OFGEM DECISION LETTER No. 0692

"Provision of Shrinkage Information : Gas Procurement & Disposals"
Version 1.0

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Shippers, Transco and other interested parties

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Dear Colleague

Network code modification proposal 0692 "Provision of Shrinkage Information: Gas Procurement & Disposals"

Ofgem[1] has carefully considered the issues raised in modification proposal 0692 to Transco's network code, "Publication of Shrinkage Information: Gas Procurement & Disposals".

Having had regard to the principal objective and statutory duties of the Authority, Ofgem has decided to direct Transco to implement modification proposal 0692 because Ofgem considers that the proposal will better facilitate the relevant objectives of Transco's network code under standard condition 9 of Transco's Gas Transporters (GT) licence. Ofgem considers that this decision is also consistent with its wider statutory duties[2].

In this letter, Ofgem explains the background to the modification proposal and give reasons for making its decision.

Background to the proposal

Shrinkage gas

Shrinkage gas is gas lost through the transportation system at both the Local Distribution Zone (LDZ) and National Transmission System (NTS) level. LDZ gas shrinkage includes gas lost through leakage, theft and gas used for operational purposes. NTS shrinkage gas includes own use gas[3], unaccounted for gas[4] and unbilled energy[5]. Transco recovers the costs associated with NTS shrinkage gas through the System Operator (SO) commodity charge whilst LDZ shrinkage gas is recovered as part of general transportation revenue.

The costs of NTS shrinkage can be influenced by Transco's actions as NTS SO. Transco has therefore been provided with financial incentives to manage shrinkage gas costs efficiently under its GT licence as part of its NTS SO incentives. The cost target is set by multiplying forecast volumes of shrinkage gas by a reference price derived using specified forward prices. The target costs levels have been set at £61.9m for 2003/04 and £82.6m for 2004/05. If costs are above the target, Transco faces 20% of the additional costs, whereas if costs are below the target level Transco receives 25% of the savings made. A cap of £4million and a collar of -£3million limit Transco's exposure under this incentive. Any balance is borne by shippers through the SO commodity charge.

Gas procured for shrinkage purposes is accounted for separately under Transco's Shrinkage Provider account. Under the network code, the Shrinkage Provider is treated as a User. However, it is currently not required to hold system capacity rights or to pay for capacity and commodity charges.

In terms of procuring shrinkage gas, in 1995, Transco entered into a long term bilateral contract with British Gas Trading (BGT) to purchase shrinkage gas at the beach. At the time, Transco and BGT were part of the same company. This contract is due to expire in September 2005. From 1 October 2002, Transco has had in place additional arrangements with other counterparties to meet its shrinkage gas requirements. Subsequently, following the approval of modification proposal 0599[6] on 29 August 2003, all shrinkage gas has to be procured by Transco at the NBP from 1 April 2004.

The procurement of gas services

As part of the development of Transco's SO incentives, Transco has been given greater discretion in procuring services for the purposes of system balancing, capacity management and residual gas balancing. For example, in the case of entry capacity management Transco is now able to enter into forward and option contracts for purchasing entry capacity ahead of the gas day. As a consequence of this increased freedom, Transco has been required to prepare Procurement Guidelines (PGs) and a System Management Principles Statement (SMPS). These are intended to aid transparency for market participants regarding the services that Transco is contracting for and to assist market participants in better understanding the principles that Transco will adopt in balancing the NTS.

Ofgem approved the form of both the PGs and SMPS in September 2002. In approving the form of the PGs, Ofgem raised concerns that the document should contain more information about Transco's procurement of system management services, such as shrinkage gas.

In terms of shrinkage contracting freedom, modification proposal 0579 "*Facilitation of shrinkage provider to make NBP trade disposals"* was approved by Ofgem on 3 February 2003. The modification allowed the Shrinkage Provider to sell any excess of gas acquired for shrinkage purposes at the NBP for any given gas day. In approving modification proposal 0579, Ofgem stated that Transco should ensure that it releases information on the procurement and sale of shrinkage gas through its PGs in order to aid market transparency.

Subsequently, in April 2003, Transco published its PGs Report for 1 April 2002 to 31 March 2003. Furthermore Transco has since published its PGs Report for 1 April 2003 to 31 March 2004. In both these reports Transco provided details of its shrinkage gas procurement for the previous year including monthly details of the quantity of gas purchased, the purchase cost and

the weighted average purchase price for that month. In addition, Transco published details of its imbalance cash-out volumes and costs for the shrinkage account for the previous year.

Modification proposal 0618 "Publication of shrinkage provider gas procurement and disposal information"

Modification proposal 0618 was raised by the London Electricity Group on 19 February 2003. This proposal sought to require that, for each gas day where the Shrinkage Provider has contracted to buy or sell gas, certain information should be provided by Transco ahead of and after that gas day. Ahead of the gas day, the following information would be required:

- Transco's unbiased estimate of shrinkage gas requirements for the next gas day;
- the volume of shrinkage gas purchased and sold before the day;
- the number of buy and sell trades executed in respect of that gas day; and
- the delivery point of all shrinkage gas bought and sold, whether at the NBP or at the beach.

