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19 June 2006

Dear Julian,

**RE UNC Urgent Modification Proposal:- 0086 Introduction of Gas Demand Management Reserve Arrangements**

Thank you for the opportunity to comment on this Modification Proposal.

British Gas Trading is not supportive of the implementation of this Modification Proposal.

However, we are entirely supportive of arrangements, which facilitate and maximise the availability of Demand Side Response. Such mechanisms will allow any Customer with a Daily Metered gas supply to cease, or reduce, their consumption in order to assist in the preservation the continuity of gas supply to other consumers.

Over the later months of 2005 arrangements were introduced to facilitate the participation of large consumers in this type of response and realise the value of the gas to the market. These have included the mechanics of notification to the Transporter when such quantities are to be offered through commercial interruption of established Interruptible customers and Firm consumers. These arrangements detailed the calculation of any quantities that may be curtailed by the transporter in the stages of an emergency and the compensation, which would be paid for these curtailments, and any curtailed storage flows. Although introduced in a series of proposals, the net effect provided for a suite of arrangements that would apply in an emergency and therefore provided a strong incentive upon Users and their customers to provide this type of response in order to avoid the need for the declaration of an emergency.

A number of Users have been able to offer such response and it is evident that in a limited number of cases it has been possible to amend contractual conditions to do so in the time available. However, such response has been incomplete and it is a general concern that the full potential for Demand Side Response (DSR) has not yet been realised. A number of Users have asserted that this is primarily due to the short time available in which to revise contractual obligations.

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With this as a background we recognise that this modification proposal seeks to encourage additional DSR by requiring the NTS Transporter to put in place a tender scheme with consumers in which their cessation or reduction of consumption would be available on days of need.

Whilst we support the initiative to encourage greater DSR we have concerns about this being enabled through the actions of the NTS Transporter. In the role of System Operator (SO) the NTS Transporter has clearly defined obligations as residual balancer. As the supply/ demand situation becomes tighter, this SO role extends to encompass the potential for an emergency situation to develop, which may require the involvement of the Network Emergency Co-ordinator (NEC).

Although the Modification Proposal identifies a potential advantage of this function being administered by a third party as an impartial agency this would be co-incidental with actions required by the NTS Transporter in fulfilling the role of system operator and residual balancer. We believe that this could lead to significant conflict of interests.

Furthermore, the establishment of such contracts through the SO may serve to undermine those arrangements which already exist or are in formulation between Users and their customers. The proposal could therefore create perverse incentives on Users to balance – relying on the SO to achieve a balance of supply and demand. Such perverse incentives were recognised in Ofgem's decision on Modification 0013a Removal of Transporter rights to interrupt for Supply /Demand reasons.

*“The interruption arrangements can potentially distort the efficiency of the gas balancing regime if the costs of interruption are not properly reflected in cash out prices. This may lead to inefficient balancing decisions on the part of shippers and distort competition in the wholesale gas market. Furthermore, it may reduce the extent to which shippers are willing to compete to sell gas to Transco as residual gas balancer.”* Ofgem Decision letter, 11 July 2005

We are also of the view that these arrangements will have an impact upon the commercial contracts held between Users and their customers. The price set in such arrangements would effectively act as a marker for trades conducted on the OCM but without transparent publication of information on a common platform and timescale, will influence the conduct of other trades. We believe that the intervention of the SO in this way will lead to an unnecessary distortion of the market. This is contrary to the established principles of the liberalised market which exists within our regime. In extreme cases it could be seen that a potential effect could be to exacerbate the supply/demand situation.

We believe that Gas Reserve tenders would be a very large additional cost to suppliers that would eventually have to be passed on to consumers. It is likely that the SO will be offered 'reserve' at high prices and with upfront availability fees that will mean that the 'service' will incur a cost whether used or not. The 'service' is likely to be that which would have been available on the day if needed, i.e. Users (and their customers) will be paying for a demand-side response that would have been available anyway. This would be particularly so where the SO were not be incentivised to minimise the costs of Reserve. In considering this proposal it is important that Users are able to see the results of the survey

on demand-side response that Ofgem have carried out so as to judge the extent to which additional response may be incentivised by such a proposal and also the SO view of the likely costs.

With the level of exposure given to this issue in recent months, we believe that there is already a significant incentive upon Users to engage with their customers to put in place arrangements for DSR which reward the consumer and benefit continuity of supply appropriately. If there are specific difficulties experienced by customers in offering their DSR to the appropriate market these should be resolved on an individual basis between the customer and their shipper/supplier. In some circumstances it may be the case that persistent difficulties require referral or intervention by the regulator. If there are specific barriers to such arrangements in the UNC then modifications should be proposed to remove such impediments.

In summary, we would advocate the encouragement and development of the extent of Demand Side Response to be pursued between Customers and their Shippers and Suppliers. We are of the view that there is more DSR available, particularly within the non CCGT sector of Daily Metered customers. However, we do not believe that it is appropriate for such arrangements to be effected through the actions of the NTS Transporter indeed this approach could prove to be counter productive.

Please contact me if you require any further information.

Yours sincerely,

Mike Young  
Commercial Manager