

Response to Ofgem's May 2005 Impact Assessment on 3rd Party Proposal on Publication of Near Real Time Data at UK sub-terminals (Modification Reference Number UNC 006)

1. The Introduction to the Summary to the document describes the proposed modification as relating to the increased provision to the market of offshore gas production information. This is a worrying mischaracterisation of the proposal. It actually relates to flows into the NTS whether from the UK upstream (onshore as well as offshore), Norwegian upstream, interconnectors or storage; in future the new LNG import facilities would also be caught.

2. The impact assessment includes a table which summarises Ofgem's views of the costs and benefits of the proposal, above the current baseline. Where Ofgem has not been able to quantify the cost and benefits a qualitative assessment has been made. It is claimed that the table also outlines Ofgem's views of the likely risks and unintended consequences of implementing the proposal and an assessment of the probability of these occurring. In fact, there is very little assessment by Ofgem of the probability of these occurring beyond a general assessment in terms such as "Low". However the costs of risks and unintended consequences are treated, the impact assessment should still have attempted to quantify the probabilities (or "risks") associated with these costs.

3. My own version of how I think the table should look is as follows (alongside Ofgem's):

Summary of estimated annual costs and benefits compared to the baseline

	Ofgem's view		Alternative view	
Benefits				
♦ Economy and efficiency				
o Economic signals	✓✓		-	
o System balancing	£2.5m		-	
o Market volatility	>£3.8m		x	
o Market perception and liquidity	✓		-	
♦ Security of supply				
o Short term	✓		-	
o Long term	✓		xx	
♦ Impact on customers	-		-	
♦ Environmental impact	-		-	
Costs				
♦ IT costs	£0.65m		£0.65m	
♦ Contract renegotiation	xx		xx	
Risks				
	Impact	Probability	Impact	Probability
♦ Withdrawal of information	xxx	Low	x	High
♦ Duplicate metering	xx	Low	<£20m	High
♦ Data accuracy	x	Low	xx	Low
♦ Ownership of data	x	Low	x	Low

On the basis of my judgemental assessment, there seems to be no case for proceeding with the proposed modification.

4. What is the relevance of the description of section 35 of the Gas Act 1986 (paragraph 2.5)? The proposed modification would not lead to *Ofgem* publishing any information.

5. Paragraph 2.69 says that *Ofgem* continues to support the DTI in seeking a voluntary arrangement for the disclosure of offshore information. If *Ofgem* were to approve the proposed modification then, given the likely adverse reaction of the upstream parties to the agreement, it would seem that this statement cannot be relied upon.

6. Phase 1 information is described incorrectly in Table 2.1. It is also not published, since it goes only to Transco.

7. Paragraph 2.71 says that, in relation to the proposal, the most relevant information to be released under the DTI information initiative is that due soon to be released under Phase 3 Category 1. In fact, Phase 3 Category 4 information seems to be just as relevant (see also paragraphs 5.9 and 5.21).

8. Paragraph 2.78 says that any decision taken by the Authority in respect of the derogation will not affect this proposal. In fact, the decision on the derogation might affect producers' willingness to participate in the voluntary agreement.

9. The point made in paragraph 2.85 that the costs of disrupting the DTI information initiative on the release of offshore information would in *Ofgem*'s opinion have outweighed the potential benefits associated with modification proposal 0593 would also seem to be the case in respect of modification proposal 006.

10. Why has *Ofgem* considered only the two options identified in paragraph 5.2? What about considering if there are alternative ways of achieving the desired outcome? No consideration is given to the timing of the change proposed - whether it would be better to leave things as they are for now and reconsider later on in the light of evidence on the value of Phase 3 Category 1 and 4 data. The proposal can be considered as an extension to either, in terms of timeliness and temporal disaggregation (Category 4 - subject to the 10 mcm/day restriction) or spatial disaggregation (Category 1).

11. In paragraph 5.5, Phase 2 Category 1 should read Phase 3 Category 1.

12. It is not clear exactly what information *Ofgem* is consulting on. Is *Ofgem* assuming that the information to be made available if the proposal were to be approved is real time (as in the proposal) or on the same near-to-real time basis as Phase 3 Category 1 data will be made available (see paragraph 5.8). Despite the three dimensions distinguished in paragraph 5.7, there is little or no discussion of the value, if any, of truly real time versus near-to-real time data and no proper discussion

of the incremental value of more disaggregated (i.e. hourly rather than daily) or more timely data.

