarding their ability to respond, some additional time to prepare for the implementation of Modification Proposal 0511 may be appropriate. For this reason this Proposal may facilitate the Relevant Objective of securing effective competition between shippers and between suppliers. The proposed delay might

assist Users to be in a position to compete effectively from the moment that the 0511 Modification Proposal is implemented rather than being prematurely exposed to risks to which they may be unable to respond.

This delay will also provide time for the industry to consider the initial work envisaged to be covered by the Review Group 0567. This Review Group may assist establishment of how Users may better respond to the assumed incentives provided by Modification Proposal 0511.

**4. The implications for Transco of implementing the Modification Proposal , including
a) implications for the operation of the System:**

Modification Proposal 0511 increases Users' exposure to marginal priced cashout. It has been suggested that this might therefore increase User incentives to balance. As such delaying the introduction of Modification Proposal 0511 could be considered to reduce Users' balancing incentives which, in turn, may result in more system balancing actions being taken by Transco than would otherwise have been had Modification Proposal 0511 been implemented to the initial timetable. However, as stated in the final Modification Report for Modification Proposal 0511, the introduction of Modification Proposal 0511 is *"only likely to improve the operation of the system if Transco were to have information about the individual User forecasts of NDM demand and Transco were able to use such information to generate more accurate forecasts in inform system operation and the system balancing decision making process"*.

"The balancing decision making process depends on the assessment of the difference between the forecasts of inputs and outputs. Transco forecasts of offtakes from the NTS take account of aggregate LDZ level demand projections. These forecasts take account of large DM nomination information provided by Users and, where appropriate, end users. Transco takes balancing actions and manages flows across the NTS/LDZ interface based upon these forecasts. Transco's ability to make accurate forecasts will not be improved by this [0511] Proposal and therefore Transco believe that this [0511] Proposal will have only minimal impacts on the operation of the system."

Given that the introduction of Modification Proposal 0511 is expected to have minimal impacts on system operation, any delay to the introduction of the Proposal could also be expected to have minimal impact.

However, it may also be considered that introducing Modification Proposal 0511 before Users can acquire, or develop internally, skills or tools to enable them to respond to the incentive, would expose Users to unavoidable risk. Exposing Users to such risks may distort their balancing behaviour to an extent that incentives to balance are reduced thus increasing the overall system imbalance and increasing the level of uncertainty experience by Transco in assessing the requirement for a system balancing action.

Transco would welcome the views of respondents to the above as part of their representations to this Proposal.

b) development and capital cost and operating cost implications:

Transco does not consider there to be any implications in this area.

c) extent to which it is appropriate for Transco to recover the costs, and proposal for the most appropriate way for Transco to recover the costs:

Transco does not consider there to be any implications in this area.

d) analysis of the consequences (if any) this proposal would have on price regulation:

Transco does not consider there to be any implications in this area.

5. The consequence of implementing the Modification Proposal on the level of contractual risk to Transco under the Network Code as modified by the Modification Proposal

Transco does not consider there to be any implications in this area.

6. The development implications and other implications for computer systems of Transco and related computer systems of Users

As the Proposal seeks to delay the implementation of Modification Proposal 0511 the effects on Transco's system developments are minimal. The Proposal would appear to assist Users in the development of their systems to support the introduction of Modification Proposal 0511 by allowing them additional time to develop appropriate forecasting tools. However, Transco would welcome representations on this issue.

7. The implications of implementing the Modification Proposal for Users

By delaying implementation of Modification Proposal 0511, this Proposal would allow Users additional time to respond to the revised incentives. The delay will enable Users to acquire and the additional information which might be needed to develop improved demand forecasting and to build, develop and/or purchase new or additional risk management tools.

In addition Modification Proposal 0553 "Amendment of Imbalance Calculations to Enable Elective Aggregation of Demand Across One or More Shipper IDs" could provide a potential risk management tool for the effects of Modification Proposal 0511. This Proposal would allow time for this new risk management tool to be developed and introduced.

8. The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non-Network Code Party

Transco does not consider there to be any implications in this area but would welcome representations in this area.

9. Consequences on the legislative and regulatory obligations and contractual relationships of Transco and each User and Non-Network Code Party of implementing the Modification Proposal

Transco does not consider there to be any implications in this area but would welcome representations in this area.

10. Analysis of any advantages or disadvantages of implementation of the Modification Proposal

Advantages:

- The Proposal maintains the incentive properties of Modification Proposal 0511 whilst allowing additional time for Users to respond to the revised incentive by developing risk management and forecasting tools, thus temporarily protecting Users from exposure to risks to which, in the short term, they may be unable to respond.
- The Proposal may provide time for the industry to establish and commence a review of the NDM forecasting and attribution process before Modification Proposal 0511 is implemented.
- The Proposal would also allow time for the industry to assess the impact of Modification Proposal 0496 "Improvements to NDM Demand Attribution" and potentially introduce changes associated with Modification Proposal 0553 "Amendment of Imbalance Calculations to enable the Elective Aggregation of Demand across one or more Shipper ID's".

Disadvantages:

- The Proposal will delay the introduction of Modification Proposal 0511 which, in itself, increases Users' incentive to balance. As such any reduction in overall system imbalance, that may have been expected to have been generated by this increased marginal priced cashout exposure, will not be realised for a further 12 months. This may lead to Transco taking additional system balancing actions over and above those necessary if 0511 was implemented on 1st October 2002.
- This Proposal delays the removal of an imbalance tolerance quantity. In its decision letter for Modification Proposal 0511 Ofgem stated that this "*deviation tolerance may create a cross-subsidy from DM to NDM cutomers*".

11. Summary of the Representations (to the extent that the import of those representations are not reflected elsewhere in the Modification Report)

To be completed following consultation period.

12. The extent to which the implementation is required to enable Transco to facilitate compliance with safety or other legislation

None

13. The extent to which the implementation is required having regard to any proposed change in the methodology established under Standard Condition 4(5) or the statement furnished by Transco under Standard Condition 4(1) of the Licence

None

14. Programme of works required as a consequence of implementing the Modification Proposal

Current systems developments associated with Modification Proposal 0511 would be completed but implementation delayed to reflect any new implementation date established by this Proposal.

15. Proposed implementation timetable (including timetable for any necessary information systems changes)

The current Proposal is to delay implementation of Modification Proposal 0511 "Removal of NDM Forecast Deviation from Imbalance Calculations" until 1st October 2003.

Timetable as follows:

Modification Panel decision ("to consultation")	18/07/2002
Draft Modification Report Published	23/07/2002
Industry Consultation close out	13/08/2002
Final Modification Report published	23/08/2002
Anticipated Ofgem Decision	13/09/2002
Proposed Implementation date	01/10/2003

16. Recommendation concerning the implementation of the Modification Proposal

17. Text

Representations are now sought in respect of this Draft Report and prior to Transco finalising the Report

Signed for and on behalf of Transco.

Signature:

Tim Davis
Head of Regulation NT&T

Date: