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18 September 2013

Gas Security of Supply Significant Code Review – Demand-Side Response Tender National Grid Gas Transmission Consultation Response

Dear Anjli,

Thank you for providing National Grid NTS (NGG) with the opportunity to respond to Ofgem's consultation on the concept of introducing a System Operator run Demand-Side Response (DSR) Tender within the Gas Security of Supply Significant Code Review (SCR) solution.

Our role as the owner and operator of the GB Gas Transmission System is to ensure the safe, economic and efficient development, operation and maintenance of the system. Shippers hold the responsibility for ensuring that their customers' gas demands are met under the shipper licence Condition 3. In support of this obligation NGG also undertakes the role of Residual System Balancer.

NGG supports the principle of the SCR SoS process; to implement measures that may, *'reduce the likelihood, severity and duration of a Gas Deficit Emergency (GDE)'*. We agree with Ofgem's view that the proposed SCR SoS reforms should seek to introduce arrangements which, *'ensure appropriate incentives are put in place for gas market participants to provide secure supplies, and mitigate the risk of an emergency'*. We are therefore supportive of the DSR aims and believe it, or any measures introduced under the wider SCR, should retain the clear accountabilities, roles and responsibilities in ensuring supplies are maintained to consumers.

We agree that developing a route to market for additional efficient DSR would compliment the proposed cashout arrangements within the SCR. This could reduce the likelihood of moving into a gas emergency if able to attract significant new demand side volumes. To be effective we believe the DSR solution should not be overly complex or create unnecessary barriers to participation in terms of designing the products, contracts or bidding process. This would encourage the maximum number of potential market participants, and reduce the administrative overhead of the Residual Balancer. It is also important to consider how the System Operator has certainty that those products are available and enforceable when needed.

NGG also believe that there remain a number of areas in the business rules and legal text which require further industry discussion and development, for example; the treatment of shortfall in funding DSR payments and the eligibility rules for entry into the DSR mechanism.

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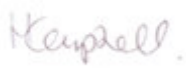
We discuss these points further and suggest an alternative solution within the detailed response to the questions posed in Ofgem's consultation.

In respect of the SCR package as a whole; while NGG agree that the market in general provides incentives to Shippers / Suppliers to balance their daily energy position in normal market conditions, we are not convinced that the proposed market arrangements will, of themselves, ensure that they meet their contractual supply obligations in more in extreme market conditions. NGG recommends that additional measures are introduced that would monitor the market's response to the proposed arrangements with the aim of providing improved clarity on how the industry plans to meet their short, medium and long term security of supply obligations.

We believe further enhancements to prevailing Shipper / Supplier licence obligations that require them to meet their contracted consumers' demand during extended periods of high demand would help strengthen existing accountabilities and further clarify roles and responsibilities in, and leading up to, an emergency. Such an obligation could be met through a range of tools, such as increasing supplies, storage or contracting for Demand Side Reduction. The effectiveness of such an obligation is in some part dependent on effective monitoring; therefore, we believe that an external party should be tasked with ensuring compliance with any such obligation.

We answer the specific questions posed in the Ofgem consultation document in the attached Appendix. Should Ofgem wish to discuss any of the points raised in this response, please contact Darren Lond at darren.lond@nationalgrid.com (01926 653493).

Yours sincerely



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Appendix - Gas Security of Supply Significant Code Review – DSR consultation Response to specific questions on behalf of National Grid Gas Transmission

Chapter 2:

Question 1: What are your views on a SO-run DSR tender? Do you think it is an appropriate addition to the Gas SCR?

We are supportive of increasing the participation, and recognition of, demand-side response within the gas market. We can see benefits in the provision of a pre-Gas Deficit Emergency (GDE) identified DSR volume, particularly in respect of providing NGG, in its role as the Residual Balancer, with a wider market of offers than are perhaps currently available. These could be utilised in order to reduce the likelihood of entering into, and/or the reducing the duration, of a GDE.

The last time a DSR type product was considered by the industry was during the development of UNC Modification Proposal 0086 – *Introduction of Gas Demand Management Reserve Arrangements*, at this time NGG responded expressing concerns relating to a number of areas. In particular these related to the potential expansion of the Residual Balancer role and its effect on the market and market prices. We continue to be aware that the introduction of an SO-run DSR tender results in the effective widening of the Residual Balancer role. It should be carefully considered whether there are any unintended consequences which may be linked to the level of supply contracted for in the market, being driven by a perceived lessening of risk by shippers, as a result of the extra layer of security the DSR contract held by NGG would offer. However, we welcome the intention that the use of DSR in this proposal is only available following the declaration of a Gas Deficit Warning (GDW). This will serve to mitigate the above adverse impacts to some degree and on balance we therefore consider that this may be sufficient to maintain the necessary clarity in industry parties roles and responsibilities we highlighted in our response to UNC Modification Proposal 0086.

