

Direct Dial: 020 7901 7374

14 January 2003

Shippers, Transco and Other Interested Parties

Our Ref: Net/Cod/Mod/590

Dear Colleague,

Network Code Modification Proposal 0590 “Provision of Additional Within Day Demand Forecast and Demand Attribution Run”

Ofgem has considered the issues raised in network code modification proposal 0590 ‘Provision of Additional Within Day Demand Forecast and Demand Attribution Run’. Ofgem has decided to direct Transco to implement the modification because Ofgem considers that this proposal will better facilitate the relevant objectives of Transco’s network code.

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

Background to the proposal

The current gas balancing regime provides shippers with incentives to balance their demand and supply over the gas day. Imbalances between shippers’ supply and demand over the gas day are cashed out. If a shipper does not deliver enough gas onto the system to meet its customers demand, it is short of gas and pays Transco the system marginal buy price¹ (SMPbuy) for the gas it is short. If a shipper delivers more gas onto the system than is demanded by its customers, it is long of gas, and receives from Transco the system marginal sell price² (SMPsell) for the gas it is long. The costs or revenues incurred or received by Transco for cash out are redistributed amongst all shippers based on the amount of gas put through Transco’s system.

¹ SMPbuy is set by the higher of the highest priced Transco buy trade on the gas day and the System Average Price (SAP) plus a fixed differential of 0.20287 p/kWh.

² SMPsell is set by the lower of the lowest priced Transco sell trade on the gas day or SAP less a fixed differential of 0.0324p/kWh.

In May 2002, Ofgem approved network code modification 511 'Removal of the NDM forecast deviation from imbalance calculations'. This tolerance, which was removed with effect from 1 October 2002, was intended to mitigate shippers imbalance risk arising from errors in Transco's demand forecasting for non daily metered (NDM) supply points.

Transco's NDM forecast demand is a function of total local distribution zone (LDZ) forecast demand and daily metered (DM) nominations. Transco forecasts each shipper's NDM demand portfolio for each LDZ based on demand algorithms. The network code currently requires Transco to notify users of forecast demand and demand attribution twice on the preceding day and three times on the gas day, with the last notification being issued no later than 18:00 hours. In addition, Transco may notify demand at other times on the gas day, when it appears that the prevailing forecast LDZ demand may be substantially inaccurate. Five days after the gas day (D+5), Transco allocates each shipper's final NDM demand allocation for each LDZ by deducting actual DM metered quantities from metered LDZ demand to obtain aggregate NDM demand, which is then apportioned to users. After cash out, industrial and commercial customers are reconciled on their meter reads and domestic consumption is reallocated based on these industrial and commercial meter reads. Reconciliation charges are paid or charged to shippers at SAP.

In July 2002, network code review group 567 'Review of NDM demand forecasting methodology' was set up. This review group was initiated with the purpose of assessing inter alia the NDM demand forecasting methodology and the basis and use of NDM demand projections in light of the forthcoming implementation of network code modification 511. It was recognised that as a consequence of modification 511 users would have an incentive to achieve a closer daily supply/demand balance, with the effect of decreasing the role of Transco as residual balancer. However, SSE believed that this change could only improve the operation of the system if users with NDM portfolios had access to effective tools to enable them to better forecast NDM demand and manage their imbalance exposures.

The proposal

Network code modification proposal 590 proposes to facilitate the provision of additional demand forecasting information to users within day by stipulating a later time at which Transco must notify users of its latest demand forecast and update each user's NDM output nomination.

In particular, it is proposed that the additional demand forecast and demand attribution run are provided by no later than 21:30 on the day. In doing so, Transco should make use of the latest weather data, DM nominations and metered information available at that time.

Modification proposal 590 was raised as part of the debate within review group 567. In its draft modification report, Transco expressed concerns about the substantial costs of procuring additional weather data from the Met Office as implied by the original proposal, and about the capability of the AT-link to allow for the implementation of the modification. The review group evaluated these concerns. The modification proposal was therefore amended. The modifications to the proposal removed the requirement on Transco to procure additional weather information, and gave Transco the discretion to decide whether an additional demand forecast and attribution run could be made available to shippers before the recommended implementation date for the modification.

Respondents' views

There were eight respondents to the proposal. All respondents supported the proposal. Most of the respondents argued that the accuracy of end-of-day demand forecasts tend to improve as the day progresses, because data used in the forecasting process becomes more certain.

