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Dear Sonia

Impact Assessment Modification UNC 006 (0727): Publication of Near Real Time Data at UK sub-terminals

BG Gas Services Limited (BG) welcomes the opportunity to respond to Ofgem's consultation. We support Ofgem's attempts to distinguish between the effect of the modification proposal and more general increased information release using the DTI information initiative as a "baseline". We do however have concerns with the analysis:

- The potential benefits to the market from an increase in information available to all market participants are at best difficult to quantify. This difficulty is further increased through the need to distinguish between benefits from the release of near real time sub-terminal flow information and benefits derived from the full implementation of the DTI information initiative. In many cases Ofgem has had no option but to make significant assumptions over the size and source of benefits.
- Conversely while Ofgem considers the "direct" costs of the implementation of the Modification such as IT costs and contract re-negotiation, it makes the significant assumption that there are no negative effects on the market of the implementation of the Modification. In particular it assumes that disaggregation of flow information does not increase the commercial risks borne by parties with physical gas positions. It therefore assumes that there are no consequential effects of increased risks on investment decisions and the long term operation of the market.

Our most significant concern with this Modification remains unchanged and in many ways is made more evident by the difficulty Ofgem has had in quantifying the impact of the release of sub terminal information. The Modification causes a potential disruption to the market for uncertain benefits and does not allow for an incremental approach to be taken which assesses the effect of the voluntary agreement reached as part of the DTI information initiative prior to any further changes to the regime.

Cost Benefit Analysis

While we agree that economic theory suggests that improved information flows generally improve the efficiency of markets, we remain sceptical over the benefit of the specific proposal in the context of the UK gas market. While we may disagree with the emphasis of some of the positions taken by

Ofgem in Section 4 of its consultation rather than repeat in detail our responses on the more general issues of information release we refer you to our initial response to the Modification proposal dated March 2^{nd} 2005 and our response to Ofgem's consultation on "Offshore gas production information disclosure" dated March 15^{th} 2005. Here we will concentrate our comments on the analysis of the specific proposal as set out in Section 5 of the document.

• Economic Signals

Ofgem has understandably found it difficult to provide a quantifiable estimate of the benefit of increased economic signals. The NBP market clears at an aggregate level, it is therefore difficult to see how disaggregation of information would send clearer economic signals to market participants. Localised capacity constraints which may have an effect on aggregate supply are signalled via Transco action in the capacity market so it is unclear how disaggregation gives any signals other than information regarding the positions of individual market participants.

• System Balancing

Ofgem estimates a benefit of £5m through increased efficiency of balancing through a decreased role for Transco in signalling outages to the market through its actions. This estimate is based on a number of assumptions.

1) The market is more efficient than Transco in balancing the system.

2) On days when Transco actions coincide with physical supply shortages increased market balancing will result in lower wholesale gas price increases. (an assumed 1p/th saving against an average price increase of 3.2p/th)

3) 2/3 of this saving will be passed through to final customer prices (and implicitly is a pure welfare gain and not a transfer)

4) The data from winter 2004/2005 is a sufficient sample to assess this proposal.

Ofgem's estimate of £5m is likely to be highly sensitive to changes in these assumptions. More importantly, Ofgem assume that of the estimated benefit 50% would be directly attributable to the disaggregation of information. As we have stated above, given the market balances at the NBP it is unclear how disaggregation increases the ability of market participants to balance.

Market Volatility

Ofgem estimates a benefit of >£3.8m through a reduction in spreads caused by a reduction in volatility caused by disaggregation of information. Again this analysis is based on a number of assumptions. 1) Market spreads will tighten by 0.05p/th

2) This results in a real welfare gain, not an economic transfer. (The Oxera paper quoted as estimating benefits in the range of $\pm 3.8 \pm 17.3$ m recognises that this is a transfer and estimates the real welfare gain from increased volumes of trades at less than ± 0.1 m)

3) There is no negative effect on volatility caused by the increased information available to the market on the positions of participants exposed to physical asset performance and the increased risks these participants face.

Finally, it is unclear how disaggregation of information in a market which clears at the NBP will increase market participants ability to better understand the physical supply/demand balance and thereby reduce market volatility.

