

Mr. Julian Majdanski
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Dear Julian,

Re: Modification Proposal 0086: “Introduction of Gas Demand Management Reserve Arrangements”

The Association of Electricity Producers wish to provide comments on this Modification Proposal 0086.

Our comments are as follows:

The Association considers that demand side response has a key role to play in managing the supply demand position particularly where supplies may be tight as in this coming winter. We therefore support in principle proposals that seek to facilitate demand side response. However we have some concerns, in particular many of the details are not clear or are yet to be developed so it is difficult to assess whether the desired outcome would be achieved in practice and physical demand side response actually delivered. In any case it will be very difficult to monitor this.

We consider there are many contractual and operational complexities to be addressed and time is relatively short before this winter. Particular attention will need to be given to the customer transfer process and whether the contracted demand side response moves with the customer or stays with the shipper.

The Association is aware that there have been difficulties between shippers and consumers in reaching agreed terms for demand side response in the past. However even though these arrangements might provide a framework for discussion, customers will still need to agree all these elements with their shipper who may then participate in the NG tender on their behalf. It therefore seems that the availability payment is the only element that is in addition to any agreement that might be reached between customers and shipper absent these arrangements. Therefore the assessment of the proposal should focus on whether an availability payment is necessary to prompt demand side response and whether this represents good value to the industry as a whole.

The proposal indicates that an incentive is created for investment in fuel switching and contracting for alternative fuel. We challenge whether this proposal itself creates those conditions or whether they are a feature of the tight supply demand conditions this coming winter with the proposal and any availability payment only having a marginal effect.

Extent to which implementation of the proposed modification would better facilitate the relevant objectives

Gas Transporter Licence Standard Special Condition A11.1

- (a) *the efficient and economic operation of the pipe-line system to which this licence relates;*

The extent to which implementation of this proposal furthers this objective will depend on the extent to which the payment of an availability fee as an insurance premium is considered to be efficient and economic when the likely delivered volumes are taken into account. Also whether recovering these costs as a premium on the SMP buy price on short positions throughout the year is an appropriate form of cost targeting.

There is also an issue as to whether customers might receive availability payments yet not actually change their behaviour such that they self interrupt before they are actually called to provide the service. Whilst this suppresses demand, National Grid may have a falsely high view of additional demand side response it could call. Similarly structures will be needed to ensure that utilisation fees are not paid to reduce offtake when the site did not intend to flow at that level. The default quantity may be overly generous in this respect.

Given that the costs involved might be large we suggest that Ofgem should undertake an impact assessment before coming to a view on the proposal.

- (b) *so far as is consistent with sub-paragraph (a), the coordinated, efficient and economical operation of (i) the combined pipe-line system, and/ or (ii) the pipe-line system of one or more other relevant gas transporters;*
- (c) *so far as is consistent with sub-paragraphs (a) and (b), the efficient discharge of the licensee's obligations under this licence;*
- (d) *so far as is consistent with sub-paragraphs (a) to (c) the securing of effective competition:*
- (i) *between relevant shippers;*
 - (ii) *between relevant suppliers; and/or*
 - (iii) *between DN operators (who have entered into transportation arrangements with other relevant gas transporters) and relevant shippers;*
- (e) *so far as is consistent with sub-paragraphs (a) to (d), the provision of reasonable economic incentives for relevant suppliers to secure that the domestic customer supply security standards (within the meaning of paragraph 4 of standard condition 32A*

(Security of Supply – Domestic Customers) of the standard conditions of Gas Suppliers' licences) are satisfied as respects the availability of gas to their domestic customers; and

(f) so far as is consistent with sub-paragraphs (a) to (e), the promotion of efficiency in the implementation and administration of the network code and/or the uniform network code.

The implications of implementing the Modification Proposal on security of supply, operation of the Total System and industry fragmentation

The implications for Transporters and each Transporter of implementing the Modification Proposal, including

a) implications for operation of the System:

b) development and capital cost and operating cost implications:

c) extent to which it is appropriate to recover the costs, and proposal for the most appropriate way to recover the costs:

d) analysis of the consequences (if any) this proposal would have on price regulation:

The consequence of implementing the Modification Proposal on the level of contractual risk of each Transporter under the Code as modified by the Modification Proposal

The high level indication of the areas of the UK Link System likely to be affected, together with the development implications and other implications for the UK Link Systems and related computer systems of each Transporter and Users

The implications of implementing the Modification Proposal for Users, including administrative and operational costs and level of contractual risk

The shipper effectively acts as a middle man between the customer and NG, yet it will face implementation costs in terms of contractual arrangements, new operational procedures and training of staff. It will also face additional contractual risk if on the day volumes are estimated incorrectly or demand is not reduced sufficiently. Disputes may also arise between shippers and their customers over volumes and prices.

The implications of implementing the Modification Proposal for Terminal Operators, Consumers, Connected System Operators, Suppliers, producers and, any Non Code Party

Consumers will need to agree detailed contractual terms with their shipper and have the necessary operational procedures in place to ensure they comply with instructions to reduce offtake. Alternatively they will face the commercial consequences

Consequences on the legislative and regulatory obligations and contractual relationships of each Transporter and each User and Non Code Party of implementing the Modification Proposal

Analysis of any advantages or disadvantages of implementation of the Modification Proposal

We have identified the following advantages:

The proposal *may* facilitate additional demand side response. Although it maybe that demand side response that was already likely to be offered gains an availability payment, creating a cost to the industry.

This could increase the mechanisms available to the System Operator on a difficult day but it will also increase operational complexity

It is not clear under what circumstances the GBA trigger could be adjusted upwards, frequent adjustments could lead to confusion in the market.

We are not certain whether this will lead to greater capability for fuel switching or establishing alternative fuel stocks over and above the preparations that a company might reasonably make in advance of a potentially difficult winter.

We have identified the following disadvantages:

The availability and timeliness of real time cashout information may be diminished if these contracts are called. This could have a detrimental impact on the market and price driven response

The cost to the industry of this ‘insurance’ may be disproportionate to the benefits of potentially accessing additional demand side response given the volumes available.

It will be difficult to establish whether a physical response has actually been delivered

The extent to which the implementation is required to enable each Transporter to facilitate compliance with safety or other legislation

The extent to which the implementation is required having regard to any proposed change in the methodology established under paragraph 5 of Condition A4 or the statement furnished by each Transporter under paragraph 1 of Condition 4 of the Transporter's Licence

Programme for works required as a consequence of implementing the Modification Proposal

Proposed implementation timetable (including timetable for any necessary information systems changes)

The proposed implementation timetable is very challenging given the number of new arrangements and procedures that need to be put in place prior to this winter. These include contractual and operational procedures for NG and new contractual clauses in customer supply contracts.

Implications of implementing this Modification Proposal upon existing Code Standards of Service

Further Comments

Yours faithfully

Julie Cox
Head of Gas Trading
Association of Electricity Producers