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Dear Julian

UNC Modification Proposal 0061: 'Facilitating further demand-side response in the event that a Gas Balancing Alert is triggered'

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Thank you for your invitation seeking representations with respect to the above Modification Proposal.

National Grid Gas plc (UK Distribution) ("Distribution") is of the opinion that this modification should not be implemented.

While Distribution understands the motives behind the raising of this proposal, and applauds every step being taken to ensure that market mechanisms remain in operation for the maximum amount of time, it does not believe that this proposal, if implemented as drafted, would satisfy that aspiration. Basically, the benefits from ensuring that demand-side period-gas is available to the residual balancer would be disproportionately offset by the detrimental effect this gas could have on the cash-out price and the efficient workings of the neutrality arrangements.

With respect to the amount of gas that would be made available through this mechanism, clearly considerable work has been undertaken by the Demand Side Working Group to establish that these rules would make gas available to the residual balancer. Distribution anticipates that the quantity would be fairly low: but this, in itself, would not be a problem. The problem arises from the significant and disproportionate effect this gas could have on the cash-out arrangements.

Distribution is concerned that, as the proposal stands, there is considerable scope for the derived SMP, associated with this type of transaction, to give rise to price spikes. This is due to the associated SMP being directly proportional to the period over which the gas has been offered and, the "delivery-profile" of the gas, (over the period), being the product of assumptions. Distribution believes, given that the derived SMP is the product of a deemed delivery profile rather than an actual transaction, the trade has the potential to affect market prices significantly and non-transparently, and therefore, inappropriately.

Distribution believes that the potentially anomalous SMP calculation could be removed by deeming these gas deliveries to have followed, rather than lead, prices; put simply, they do not feed through into setting SMP.

Therefore, Distribution believes that in principle and practice, the proposed method by which any gas purchased OTC would flow through into the SMP equation is flawed.

Should the proposal be amended to remove the potential for extreme price setting, then Distribution would support implementation. Distribution believes that gas released by this mechanism should be capable of being traded, and if in extreme circumstances this means OTC rather than OCM, then so be it, but these marginal trades should not have the potential to disproportionately skew the market and overwrite prices established by the bulk of trades struck on the OCM.

For the avoidance of doubt, these concerns mean that Distribution is of the opinion that implementation would not further the relevant objectives, as the scope for huge variances in the cash-out price would increase shipper risk, reduce effective competition and not act in the interests of customers.

Yours sincerely,

Declan McLaughlin