During the Ofgem SCR workshops it was recognised that any DSR tender process would benefit from being as simple as possible. The replication of the existing Operating Margins annual tender process was proposed as an appropriate and familiar mechanism that could be adopted. However, we have some concerns that, as a result of the nature and anticipated volumes of DSR offers, the volume of tenders is likely to be much greater than the current OM process and therefore, adopting an OM tender type mechanism may lead to a material increase in development and administrative resource requirements. As a result, if the concept of a "SO led DSR tender" is taken forward, we would suggest that it may be beneficial to explore alternative approaches which could deliver the same or similar benefits without the need for annual contractual processes. We outline a potential alternative approach within our response to Question 9 of this chapter.

If the DSR Tender option is to be introduced then we would consider that this expands the existing role of Residual Balancer beyond that previously agreed and funded. As such we would ask that the industry consider how the costs of developing and operating such additional activities should be recovered.

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Question 2: What do you think the purpose of the tender should be?

We believe that the purpose of the tender is to provide an additional 'route to market' for a specific customer group. Providing that group with a mechanism within which they are able to offer, upfront, a value of lost load (VoLL) and therefore a demand side turn down service to the Gas System Operator post the declaration of a GDW for a tranche(s) of their demand.

We consider that any requirements which are site specific or more complex should be captured and facilitated within the Shipper to Consumer contract as part of the Shipper's primary balancing role.

Question 3: What benefits do you see a DSR tender providing?

From a Residual Balancer perspective the principle benefit of introducing a DSR product, which may be a tender, is the potential to provide an additional route to access a volume of demand reduction which can be utilised, in specific circumstances, to maintain the balance of supply and demand and therefore, to reduce the likelihood and/or duration of a Gas Deficit Emergency (GDE).

Question 4: What costs do you see arising from a DSR tender?

There are three main areas in respect of costs arising from the DSR tender. Firstly the costs associated with the development of the service, required systems and contractual framework prior to the DSR service being implemented. Secondly, the costs associated with the annual process of running the tender and administration processes to enable timely exercise of any contracts. Thirdly, as the Residual Balancer we currently only have a credit requirement, and therefore agreement, with one counterparty, ICE Endex, in its capacity as the OCM Market Operator. Dependant on the final solution design for DSR the Residual Balancer would therefore incur additional costs in the above areas.

Question 5: Do you think a DSR tender should have a role subsidising investment in back-up facilities? If so, why?

We are not in a position to understand the existing back up arrangements in place for demand side users. However, under existing arrangements all gas supply contracts carry a degree of delivery risk for consumers and as such we consider it would be prudent that each consumer would already be taking some measures to manage this risk. Participation in the proposed DSR tender may trigger a reassessment of the above risk.

We do not believe that the DSR tender should have a role in subsidising "back up fuel" facilities as there are many different routes to facilitating the provision of DSR and not just through such facilities. We consider that singling out this approach would be inconsistent with facilitating and promoting innovative demand management solutions.

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Chapter 3:

Question 1: What do you see as the key design issues for the high level design of a DSR tender? Are there any we have not included here?

As it is proposed that the DSR offers would be exercised immediately prior to the potential onset of a Gas Deficit Emergency their use would fall within the role of the Residual System Balancer. This role is governed by NGG's licence conditions and would need to be described with the System Management Principles Statement (SMPS) and Procurement Guidelines document. In order for NGG to demonstrate compliance with its licence conditions and the above documents we view ensuring compliance with the exercise of a DSR contract as a key design issue. A proportion of the sites that may be considered as eligible to participate in the DSR product are not telemetered in real time and therefore we do not have within day visibility of flow rate changes. On a day where DSR is being exercised the system is likely to be significantly out of balance and therefore, we would be seeking to utilise tools which provide a high degree of visibility of delivery, or which incur a penalty for non delivery, e.g. a variant of the Physical Renomination Incentive (PRI) charges imposed on "Physical Market" actions taken through the OCM. We would therefore like the industry to consider including some form of penalty for non-delivery as part of any DSR product design.