13. The impact assessment does not indicate which current *or planned* entry points would be excluded by the 10 mcm/day threshold (see e.g. paragraph 5.9, where this should have been done). There is also no discussion in the impact assessment of the differences between flows into the NTS from the "offshore" or from storage sites. As mentioned previously, the proposal relates to flows into the NTS whether from the UK upstream (onshore as well as offshore), Norwegian upstream, interconnectors or storage; in future the new LNG import facilities would also be caught. There is no discussion of the distinction between gross and net flows into the NTS from interconnectors and storage or whether the proposal would make (better) sense (only) if equivalent information were to be published about offtakes from the NTS (whether into storage or interconnectors or by major users).

14. It is to be hoped that Figure 5.2 is not intended to be to scale. It is difficult to believe that Ofgem considers the range of gross benefits of the proposed modification to be greater than the range of its actual costs or potential risks (as Ofgem terms potential costs) or that Ofgem believes that the benefits exceed those of "existing" information (presumably meaning information existing before the voluntary agreement between DTI, Ofgem, Transco, DFOs and SFOs) and the information (to be) released under the voluntary agreement. It is difficult to see how the benefits from the additional information that would be released if the proposed modification went ahead could be as great as that from Phase 3 categories 1 and 4.

15. The baseline Ofgem have adopted - i.e. looking at the incremental costs and benefits of the proposed modification over and above the full information available under the voluntary agreement - is the only sensible one (paragraph 5.19). However, since not all of that baseline information is yet being published, it is difficult if not impossible to make an informed assessment of the benefits of yet further information being published. Since publication of Phase 3 Category 1 information is due to commence so soon, it would seem to make sense to take stock and assess whether the expected benefits materialise before going further. Another concern is that it is not clear, despite the attempt to consider only the incremental benefits and costs of the proposed modification in Chapter 5 of the impact assessment, that those are the only benefits and costs that are being considered (see, for example, the discussion below of the summer 2003 interruptions).

16. Paragraph 5.20 says that Ofgem considers the key areas where incremental benefits of the proposal could be achieved relate to the fact that the release of the proposed additional information on entry flows could allow for an improved understanding of the supply curve by a significant number of market participants and allow for an increased level of responsiveness to short term market conditions. There is no proper discussion of how this is expected to happen or of the extent of the improvement in understanding or responsiveness. Paragraph 5.21 says that the potential benefits of the proposal will depend to a significant extent on the benefits of

market participants being able to observe - after only a short time delay - short-term fluctuations in the level of supply by entry point rather than simply being able to observe short-term fluctuations in the level of north-south aggregated flows. That characterisation ignores the extent to which disaggregated information on flows at sub-terminal level is already available on a daily rather than hourly basis.

17. Paragraph 5.22 asserts that "The increase in the level of disaggregation under the proposal should also enable market participants to more readily identify actual supply issues from the 'noise' of movements in supply and therefore respond accordingly." There would in fact be an increased amount of "noise" and no more disaggregation than is already available (albeit after the day). It is also not clear that knowledge of actual supply issues (to the extent that it would come from publication of near-to-real time flows at major sub-terminal level, which is highly questionable - see below) would or should change market participants' responses. If and when those shippers affected by "supply issues" need to react to them by entering the market to make good a shortfall of gas within the day, they will signal their need through increased demand which should put upward pressure on prices to which the best placed market participant can react. If market participants react to partial information of the sort that would result from the proposed modification, as they apparently do at present to rumours, there is a risk of over-reaction as there is no co-ordination of responses and the likelihood that the response will be inefficient. The impact assessment does not explain why it is important for market participants to be able to identify supply issues within day. The aggregation to sub-terminal level will preclude the ability to be sure which field is responsible for a change in flows into the NTS or whether the cause is due to a change in nominations or a planned or unplanned "outage". And, as the impact assessment notes, as the proposal does not require the publication of information where capacity is under 10 mcm/day, there would be limitations in respect of the level of information to which market participants could anyway respond.

18. In contrast to the position Ofgem has taken in paragraph 5.25, it is not clear how the provision of the additional information on near-to-real time flows at major sub-terminals could make a material difference to market participants' understanding of offshore reliability or the economics of flexible supply, since the additional information would not identify the actual source of supply and temporally would go below the balancing period.

19. The discussion of the summer 2003 interruptions in Chapter 5 seems to be misplaced if not actually disingenuous. Ofgem says that it appears (to Ofgem?) that a lack of information at sub-terminal level *may* have impacted on the ability of market participants to provide timely and effective responses to a gas supply shortfall offshore, thereby requiring Transco NTS to enter the market and trade on the OCM where there was limited response from shippers. Ofgem have never explained how additional information would have made a difference. Is the suggestion that had information on sub-terminal level flows been available hour by hour, resulting in shippers knowing (or at least believing) that there was a locational shortfall, those

shippers would have voluntarily sold gas to other shippers or to Transco to make good the locational shortfall? Since they did not react to price signals when Transco tried to buy locational gas on the OCM, why would they have acted altruistically in response to information?