In its draft modification report, Transco recommended not to implement the proposal because of the material cost of procuring additional weather data from the Met Office. Some respondents said that additional weather forecast data was not necessary to produce the extra demand forecast and attribution run and that the intent of the proposal was simply to take account of the latest gas flow information. One of these respondents agreed with Transco's statement in the draft modification report, that the weather information at that point in the day would have only a marginal bearing on demand forecasts as Transco mostly relies on actual flows being seen on the system. Another respondent suggested that this proposal be implemented without the requirement for additional weather data and that this possibility could be reviewed through a separate modification proposal. Another respondent stated that the additional weather information at 19:00 from the Met Office would be beneficial when Transco updates its demand forecast.

Several respondents stated that Transco should quantify the costs of procuring an additional weather forecast and inputting them in the system. A respondent stated that where cost is given as the main reason for Transco's views on a modification a clear cost benefit analysis should be provided.

Some respondents stated that a further attribution run at 24:00 would also be helpful. However, one respondent commented that an additional attribution run at midnight would be more likely to lead to more residual balancing actions by Transco as shippers would be less able to respond to any changes.

One respondent urged Transco to implement the modification proposal on the first available date in late January. Another respondent stated that if Transco were unable to give reassurance that implementation of this proposal would not cause further deterioration in the AT link performance, the modification should be delayed until it can be incorporated in the Gemini system.

Transco's view

Transco supported the proposal as revised. However, Transco stated that it is too early to assess fully whether sufficient improvement had been made to the IT system to allow for a robust provision of an additional attribution run. Transco considered that immediate implementation of the proposal may conflict with batch processing schedules already in place, with a high probability of deteriorating the performance of the AT link system. Transco indicated that AT link performance was adversely affected by the large increase of logical meters and that a programme of works has been initiated to rationalise AT link logical meters. This programme should deliver results by the end of March 2003. For these reasons, Transco recommended implementation of the modification proposal with effect from 1 April 2003. Transco also suggested that it should be allowed to use its discretion as to whether it can provide an additional demand attribution run before that date.

Transco indicated that the proposer had stated that the procurement of additional weather data from the Met Office was not the primary intention of the proposal and that it is satisfied that an additional receipt of weather data should not be included within the draft legal text of this proposal.

Ofgem's view

In Ofgem's decision letter for network code modification 511, we stated that as a consequence of this modification shippers will decide whether to use their own demand forecasting or Transco's forecast, considering the potential risks and costs associated with the cash-out regime. If some shippers are able to forecast their own demand and manage consequent cash-out risks better than other shippers, they will obtain a competitive advantage.

Ofgem believes that modification proposal 590, by requiring Transco to provide more accurate demand information later in the day, will give shippers a further opportunity to respond to later revisions of NDM demand forecast and therefore could increase their ability to balance to Transco's NDM demand allocation in D+5. This may in turn reduce the need for Transco to take balancing actions later within day. Ofgem believes that this should better facilitate the economic and efficient operation of Transco's pipeline system, given the current gas balancing regime, in which Transco provides demand forecasts for individual market participants.

Transco had originally stated that the procurement of additional weather information from the Met Office as part of the proposed additional attribution run would imply material costs that could outweigh the potential benefits deriving from the modification proposal. However, the proposer, participants at the meetings of Review Group 567 and some respondents have stated that additional weather data are not strictly necessary to produce the extra demand forecast and attribution run and that the intent of the proposal was to take account of the latest flow information. Therefore, the anticipated costs of implementing the modification proposal are not expected to be significant.

Ofgem is directing Transco to implement this modification proposal because it will improve the operation of the current gas balancing regime. However, as part of future developments of the gas balancing regime, Ofgem would expect shippers to become fully responsible for their own demand forecasting either by investing in internal resources or by acquiring such a service from external providers. Transco would still need to separately forecast demand at an aggregate level to fulfil its system operation role. This would make the current arrangements in gas more consistent with the electricity regime where market participants are responsible for producing their own demand forecasts and NGC only produces aggregate demand forecasts to fulfil its system operation role. We would therefore welcome any proposals to develop the regime in this way.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to consent to this modification, as we believe that it better facilitates the achievement of the relevant objectives as outlined under amended standard condition 9 of Transco's GT licence. In particular, Ofgem believes that this modification proposal better facilitates the economic and efficient operation of Transco's pipeline system, given the current gas balancing regime.

Ofgem expects Transco to implement the modification proposal with effect from 1 April 2003. This will allow additional time to Transco to complete its programme of enhancement of the IT systems, thereby ensuring a robust implementation of the modification proposal. Ofgem would also expect Transco to make use of its discretion as to whether it can provide an additional forecast demand and demand attribution run before that date.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number or Samanta Padalino on 020 7901 7033.

Yours sincerely,

Paul Smith
Head of Market Surveillance