Another area which NGG believe is a key design issue are the eligibility criteria. There are a number of factors which need to be considered in the decision on eligibility criteria, such as:

- Existing market access
- IT system impacts
- Physical impacts - materiality
- Response time
- Complexity of contractual arrangements
- Logistics in exercise
- Ability to confirm / monitor delivery of the contract

Question 2: What are your views on having variable option fees in the tender? Do you have any concerns about the costs that these could impose irrespective of a GDE actually occurring? How should these be funded?

We believe that the inclusion of variable option fees would be inconsistent with the objective of having a simple process aimed at discovering a consumer's VoLL.

Especially during the initial years, we have concerns at the potential for inefficient annual costs which may be incurred by the industry if option fees were to be included within the tender design when the eventual value to the market needs time to develop.

If option fees are to be paid (regardless of them being fixed / variable) we believe there needs to be further consideration of the means by which such costs would be recovered. Again, for example, one method would be through the existing Balancing Neutrality mechanism. However, this may lead to further impacts in terms of amount of monies being processed through the Balancing Neutrality account and the administrative

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processes needed for money to be passed from Balancing Neutrality to the shipper and then passed onto the relevant customer.

During industry discussions, one option raised was to recover these costs through an uplift to the fixed differential applied to the System Clearing prices. We do not believe this to be appropriate. The fixed differential is there to provide an incentive for Shippers to balance their daily portfolio and is not intended to be a cost recovery mechanism. If the fixed differential is influenced by variable option fees there could be unintended consequences. Dependant on the extent to which the fixed differential is impacted there could be impacts on liquidity in the market and/or market signals for investment. Also there is a risk, if the costs are sought to be recovered in this manner, that the costs will not be recovered or indeed costs are over recovered. As such an adjustment mechanism would also be required, thereby adding further complexity to the system clearing process. In our response to Modification Proposal 0086, we outlined an example of a potential consequence of recovering option fees through an adjustment to the SMP Buy price.

Question 3: What are your views on the eligibility of gas-fired power stations? How should the interactions with the electricity market be managed?

The eligibility question is linked to the eventual design of the tender in terms of how exercise prices are structured. However, we consider that this eligibility question on CCGT's with firm capacity equally applies to some of the larger industrial loads and is focussed on whether those offtakes which have historically had direct access to the OCM via the Locational and Physical markets should be included in the DSR Tender process or if the DSR Tender should only provide those parties without immediate market access with a route to market.

With specific reference to gas-fired generation the price such offtakes will submit into any DSR process depends on a number of factors which vary both day on day and within day, such daily and sub-daily variability would not appear to fit well with a potentially yearly fixed exercise pricing process.

With the electricity cash out price potentially moving to £6,000/MWh[1] in times of electricity demand disconnection, there is the possibility that gas fired generation will tender prices that seek to mitigate this potential risk – with a CCGT that is 50% efficient, this equates to ~£85/therm. In addition, a price risk may materialise through the penalty regime within the proposed EMR capacity mechanism, with the penalty regime potentially moving to £17,000/MWh, with a corresponding gas price (with a 50% efficient CCGT) of ~£250/therm. It is our opinion that this risk exists in the market regardless of whether gas-fired generation is able to participate in the DSR mechanism or not.

If gas fired generation were to tender into the gas DSR process at the above price point, and if this price is accepted by the Residual Balancer prior to an emergency being declared, the impact on the market and industry credit arrangements that underpin the market arrangements would be significant.

[1] Ofgem Electricity Balancing Significant Code Review – Draft Policy Decision document - https://www.ofgem.gov.uk/ofgem-publications/82294/ebscrdraftdecision.pdf

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In addition, if Shippers supplying gas fired generation have hedged against a Gas Deficit Emergency (by receiving £250/therm for their interrupted gas), then there will be little if any incentive on them to provide improved fuel security. However, if as originally planned, the gas cash out is capped at £14/therm, gas fired generation will have a strong incentive to ensure that their financial risk of being exposed to electricity cash out (or EMR penalties) due to a GDE is adequately managed.

The main issue of the interaction between the gas and electricity markets is the distortion of the gas cashout price signal potentially created by the electricity cash out / capacity mechanism penalties and how this will interact with gas emergency arrangements. In effect the VoLL price of electricity customers would potentially feed through to the gas clearing system and be paid by gas consumers. This would therefore see gas consumers potentially subsidising the security of supply in the electricity market.

Question 4: Could participation of gas-fired power stations have a negative impact on the tender, or on the gas market as whole? If so, can you suggest any steps that could be taken, or an alternative mechanism that could be created, that would help mitigate these concerns?