20. Further, in relation to the period of the summer 2003 interruptions, paragraph 4.8 says that "As part of its analysis of the activities over this period, Ofgem considers that this limited response appears to have been partly a function of a lack of sufficient information made available to the market. That is, because only a limited number of parties had access to the information regarding the relevant offshore situation at that time, these were the only market participants that could have reasonably responded in a timely manner to assist the SO's requirements. Given asymmetric access to relevant information, other parties were not sufficiently informed as to where the offshore failure occurred in enough time to respond." Why did anyone need to know there was a problem to respond to higher demand for locational gas on the OCM? The Ofgem conclusions document does *not* provide any evidence in support of the Ofgem position.

21. Ofgem asserts (paragraph 5.28) that the example of the summer 2003 interruptions highlights the potential for timely economic signals to improve the efficient operation of the market and that, had timely and enhanced information been available to the market at sub-terminal level over this period, the market may have been able to respond earlier and with alternative supply sources potentially lower down the supply curve. There is no evidence to support this position which, as with so much of the impact assessment, is based on "maybe" and "possibly" assertions. Ofgem further asserts (paragraph 5.30) that, had more information been made available more widely to market participants in respect of the level of flows at sub-terminal level, market participants *may* have reacted earlier to the signals coming from Transco's actions on the OCM. How and why? The most obvious reaction is to withhold supplies that would otherwise have been forthcoming in the hope of making a killing from the distressed shippers who are short later in the gas day.

22. Having laboured the "example" of the summer 2003 interruptions, Ofgem then concludes (paragraph 5.30) that "it is likely that the magnitude of the benefit in this situation would have been small". That much is patently true. The worry here is that there is no proper consideration of the extent to which Phase 3 Category 4 information, if it had been available in summer 2003, would have provided all of these benefits, if they exist.

23. In paragraph 5.34, Ofgem asserts that some of the recent rise in natural gas prices has resulted from a lack of information rather than the underlying supply and demand conditions. It would be interesting to know the basis for this assertion? Does it relate to information on the UK market or about the position on the Continent?

24. In paragraph 5.35, Ofgem notes that it considers that whether or not information is currently available in the electricity market does not imply that it is or is not appropriate for this information to be made available in the gas market. This is an

important and welcome statement from Ofgem. It is to be hoped that no further time will be wasted on pointless comparisons between gas and electricity (such as Appendix 1; see also paragraph 5.100) and that, instead, the case for additional information in the gas market can be considered on its own merits.

25. In paragraph 5.43, Ofgem says that "In a highly transparent market, it would be apparent to market participants when an unexpected loss of offshore production occurred, and market participants could appropriately adjust their cash out exposure to this incident and would also be likely to offer gas on the OCM to assist Transco NTS in making up the supply shortfall." Why would market participants "offer gas" other than in response to price signals? A pre-emptive offer would depress prices on the OCM when what is actually required is a *higher* price to call forth additional supply. Ofgem is supposed to believe in the efficacy of the market mechanism and the value of price signals. Most markets work perfectly well without detailed real-time information on supply (or demand) since the market co-ordinates all participants' supplies and demands through the price mechanism. What is the difference in the gas market?

26. Paragraph 5.45 implies a signalling effect from Transco's actions on the OCM (indeed, Appendix 5 indicates that Ofgem assumes that when Transco buys gas on the OCM it is doing so to 'stimulate' the market rather than simply to buy gas). Since Transco already has the information which the proposed modification would make available to the market (and more, since it knows about flows at *all* sub-terminals, not just the major ones), this seems to imply that the market can and does rely on Transco's assessment of the need for it to take balancing actions. If that is true, would the additional information proposed help, especially if it is incomplete and not backed up by the detailed information Transco gets alongside the DFNs that are updated hourly through the day?

27. Similarly, paragraph 5.46 says that "The fact that Transco NTS actions can have a substantially greater impact on market prices is related to the fact that the action will often have a significant level of 'information content' for market participants. For example, a Transco NTS action may cause market participants to revise their view of the supply position." This raises a significant question mark against the value to the market of the additional information that would come from the proposed modification.

