TRANSCO WORKSTREAM REPORT

"Reform of Energy Balancing Regime"
Version 1.0

Review Group 0513 –Reform of the Energy Balancing Regime

2nd Workstream Report – For June Modification Panel

Background to this Report

This report provides further information about the progress of Review Group 0513 since the 1st Workstream Report was submitted to the May Modification Panel. This report will be verbally presented to the June Modification Panel and focuses on the work and key findings from the 22nd May and 12th June meetings.

Transco and Shipper Incentive Structures & Interactions

The Review Group noted that regime performance depends critically on the incentive structures within the regime, particularly those associated with shippers and Transco, and the complex behavioural interactions between industry players. Specifically the Review Group noted that the Network Code incentivises contract parties in respect of "end of day" performance, namely:

- Each shipper to achieve a gas balance (based on the net of gas entered, offtaken and traded on the system) and accurate locational nominations (promoting nominations at the end of the day close to gas flow allocations)
- Transco to achieve an efficient trade-off between day on day linepack change and the price efficiency of market balancing actions.

The Review Group noted that the changes introduced as part of the New Gas Trading Arrangements (NGTA) had increased the commercial freedom of both Transco and Shippers and may have better facilitated the within day gas market. However the associated behavioural interactions between all industry players and the evolution of their balancing policies may have contributed to the increase in within day linepack variation that has occurred since NGTA. The Review Group noted that these variations exceed those envisaged as part of the underlying system design and operational assumptions. Specifically the Review Group noted that particularly early in the day, the mismatch between nominated inputs and offtakes from the system was generating within day linepack variations.

The Review Group noted that any proposals designed to enhance the operation of the regime should consider the impact of any incentive changes, and particularly shipper/Transco interactions.

Transco Balancing Tools

The Review Group noted that Transco balancing policy had evolved since the introduction of NGTA in the light of experience and regime performance discussions with industry stakeholders, particularly shippers and Ofgem.

The Review Group noted the difficulties associated with assessing the “physical performance” of the OCM balancing tool, particularly in respect of the use of the Title market.

Given the tendency for shippers, in aggregate, to get closer to balance later in the day and the price premia associated with the OCM Physical/Locational markets Transco balancing policy has evolved to reduce the likelihood of actions early in the day and to focus activity in the Title market.

Analysis has indicated that the OCM Physical/Locational markets generally give rise to timely flow rate changes. The Review Group noted that Transco is required to choose between the greater certainty and cost of the Physical/Locational markets and the commercial efficiency of the Title market.

The Review Group noted that Transco’s balancing tools were “fit for purpose” to secure the safe operation of the regime provided regime performance did not further deteriorate. However, Transco pointed out that if within day linepack variations increased then Transco might need to increase utilization of the OCM for within day linepack management purposes. Such OCM usage might give rise to increased balancing costs which would be smeared to all shippers inputting or offtaking from the system.

The Review Group agreed, as part of the next phase of the review, to assess options regarding application of current balancing tools and the development of additional tools.

Identification of the Strengths and Weaknesses of the Current Regime

The Review Group has developed, refined and prioritised a set of strengths and weaknesses aligned to the various stakeholders in the regime. This list will be reviewed again at the 26th June 2002 meeting. However the majority of Review Group participants were of the opinion that the only weaknesses that might require reform of the regime were those identified by Transco, and potentially those identified by Ofgem which will be confirmed at the next meeting.

Regime Objectives

The Review Group has agreed that the gas balancing regime should be structured to deliver:

- an overall efficient level of regime cost,
- competitive gas markets,
- a simple commercial regime compatible with key operational parameters,

and secondly;

- appropriate targeting of balancing costs
- appropriate commercial incentives on Shippers to balance
- incentives on Transco to deliver efficient residual system balancing
- improved information flows

Next Steps and Work Programme

The Review Group noted that Transco had indicated that, with current levels of linepack variation, it has adequate tools to manage the system. Whilst many Review Group participants identified there is a concern associated with the potential escalation of costs and the allocation of these costs, few participants were convinced that present costs were at inappropriate levels or trending towards an escalation. Transco indicated that increased linepack variation may jeopardise both the effectiveness and commercial efficiency of current balancing tools.

The Review Group agreed that any potential reform needed to be considered in the context of the identified weaknesses of the regime. Any such consideration should however also consider the potentially detrimental effect of a change on the agreed strengths of the regime. Any potential changes would further need consideration against the desired regime objectives.

The initial focus of the Review Group for Phase III – "Identify alternative proposals to enhance efficiency of regime operation" will involve consideration of what the Review Group classified as "incremental reform". The Review Group noted that it would only seek to develop what it classified as "fundamental" reform if the "incremental" reforms are considered to be ineffective in delivering a sustainable regime.

The Review Group will therefore develop initial strawman proposals for the 26th June Review Group session in the following areas:

- Shipper incentives to balance own inputs and outputs by the end of the gas day
- Shipper incentives to provide robust information to Transco regarding end of day flows
- Transco residual gas balancing incentive arrangements
- Transco balancing policy
    - application of current balancing tools
    - development of alternative balancing tools
    - within day information released by Transco
- End of day linepack service
- Physical flow rates on or off of the system
    - incentives to flow close to agreed flow notifications
    - incentives for flows consistent with uniform flow rate assumption
    - scheduling incentives.

Development will be undertaken by various stakeholders ahead of the 26th June meeting to facilitate consideration and refinement of the proposals to establish whether such proposals might afford the opportunity of delivering a sustainable regime thereby avoiding the need for consideration of more "fundamental" reform.

Future Meeting Schedule

26th June
10th July
24th July
7th August