Whether gas-fired power generation is able to participate in the DSR tender or not their prices still have the potential to impact on gas cashout, Balancing Neutrality and market credit positions in the period following a GDW as they do during normal operation. The difference in the impact they have is dependant on the design of the DSR product. For example, if they are excluded from the DSR Tender they would still be able to offer their DSR on to the OCM. This could be accepted by either another market participant, in which case it would impact the SAP price but not necessarily the marginal price, or it could be accepted by the Residual Balancer where the price will be eligible to set the marginal price on the day. If they are included in the DSR tender then their offer would only be available to the Residual Balancer and wouldn't be available to the rest of the market and is therefore more likely to set the marginal system clearing price, the final design will dictate which elements of cashout will be impacted.

The participation of gas-fired generation also potentially has an impact on the level of participation in the Operating Margins (OM) tender. In 2008, through the contestability work, we worked with our customers to introduce the ability for CCGT's connected to the NTS to offer some OM services. Given the role of OM in the safe operation of the pipeline system we would wish to ensure that any new tender process did not undermine this service. This equally applies to the further potential development of supply side inclusion discussed in the Ofgem consultation.

Question 5: Do you have any views on what consumers whose bids were unsuccessful should be paid if they are firm-load shed?

We understand that this question involves consideration of the balance between promoting competition within the DSR Tender process and reflecting the consumer's cost of loss of supply. We are supportive of a solution which strikes an appropriate balance between these two priorities. As such we consider that if there are unsuccessful bidders then these bidders should be paid a proportion of the highest priced successful tender. One such possible mechanism would be to pay those unsuccessful bidders, whose price was close to the highest accepted price, the average accepted price and then reduce payments to other unsuccessful bidders depending on how far away from the highest

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accepted price their bid was. The aim of this would be to further encourage cost reflective bidding.

Question 6: What are your views on the response type the tender should contract for?

The traded gas market and all SO related energy actions such as those taken for Residual Balancing, or Operating Margins, tend to be structured around the delivery of a quantity of gas either into or out of the System. It would therefore seem sensible for the DSR product to be designed with this principle in mind. In our view the product should be designed as a 'turn down by' product rather than a 'will not flow more than' product.

A 'turn down by' product simplifies the payments made under the contract allowing a p/kWh type arrangement, this type of arrangement also lends itself to more accurate reflection of the exercise within a Shipper's imbalance position and cashout prices. Assuming the product has the right incentives to ensure compliance with the exercise of the contract by the Shipper, a volume delivery product provides a clearer view of the physical effect of the action. This in turn would enable the Residual Balancer to demonstrate the efficiency of the action taken.

Question 7: What are your views on a minimum volume threshold? Do you have any ideas on how this could be set? Should there be a limit on the number or size of tranches that consumers can bid?

The level at which a minimum threshold should be set depends on the eventual design and rules around usage but in general we believe that a minimum threshold should be applied to each tranche offered to capture the load which fits with the levels prescribed by systems such as Gemini and the OCM, with a limit on the number of tranches offered,

NGG feel that tranches are a key element in the design of the DSR product, the limit on the number of tranches a site may offer should be developed through discussions with industry around the more detailed design of the product.

Question 8: What is your preferred length of time and/or frequency with which NGG may exercise a DSR contract? Do you have a preferred minimum response time if a DSR contract were to include one?

The DSR product is being developed to be used, by the Residual Balancer in times of system and market stress. Given recent history we do not envisage the exercise of these contracts to be a frequent occurrence and as a result think that once the contract is exercised, then the end consumer should remain constrained until instructed that they can resume flows. Additionally, due to the expectation of exercise not being frequent, we do not believe there should be a limitation on the number of exercise events during the contract duration.

Response time to commence reductions in similar historic products sought to balance the needs of the Residual Balancer and the ability of the consumer; therefore we consider that a potential response time could be between 4 and 6 hours. However, in the circumstance where a GDW has been issued a quicker response time may be beneficial and therefore the design of the product should allow for quicker response times where they are feasible. The design should consider the views of industry on how the time set for response may impact on volume of participation, to ensure that an appropriate

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balance is struck. Response time could therefore be a factor into whether a site is eligible to participate, meaning that the eligibility criteria could be linked to both a minimum size and their ability to respond.

Question 9: Do you have any views on any other tender design issues? Gas Security of Supply Significant Code Review – Demand-Side Response Tender Consultation

Should the design of the final proposed DSR product result in a tender, then the design of the tender will drive different solutions in terms of systems requirements for assessment and exercise, the costs of this need to be established and considered against the benefits provided by the subset of sites deemed eligible to participate in the tender.