28. Paragraph 5.52 says that Ofgem considers that the proposal, in providing disaggregation by entry point/sub-terminals with a capacity of 10 mcm/day, will allow market participants significantly more certainty in relation to identifying offshore outages. But, as discussed previously, the level of detail on offshore outages that would be provided by the proposed modification is not great. Producers' best estimates of the effect of outages and other factors are already published to the market in aggregated form at north-south level as forecast flows into the NTS (Phase 3 Category 2). The alleged greater certainty is in practice more likely to be greater noise (akin to rumours) and thus volatility which does not reflect market

"fundamentals". Paragraph 5.52 goes on to say that Ofgem considers that it is appropriate that half of the system balancing benefit it calculates from a move to a highly transparent market should be attributed to implementation of the proposal. Taking a half is completely arbitrary and, even if the £5 million p.a. benefit were agreed to be a reasonable estimate (which I don't think it is), it is likely to be a gross over-estimate. The £5 million p.a. benefit is based on multiple assumptions most of which are dubious. Why, for example, are prices assumed to react to Transco 'stimulation' rather than, say, to the actions through the market of those who have suffered a supply shortfall? Why assume a 1p/therm saving rather than a .001p/therm saving? Ofgem's "methodology" is said (Appendix 5 paragraph 5.5) to assume that the market would have been able to trade out the shortfall more economically had it been aware that the outage had occurred. This is not a "methodology": it is a statement of faith.

29. In paragraph 5.56, Ofgem argues that "as in all markets, individual participants can and will develop their own views on optimal trading strategies and learn from past behaviour". However, Ofgem has not explained how the alleged process of learning can take place without further information becoming available in due course e.g. on field level production by hour. Without such information, market participants will remain in the dark about the reasons for changes in sub-terminal level flows into the NTS and cannot possibly learn in the way suggested.

30. In paragraph 5.57, Ofgem says that historic data may assist market participants to make initial assessments in respect of whether to act or trade upon the information being released. Does this mean that Ofgem will be pressing for historical data to be made available or that it believes the claimed benefits will build up only over time?

31. In paragraph 5.58, Ofgem asserts that any potential costs associated with a short-term increase in market volatility and balancing costs, as a result of market participants misinterpreting the new information stream, are unlikely to be material and are unlikely to persist. There is no attempt to justify the dismissal of these costs or to identify the timeframe over which the market is supposed to learn.

32. In paragraph 5.61, Ofgem says that it considers that information could be provided to the market in respect of the accuracy of the data released, thereby allowing it to take its own views as to whether to trade on the information provided. Is this being treated as part of the proposal? Has the cost of providing information on the accuracy of the data that would be released been included in Ofgem's assessment?

33. In respect of failures of meters or associated telemetry, in paragraph 5.62 Ofgem notes that the number of such failures that actually occur is likely to be very low. However, even if there were few such events, the magnitude of the effect could be very large, with the costs of market participants acting on erroneous information at such times exceeding any small benefit at other times.

34. In paragraph 5.63, Ofgem asserts that increased information is likely to have a beneficial impact on market confidence. It is also likely to have a very damaging effect on the confidence of those responsible for bringing gas to the NTS, including both UK and Norwegian gas producers. The impact assessment seems to be silent on the effect on their investment intentions of the regulatory uncertainty created by the failure to reject the proposed modification at least until the full benefits of the voluntary agreement have been given time to be seen. Paragraph 5.63 also refers to the information asymmetry between those shippers with producer affiliates and those without. Is this a perception of some market participants? Is there any reason why a shipper should not act on his own private information? The fact that a shipper is affiliated to a producer does not seem to make a difference. Non-affiliated shippers who find they are short of gas because of an offshore problem don't broadcast the fact to the world - other than by entering to market to cover their positions. Finally, paragraph 5.63 asserts that if more information were published market players would have greater confidence that price movements reflect market fundamentals rather than anti-competitive behaviour. Is there any evidence of anti-competitive behaviour? If not, then alleged perceptions that there might be some do not provide a good basis for increasing regulatory burdens on industry.

35. In paragraph 5.64, Ofgem notes that market participants have expressed a desire to be better able to determine and act upon information when faced with potential price movements and on this basis have called for greater transparency in relation to the offshore regime. The proposed modification is very specific in terms of the information that would be released to the market whereas this call for greater transparency is very general. The proposed modification is also not specific to the offshore. Ofgem also notes that "a number of respondents to the DMR highlighted how they were unable to make informed decisions with respect to the price rises in February and March 2005, as they did not have access to the appropriate information". Would the proposed modification provide such information? It is not clear how within day disaggregated information would have been relevant to a lengthy period of sustained high prices.

