Uniform Network Code (UNC) Modification Proposal 006: Publication of Near Real Time Data at UK Sub-terminals Response to Ofgem's Request for Information by Barclays Capital 11 November 2005

Barclays Capital continues to support the implementation of proposed UNC Modification Proposal 006 from energywatch and welcomes Ofgem's proposal to undertake a further impact assessment of the incremental benefits of the proposal in the light of the release of aggregated North-South terminal flow information from June 2005. In our view, the incremental benefits of the proposal continue to significantly exceed the likely costs. The incremental benefits from the release of further information in June 2005 have been limited and marginal. The vast majority of the benefits of greater information release identified by ourselves and energywatch and highlighted in Ofgem's original impact assessment of May 2005 can be attributed almost entirely to the release of <u>disaggregated</u> sub-terminal flow information rather than the release of aggregated flow information beginning in June 2005. As a consequence, the estimates of the <u>incremental</u> benefits of the proposal against the background of the incremental information released from June remain broadly in line with the earlier assessments. In the following we provide some specific responses to the issues raised in the Ofgem letter of 24 October requesting further information on the proposed modification.

The Use of the Information Provided as Part of the DTI-UKOOA Voluntary Information Initiative

The publication of aggregated sub-terminal flow information has not significantly improved our ability to participate in the wholesale gas market. The information that NGT publishes on linepack already provides market participants with an hourly assessment of the likely supply and demand balance at the end of the gas day and, hence, by imputation, with information on the balance of flows emerging over the day. (We would like, however, to know how Transco derives these figures from the nomination information that they receive to have greater comfort on the robustness of these figures.) While the aggregated North-South flow information provides information differences some additional on between actual flows and the nominations/expectations incorporated into the line-pack assessments, this data is of little incremental use to our trading operations because:

- The hourly line-pack assessment "leads" the hourly flow data (and to some extent will include revised expectations following events on the system); and
- North-South information is still too aggregated to discern the likely cause of any change in the actual flows. Specifically, the vast majority of flexible facilities are located within the Southern zone such that it is impossible to discern whether a change in flow result from changes at storage sites, the interconnector, LNG facilities or flexible fields and consequently impossible to discern the shape of the supply function and hence to predict the likely price impact of any change in the aggregated flow. As a trader, we therefore have no means to assess whether any hourly reduction (increase) in the flow



observed at the North-South level is or is not likely to persist for the day or beyond and hence have a material impact on prompt or forward prices.

• While the market as a whole may observe the aggregated information, physical players have an inherent information advantage since they get private, disaggregated information on the breakdown of these flows via their operations and/or contractual arrangements with the supply facilities.

In summary, therefore, the aggregated North-South data is of little incremental use to our trading operations.

The Use of the Information under Modification Proposal 006

The disaggregated near to real time information that would be provided under the proposal would provide significant benefits over and above the information provided under the voluntary scheme. In transparent markets (eg, UK and Nordic electricity), we are able to build a sophisticated picture of the breakdown of the industry supply curve at an individual plant level. This supply curve will take account of the cost conditions (eg, fuel costs) and operational constraints (eg, emissions limits, dynamic parameters) that we expect to obtain for individual plants making up the supply curve. In turn, this enables us to take a view on the likely spot and forward price responses to changes in demand, to individual supply events (eg, plant failures, plant pricing etc) and to changes in other market fundamentals (eg, fuel prices, CO₂ prices etc).

The release of near to real time sub-terminal data in the UK gas market would allow us to invest in and develop similar detailed analysis of the gas supply curve along similar lines, ie: instead of aggregate supply on any one day we would know the composition of the supply curve at any one time in respect of the breakdown between associated gas flows, flows from swing fields, storage injections and withdrawals, system actions and interconnector flows. This would allow us to monitor and observe emerging changes in the composition of the supply curve following outages and/or "economic" decisions to flow (or not flow) gas from flexible sources of supply. In turn, the ability to understand what drives current and historic prices would be a crucial input into our view on the future evolution of prices. In total, this allows for a more measured and accurate assessment of the likely impact of changes in market fundamentals on wholesale gas prices both in the short-term and along the forward curve.

As we articulated in our paper which estimated the benefits of greater information transparency¹, the release of more information would lead to significant benefits in terms of reduced market spreads, better outage coordination, reduced balancing costs, improved long-run investment signals and increased security of supply. We will not repeat that analysis here, but would like to emphasise the following:

• Despite the greater release of information under the DTI voluntary information initiative since the paper was written in 2003, the vast majority of the benefits that we highlighted stem precisely from the release of **disaggregated** information. Specifically, the benefits in

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terms reduced risk management costs – which we estimated at £200 million - stem primarily from increasing confidence in how market fundamentals drive prices at different times which requires detailed information on the breakdown of the supply function rather than aggregated flow figures which obscure the underlying price drivers. The <u>incremental</u> value stemming from the approval of Modification 006 would therefore account for the vast majority of this overall benefit.

- Ofgem's Impact Assessment from May 2005, reported Oxera analysis which suggested that price spreads would reduce by 0.05p/therm only in uncertain periods which gave a much lower (but still large) benefit from releasing further information. It should be noted, however, that our calculation was based on the premise that market spreads increased from a "normal" level of 0.10p/therm to 0.2p/therm at times of greater uncertainty and that the "average" reduction of 0.05p/therm included an implied assumption that the higher spreads were experienced only 50 per cent of the time. (To take our average spread reduction and *then* apply it only to "uncertain" trading periods only as Oxera appear to have done would therefore double count the assumed proportion of uncertain periods and, hence, understate the likely benefits.)
- At times when the supply-demand balance is tight, significant uncertainty over the shape of the supply function results in much wider spreads still. For example, over the last week, spreads have widened to as much as 1p/therm.

We therefore believe that our original estimates remain a relatively conservative and reasonable estimate of the likely benefits from greater information release and, specifically, for the release of disaggregated flow data as envisaged by Modification 006.

We have not made a further assessment of the incremental value based on the disaggregated data provided for the period 12 September to 18 September for the following reasons:

- The data provided is incomplete and several sub-terminals are missing;
- The period is a relatively uneventful summer period without significant interconnector, storage or LNG flows, whereas the impact of disaggregation is likely to be most profound over steeper portions of the supply curve (eg, at Winter peak) where changes in flows have the most significant impact on prices and where inaccurate assessments of the supply function results in widening spreads.
- It is difficult to identify the counterfactual, ie, what would have happened differently had the data been provided over that period.

Although we have not specifically analysed the week for which the data is provided, there are clear, substantiated reasons why greater information release will yield benefits of an order of magnitude greater than any costs. Given the strength of the arguments supporting the release of greater information, we would hope that those seeking to prevent greater information release bear the burden of proof in demonstrating that these benefits would <u>not</u> accrue rather than requiring the proponents of information release to somehow "prove" these benefits on the back of analysis of a single, arbitrary, relatively-benign week's worth of data.