Transco would also be required to publish the following information after the gas day:

- Transco's final net shrinkage position;
- the volume of shrinkage gas purchased and sold on the day;
- the total number of buy and sell trades executed in respect of that gas day;
- the weighted average price of all buys and sells;
- the delivery point of all shrinkage gas bought and sold, whether at the NBP or at the beach;
- the minimum price at which the shrinkage gas was bought;
- the maximum price at which the shrinkage gas was bought;
- the minimum price at which the shrinkage gas was sold; and
- the maximum price at which the shrinkage gas was sold.

Ofgem rejected this modification proposal but noted that the publication of up to date information as outlined in the proposal could, in principle, provide additional transparency and benefits to competition. Ofgem considered that the publication of day-ahead information about both the estimated shrinkage requirements and the shrinkage gas purchased could place the Shrinkage Provider at a commercial disadvantage, thereby impairing its ability to fulfil the network's daily gas shrinkage requirements. This could, in turn, increase the costs of managing the shrinkage gas account, thus hampering the efficient and economic operation by Transco of its pipeline system. Transco also expressed its intention to develop an alternative proposal to publish additional information about Transco's activities under the Shrinkage Provider account in line with the intent of modification proposal 0618.

The modification proposal

Modification proposal 0692 was proposed by Transco on 16 April 2004. It sought to require that, in respect of each gas day, the Shrinkage Provider should publish the following gas procurement and disposal information associated with Transco's NTS SO incentives:

- the net quantity of gas purchased and sold (kWh);
- the quantity of gas purchased (kWh);
- the quantity of gas sold (kWh);

- the total number of buy and sell trades executed;
- the weighted average price of all buys (p/kWh);
- the weighted average price of all sells (p/kWh);
- the minimum price at which the gas was bought (kWh);
- the maximum price at which the gas was bought (kWh);
- the minimum price at which the gas was sold (kWh); and
- the maximum price at which the gas was sold (kWh).

It was proposed that this information should be provided to Users in a readily accessible form and in a timely manner. The proposal was that the information should be published daily (on each business day) on a D+5 basis, in line with the Shrinkage Provider's internal operational and administrative processes in relation to this information.

Respondents' views

There were five responses all expressing support for this modification proposal. Several of respondents stated that the publication of ex-post information would increase the level of transparency of the Shrinkage Provider's operations and help the industry monitor Transco's performance in relation to its licence obligations and NTS SO incentives. Several of the respondents expressed support because this modification proposal would help to provide a level playing field allowing Transco and shippers to contract more efficiently for shrinkage requirements.

Furthermore, several of the respondents considered that there were merits in publishing ex-ante information with respect to the Shrinkage Provider. One of the respondents stated that because the Shrinkage Provider operates as a monopoly service provider, it should be the case that it is subject to a higher level of information release than would be expected from those operating under normal competitive arrangements. A respondent stated that, in its decision letter for modification proposal 0618, Ofgem considered that the publication of ex-ante information would be beneficial only if the information did not compromise the Shrinkage Provider's commercial position. Therefore, with this in mind, two of the respondents considered that there was ex-ante information which could be published without exposing the Shrinkage Provider's commercial position, such as information concerning the day-ahead net shrinkage position. These respondents considered that the release of this type of information would be useful for non-daily metered (NDM) shippers to allow them to better predict their NDM demand day ahead because the shrinkage gas is represented in the NDM forecast formula and may improve balancing performance. One respondent however, considered that publication of ex-ante shrinkage information could be prejudicial to the Shrinkage Provider's commercial operation.

One respondent also considered that although the modification proposal stated that the ex-post shrinkage information would be published on a D+5 basis, it thought that it would be more beneficial to use reasonable endeavours to publish this information as soon as possible after the day up to D+5. This respondent asked for Transco's and Ofgem's view on the proposed timing given that the one-off publication at D+5 may not provide shippers with sufficient time to analyse and respond to changing system demand levels after the day.

Transco's view

Transco supports this modification proposal and acknowledges that the industry requires greater information provision and increased transparency of incentivised activities which would allow

Users and non-network code parties to monitor the performance of Transco in the operation of its Shrinkage Provider activities against the NTS SO incentives. Transco also considers that the modification proposal would increase competition between Users for the provision of gas procurement and disposal arrangements to the Shrinkage Provider which could decrease the cost of shrinkage provision and may improve liquidity in the market for shrinkage gas management.

Transco considered that the proposed D+5 publication timescale is appropriate because it aligns the publication of this information to the Shrinkage Provider's internal operational and administrative activities which process and collate the relevant information. However, Transco also considered that, dependent on the liquidity of the gas market, the provision of the shrinkage information even at D+5 could place the Shrinkage Provider in a distressed commercial position.