36. It is not clear what Ofgem means in paragraph 5.65 by "case study analysis". If it means the discussion of the summer 2003 and February–March 2005 periods, then it should be noted that they pre-date the (full) publication of information under the voluntary agreement and that the discussion does not focus on the incremental benefit of the information that would be released under the proposed modification.

37. Ofgem considers (paragraph 5.67) that the level of disaggregation for publication of information flows as intended by the proposal is likely to yield additional security of supply benefits in both the short and long term. The proposal would provide no greater level of spatial disaggregation than that already available and the timeliness would apparently also be no greater than that soon to be available under Phase 3 Category 1. Given the nature of the information, it is difficult to see how it could have any material effect on long run security of supply - other than a significant negative impact to the extent that UK and Norwegian producers perceive

an increased level of regulatory and commercial uncertainty. In respect of the short term, Ofgem considers (paragraph 5.68) that increasing the transparency and availability of information will better assist market participants in balancing their positions and therefore enhance short term security of supply. Is this an additional benefit to that quantified earlier? It is not clear how the additional information would result in any more gas being delivered to the market which is surely the best measure of security of supply. In relation to the long term, Ofgem claims in paragraph 5.69 that (presumably near-to-real time) information regarding flows at a sub-terminal is likely to better enable the market to better understand the reliability of existing sources or infrastructure compared to information made available on a north-south level. This information is likely to also aid market participants in forming their own view as to whether new supply sources or infrastructure facilities would be economic and efficient in the medium to long term. This is simply ridiculous. Those who might invest in such supply sources or infrastructure would not need this information to assess medium to long term economy and efficiency. Disaggregated data are already available after the day. Ofgem also claims that the release of flow information at sub-terminal level would potentially provide signals to the market as to the location of likely areas for future investment (i.e. where flows indicate that supply sources are 'reliable' or are in decline) It is clear that hourly data are not relevant to whether supply sources are in decline.

38. In respect to the identified impacts of the proposal on security of supply, it should be noted that Transco already has the information and that Ofgem has ignored the significant negative effect on producers' confidence. In the discussion of the ability of the demand side to respond to information (paragraph 5.72), Ofgem notes that over the period of high wholesale gas prices in February and March 2005 the demand side did respond to very high prices. It fails to discuss the effect on demand side response of more information, which is presumably the relevance of the "example". In connection with the summer 2003 interruptions, Ofgem fails to explain how and why the demand side may have been able (or willing) to respond more quickly to the situation that arose if they had had access to timely and accurate information at sub-terminal level over that period. The most obvious response would have been for them to raise their reservation prices - to make a killing from distressed purchasers or Transco - and making the situation even worse. (In paragraph 5.73, Ofgem does say that "If the proposal had been implemented at that time, given the disaggregated nature of the sub-terminal flow data, this response may also have enabled locational decisions to be taken *by Transco NTS* to reflect where supply shortfalls were being experienced. But this is patently ridiculous since *Transco had access to the sub-terminal level flow data*. Is the problem here - if there is one - the design of the OCM? Can Transco not make geographically specific its need for more gas as balancer of last resort?)

39. In the discussion in paragraph 5.110 of the value of information already being published (or provided to Transco) and which might be at risk if the proposal were approved, it seems more likely that (for example) Phase 3 Category 3 information is at risk rather than TBE information? The impact assessment should have addressed

the risk to *that* information not being published (quite high?) including an assessment of its value to the market (possibly quite low?). This is also relevant to the discussion of "reasonable conduct". There is a difference between restricting the flow of information to Transco - which is unlikely - and refusing to allow that information (e.g. Phase 3 Category 3) to the market. It should be noted that to date a clear benefit has **not** been demonstrated for any of the information released to the market. Ofgem's analysis of the average magnitude of offshore outages as compared with winter 2004/05 maximum flows at sub-terminal level - which shows that outages typically represent less than 20 per cent of maximum flows - seems to indicate the likely *lack* of value from the publication of more information about sub-terminal level flows.

40. In its discussion of meter failures (paragraph 5.122), Ofgem notes that such failures are likely to be infrequent given the reliability of the technology. Whether infrequent or not, should this risk not be quantified or at least discussed further and not be dismissed in such a cavalier fashion? Ofgem also considers (paragraph 5.123) that, in relation to the potential risks regarding the accuracy of the data that would be released under the proposal and the potential for inaccurate data to prove misleading, these risks are likely to be small. Small in absolute or relative terms compared with the benefits and other costs/risks of the proposed modification?

A concerned gas consumer
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