Mr. Julian Majdanski
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Dear Julian,

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

In principle Scottish & Southern Energy plc (SSE) are supportive of mechanisms to encourage more demand side response. However, the modification lacks sufficient detail and creates concerns over appropriate incentives, cost recovery and sharing of costs. We believe this modification may generate unnecessary costs thereby impacting on efficiency and effectiveness. As a result SSE do not support the implementation of this Modification Proposal 0086.

Our detailed comments are as follows:

This proposal will make NGG the balancer of first resort rather than last resort as is currently the case. SSE do not believe it is appropriate that NGG should become a balancer of first resort, market based principles incentivise shippers and suppliers to balance supply and demand. Inaddition, SSE are concerned that if NGG were to become a balancer of first resort they may "crowd out" the developing market for demand side response and have an unfair advantage over shippers trying to offer the same service to customers.

No evidence has been provided to demonstrate that contracting in advance will encourage incremental demand response additional to that which would have been offered anyway on a real time basis. This modification will introduce inefficiencies because it potentially pays customers to reduce demand who on a spot basis would have reduced demand due to high price.

The proposed modification may cause the SO to create a large option/futures position. SSE are concerned that if incentives are not appropriately created and governed NGG may speculate through such a position.

NGG already have the authority to contract for demand side response should they wish to do so. Inaddition, should this modification be implemented there would be no requirement on NGG to accept any offers following the tender exercise. Thus wasting the resources invested in creating and responding to the tender exercise. However, we do not believe there should be an obligation to accept tenders as this will force NGG to be a distressed buyer.

The availability cost for this insurance policy has been estimated at between £ 13 and £ 47 m per annum. This is a significant cost that is not currently incurred and may not be required in future years, but would nevertheless be paid for in advance for each subsequent year if this modification was approved.

The process for determining the reserve volume and duration is not clear. We are uncomfortable that this is entirely at the discretion of NGG. It would have been preferable that during the consultation period this important information was made known inaddition to information regarding how this scheme would operate. In particular we are concerned about the level of potential costs that might arise from the reserve contracts.

It is proposed that the availability and utilisation fee will form part of the cash out payment for SMBP. However, we do not believe that the costs should be recovered via SMBP as we understand that cash out is meant to provide an incentive to balance and not to recover costs. If availability fees are included within SMBP this will potentially result in users of the system avoiding being short even when there might be a requirement for the system to be short.

SSE are opposed to this modification. If Ofgem insist on this modification being implemented then the incentives and ancillary service documents required to ensure that NGG control costs, ensure appropriate risk taking and sharing of costs should be agreed before implementation of this mod. The ancillary documents should then form part of the UNC to ensure adequate governance.

Yours sincerely

Jeff Chandler
Energy Strategy
Scottish & Southern Energy