Ofgem's view

Ofgem has carefully considered the views of all the respondents and Transco on modification proposal 0692. Having had regard to its principal objective, Ofgem considers that this modification proposal does better facilitate achievement of the relevant objectives (a) and (c) of Transco's network code. Ofgem also considers that this decision is consistent with its wider statutory duties.

Relevant objective 9(c) of the GT licence – securing effective competition between relevant shippers

Ofgem agrees with those respondents who considered that the publication of the proposed ex-post information should provide more transparency with respect to the Shrinkage Provider's procurement of gas shrinkage services. Ofgem considers that increased transparency in this area is appropriate following the increased discretion and contracting freedom which Transco has been given as part of the development of its SO incentives. Ofgem considers that increased transparency could enable increased liquidity and competition in the provision shrinkage services. Therefore, Ofgem considers that the publication of shrinkage information of the nature proposed should better facilitate competition between shippers seeking to offer system balancing services to Transco, thus better facilitating achievement of relevant objective 9 (c) Transco's network code.

Relevant objective 9(a) of the GT licence – the efficient and economic operation by the licensee of its pipe-line system

Ofgem notes that several respondents, and Transco, considered that the publication of the proposed information would enable the Shrinkage Provider to contract more efficiently for its shrinkage requirements. This was in part linked to the anticipated increase in competition referred to above. Ofgem agrees that the anticipated increase in competition between Users linked to the information provision referred to above could reduce the cost of shrinkage provision. Therefore, Ofgem considers that the proposed information release should better facilitate the efficient and economic operation by the licensee of its pipe-line system, thus better facilitating achievement of relevant objective 9 (a) Transco's network code.

Ofgem notes that a respondent considered that the increased ability of market participants to monitor the performance of Transco as Shrinkage Provider conferred by the proposed information release would help to facilitate the efficient and economic operation by the licensee of its pipe-line system. Ofgem agrees that it is appropriate for there to be increased

transparency of Transco's activities as Shrinkage Provider (which it undertakes as a monopoly SO) to enable market participants to assess its performance under the incentives.

Timing of information release

As previously discussed, this modification proposal seeks to provide ex-post information in relation to the Shrinkage Provider's activities on a D+5 basis. Ofgem notes that Transco considers that publishing the ex-post shrinkage information on this basis could place Transco in a distressed position. However, Ofgem does not consider that this possibility has been demonstrated and, as discussed above, considers the release of more information in this area to be advantageous.

Furthermore, Ofgem acknowledges that ideally it would be beneficial for the market to receive the ex-post information contained in this proposal as early after the day as possible and agrees with one of the respondents that Transco should use its reasonable endeavours to publish this information as soon as possible after the day. Ofgem acknowledges that the publication of the ex-post information on a D+5 basis has been aligned with the Shrinkage Provider's internal operational and administrative activities that process and collate the information. However, Ofgem would welcome further consideration of whether the ex-post reporting timescale could be shortened.

Additionally, in the electricity market, NGC, as SO, publishes a substantial amount of ex-ante and ex-post information with regard to its system operation activities on its information website. Ofgem is of the view that this proposal will bring about greater alignment between the timing of information provision by the relevant SO in the gas and electricity sectors. However, while Ofgem acknowledged the potential issues associated with ex-ante provision of shrinkage information in the context respect of modification proposal 0618, Ofgem considers that further consideration should be given to whether or not aggregated ex-ante information could be provided in this area which would not prejudice the relevant SO's commercial position.

Ofgem's decision

For the reasons outlined above, Ofgem has decided to direct Transco to implement network code modification proposal 0692 as it considers that the proposal better facilitates the achievement of the relevant objectives as outlined under standard condition 9 of Transco's GT licence and is consistent with the principal objective and statutory duties of the Authority. In particular, Ofgem considers that this modification proposal should better facilitate the securing of effective competition between relevant shippers and suppliers in the provision of shrinkage management services to Transco and therefore should better facilitate the efficient and economic operation of Transco's pipeline system.

If you have any queries in relation to the issues raised in this letter, please feel free to contact Simon Bradbury on 020 7901 7249 or Fiona Lewis on 020 7901 7436.

Yours sincerely

Steve Smith

Managing Director, Markets

[1] Ofgem is the office of the Gas and Electricity Authority. The terms 'Ofgem' and the 'Authority' are used interchangeably in this letter.

[2] Ofgem's principal objective and general duties are contained within section 4AA of the Gas Act 1986. Ofgem's principal objective is to protect the interests of consumers. In carrying out its functions, the Authority has regard to social and the environmental matters.

[3] Own use includes gas used for compression, venting and preheating.

[4] Unaccounted for gas arises from meter inaccuracies and discrepancies between measured flows and actual physical flows leading to differences in measured NTS entry and exit volumes.

[5] Unbilled energy is the result of differences between the actual calorific value of gas delivered onto the NTS and the average (flow weighted) Calorific value upon which billing is based.

[6] Modification proposal 0599: "Obligation on shrinkage provider to purchase gas at the NBP".