



**Comments in respect of
Modification 0061: Facilitating further demand side response in the event
that a Gas Balancing Alert is triggered**

21 November 2005

The Association of Electricity Producers welcomes the opportunity to comment on this urgent modification proposal. The Association is sympathetic to what this proposal is trying to achieve, but considers it has not been adequately justified and some important details are absent. We are therefore unable to support this package of measures at this time but consider it raises issues of importance that should be considered in a full review of National Grid Gas's (NGG) role in relation to balancing the system. For the avoidance of doubt we do support the introduction of a Gas Balancing Alert (GBA). Our comments relating to this are detailed in our response to modification 62.

The Proposal

A key issue that is not addressed in the justification of this modification proposal is materiality. No indication is provided of how much gas is supplied by non-trading participants, nor what proportion of this would only be available to NGG by multiple day offers. Materiality is important as there are a number of downsides to this modification and a balance needs to be sought between the consequential advantages and disadvantages.

NGG's recent consultation with regard to the SMPS used the words *discernable positive impact on supply/demand position* when determining which offers should be accepted. Whilst we accept that a further consultation on the SMPS will be necessary if this modification is accepted we would not expect this principle to change and would be concerned if accepting offers solely for price setting purposes became more acceptable as we fail to see how this is consistent with the principles of cost reflective cashout prices or economic and efficient operation of the system.

We would expect Users who are not trading participants to provide an indication of the magnitude of demand side response that this proposal could facilitate in their response to this consultation in order that Ofgem might make an informed decision.

We understand that the APX systems are due to change from 1 December to provide for locational multi-day trades, but that OTC trades are likely to be the equivalent of 'title' trades. This means that once a GBA has been issued non-market participants will have a wider range of trading opportunities with NGG

than trading participants. Due to the linkage of OCM locational trades with renominations at specific locations consumers whose shippers are trading participants may face greater restrictions in offtaking gas following a multi-day trade, particularly where the GBA does not persist for the duration of the trade.

Advantages of the Proposal

- NG argues that cashout price apportionment in the event of multiday trades will reflect forecast requirements of future days and hence target costs and incentives appropriately. We do not agree that this is an advantage of the proposal. The discretion afforded to NGG in these circumstances cannot ensure that costs are targeted appropriately. We also question whether NGG discretion in setting SMPB is consistent with its incentives.
- Provision of trading options outside the OCM could be considered to be an advantage and consistent with the economic and efficient operation of the system. But only if this does not lead to market distortion, as may be the case if real-time cashout information is not available to all parties. For example if an OTC trade sets a new SMPB price then the counterparty will have this information before other participants and could trade on the basis of this knowledge. In addition it is unclear as to when and how NGG will compare OTC and OCM offers with respect to price, duration, location etc.
- Creation of additional price signals – this seems to assume that OCM trades will not create adequate price signals. NGG will have to demonstrate that any extreme priced offers accepted either on the OTC or OCM are consistent with economic and efficient operation of the system.
- We agree that as this provides a facility for non-trading participants to offer demand side response to NGG, but consider the materiality of this must be assessed.
- The enhancement of competition by this proposal will against depend on the materiality of offers that might be captured if this modification were implemented
- We agree the proposal is limited to days when a GBA has been issued and will have no effect on other days, but days of system stress are those that the market must function most efficiently and any information asymmetry will have a detrimental affect of this.

Disadvantages of the Proposal

- The lack of real-time cashout price information to the market is a major disadvantage in the event that non-OCM trades are undertaken for balancing purposes. We accept that this would only occur once a GBA had been issued but this is the time that it is arguably most important that the market is aware of the prevailing cashout prices. What undertakings are NGG going to make concerning the delay in publication of real-time cashout prices, how will these prices be communicated?

- The lack of clarity over how NGG will compare OTC and OCM single and multi day offers and those with a locational element and hence a higher probability of delivery with non-location specific trades. For instance in example 1 in the proposal would NGG take 45p single day locational gas on the OCM in advance of gas at 10p for six days OTC with a weighting that would give an SMPB of 48p? Or would the comparison be against the offer price of 10p?
- Additional complexity – agree this is an issue that will require operational procedures, training of staff and new settlement processes. Is this justified given the materiality?
- Further consultation on the SMPS and Procurement Guidelines will be necessary before this proposal could be fully implemented. It is disappointing that NGG has not indicated the changes that it would propose as this may influence opinions with regard to the modification. For example the recent SMPS consultation indicated that NGG would be more likely to take OCM trades with a physical or locational element when supplies are close to maximum which will give some degree of confidence of delivery. This also implies that it might take higher priced physical / locational trades ahead of title trades in such circumstances. OTC trades would be ‘title’ and hence would have nothing to favour them over an OCM title trade. Will the OTC terms and conditions link the trade to a specific location?

Implications for security of supply and operation of the total system

In principle we agree that encouraging demand side response through any mechanism should enhance security of supply. The key issues here are materiality of possible offers, the information asymmetry that may emerge if OTC trades are undertaken, and the loss of real-time cashout information and absence of any insight into how NGG will judge various types of OCM trades against OTC offers. We do not expect the volume of gas offered as a consequence of this proposal being implemented to be sufficiently material that it could avert an emergency, such that implementation in urgent timescale before this winter would be justified, given the numerous unresolved issues which could have a more significant detrimental impact on efficient market operation.

Implications for transporters

Implementation of this modification proposal will increase the complexity of operation for NGG, new operational procedures will be required and staff will need to be trained, just in case a scenario occurs where a GBA is issued. Given that we are already in the winter period the introduction of new processes will, via lack of familiarity, introduce additional risk and stress for operational staff at GNCC at a time when attention should be focussed on the safe and efficient operation of the system in pre-emergency conditions.

Legal Text

The legal text has only been made available 3 working days before the consultation period; this makes a full assessment of whether the text is consistent with the proposal more challenging, given that new principles are being established.

We have some observations:

- 1) The text seems to contemplate multiday and OTC Market Balancing Sell actions whereas the intent of the proposal is to facilitate demand side response which will inevitably require Market Balancing Buy actions.
- 2) F 1.1.2 (c) should refer to D 4.1.6 not D4.1.7