• Market Perception and Liquidity, Impact on Customers and Security of Supply

Ofgem do not quantify the benefits of the proposal in these areas but assume that they will be positive in the case of "Market Perception and Liquidity" and the "Impact on Customers" in that either new entrants will be attracted to the market or existing demand side participants will increase their involvement in the market. In the case of "Security of Supply" Ofgem assume that disaggregation will allow shippers to better understand the operation of the market. In the short term this will increase their ability to balance and in the longer term enable shippers to better understand physical flow patterns increasing security of supply.

Again these potential benefits are reliant upon the assumption that disaggregation provides a positive benefit in understanding the operation of the NBP market. Furthermore it assumes that disaggregation does not increase the risks of physical market participants. If this assumption is incorrect it is arguable that there may be a cost in terms of reduced market entry and security of supply if on the margin participants are disincentivised to invest in physical assets.

• Disaggregation and the effect on individual commercial positions

In the UK market the contractual holdings of various shippers at various entry points are widely known or can be quickly deduced from trading activity in locational gas or capacity. Real time disaggregated information would effectively give the market information on the position of shippers with known physical flows at a sub-terminal. For example, in the case of a sub-terminal "trip", the market would know that a shipper was short and that shipper would be in the position of being a "distressed buyer" of gas. In the long term, the consequence of potential exposure as a distressed buyer will be an increase in the commercial risks associated with physically supplying gas to the UK market.

It has been suggested that such concerns can be addressed through contract re-negotiation. This not only ignores the costs and complexity of contractual re-negotiations; it also to some extent misses the point that residual physical performance risk will always exist in a commodity market. If gas, which is planned to be delivered to the system is not delivered, then a market participant that was expecting that gas to be delivered will be "more short" than they intended and will be a distressed buyer.

Ofgem suggest in their document that this is not likely to be a material issue as the majority of subterminals are supplied by a multitude of fields owned by a number of producers. Furthermore on average outages are less than 20% of sub-terminal flows. Therefore producers will face minimal commercial risks under this proposal. We have a number of significant concerns with this analysis.

1) Ofgem's analysis deals with "average" outages. Commercial risk and exposure increase exponentially as non-average outages occur. For example, a 100% outage at a sub terminal is likely to have a greater than fivefold impact on the market than a 20% outage. In such a situation it would also be apparent to the market that all producers flowing at the sub-terminal were short of gas.

2) The "average" outage quoted by Ofgem deals with daily deliverability. It is likely that in many cases flows that are 20% below max for the day have been caused by a within day outage significantly affecting sub-terminal flows for a more limited period. For example, in a day daily deliverability may be 25% below max, but this has been caused by a 100% outage lasting for six hours. For the period of the outage it would be obvious to the market that all producers flowing at a sub-terminal were short gas.

3) The normal deliverability of various fields to a sub-terminal are widely known. A reduction in within day flows can often be identified as the approximate deliverability of a specific field. In such a situation the wider market can determine which field has "tripped" and thereby identity the shippers short of gas.

Issues not considered in this response

Notwithstanding the above arguments, we have not considered the possible effect of the implementation of the modification on perceived regulatory risk and confidence in the regulatory regime. Nor have we examined in detail the direct costs and difficulties surrounding technical implementation of the modification. These issues are difficult to quantify and have been raised by BG in the past. In any event even without considering these potential costs we do not see a convincing case for a positive benefit to the market on the basis of the information and analysis available to Ofgem at this time.

Conclusion

We repeat our conclusion from our initial response to the Modification proposal that is not clear to BG that the levels of information available to the wider market on offshore production have been in any way detrimental to the operation of the UK gas market. However, BG recognises that there have been concerns expressed over information and that is why it supported the voluntary agreement between Ofgem, DTI, Transco and the offshore community. It is in BG's view a considered compromise which balances the desire of some to release more information to the market on the aggregate physical position of the system with the need to protect the confidentiality of individual market participants' commercial positions. Given the lack of any clear benefits from the implementation of the Modification it would seem prudent to allow the implementation of the regime are implemented.

Yours sincerely,

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