In addition we believe that the proposed introduction of capability to place DSR tender offers in tranches, which enables the DSR user to apply a specific VoLL to each tranche, introduces an alternative approach for each end customer in respect of managing risk associated with certainty of supply, and may provide a means through which they may protect their assets and/or production during the progression into a GDE.

A consideration in respect of the design of the tender is the interaction with other processes. We believe that the industry may want to consider whether it is appropriate for a site to participate in a number of disparate mechanisms, which may be utilising the same volume of turn down at similar times, for example the DSR product, OM Tender, OCM offer and Distribution Network interruption.

The SCR workshops, as well as those held for UNC Modification Proposal 435 – *'Arrangements to better secure firm gas supplies for GB consumers'*, have both focused on delivering DSR through the development of a DSR tender or auction mechanism. However, NGG considers that the industry may wish to consider the merits of an alternative approach that has the potential to equally provide the Residual Balancer with access to contracts with those participants who are not currently active players in the wholesale market whilst also mitigating the expressed consumer concerns regarding contracting directly for DSR with their Shipper. We feel that any solution needs to encompass flexibility to allow consumers to reflect latest information within their VoLL and/or available volume which an annual tender may not facilitate; this approach may also result in a less complex, more transparent and cost efficient solution.

In this approach Shippers, acting on behalf of eligible demand side consumers, would have an obligation to provide a VoLL(s) for tranches of the consumer's demand at each eligible offtake which would be held in a central system for use by the Residual Balancer in prescribed circumstances, for example following a GDW. This information could be held either within the UK Link system alongside existing supply point information, to be exported to the OCM in the event of a GDW being declared, or, held within the OCM systems. In each case the Shipper is able to amend the VoLL and available volume information on behalf of their customer at any time to reflect current availability. There would be no distinct tender and therefore all offers would in effect be available for use by the Residual Balancer in the event they are needed, given the ability for availability updates by consumers there should be more confidence in the delivery of any volume taken.

The market for DSR would be frozen at the time of a GDW being declared and at this point available solely to NGG in its role as Residual Balancer to accept offers.

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The contractual solution to this would then be between the Shipper and End Consumer thus negating the need for the significant development work around a DSR methodology and separate contractual framework between the Residual Balancer and DSR Tender participants. This option would also mitigate the complexity associated with reflecting any changes in Consumer to Shipper contract relationships occurring during a DSR contract period.

Chapter 4:

Question 1: What are your views on the three straw men?

Our comments on the strawmen are based on the assumption that DSR offers would be exercised in line with all other balancing tools as described in the Procurement Guidelines and SMPS.

Straw Man 1:
As stated in previous SCR consultation responses we do not believe that there should be an explicit VoLL related price cap on system clearing prices. This in theory equally applies to DSR tender Residual Balancing actions as they are intended to become a function of market operation and cashout and provide the incentive to Shippers and Suppliers to meet security of supply obligations. Our concern is that this may discourage the delivery of supplies or reduction in demand, which may be at a cost above VoLL, that could be used to avoid an emergency or resolve the emergency more quickly. Although we understand the arguments behind seeking to identify how pay-as-clear may drive out more optimal bidding behaviour in the tender, we believe that there may be additional consequences around the impacts on Balancing Neutrality. We believe that pay-as-clear has the potential to drive higher costs through the regime than the current market function of a pay-as-bid approach.

Straw Man 2:
Straw man 2 would be our preferred option of the three described within the consultation document. As you have discussed in the consultation document the challenge with this design is how to create the volume requirement. Ideally, it should be something simple. UNC Modification 0435 initial discussions were around linking the volume requirement to the European security of supply standard, however GB currently meets this and therefore this would result in a volume requirement of zero. Defining a volume cap linked to the cheapest x% of bids received could result in a significant volume being not accepted where the price is only marginally different to the previous bid. We outline a potential alternative solution with Question 10.

Straw Man 3:
We have concerns with the concept of a budget and the inclusion of option fees; we expand on this point within Question 8. We favour the approach of pay-as-bid as this aligns with the existing day to day gas market balancing activity and minimises the risks of there being shortfalls in Balancing Neutrality.

Question 2: Do you think a price cap is necessary to limit shipper liabilities?

While a price cap could limit Shipper liabilities there are potential unintended consequences. As we have already commented within this response we have concerns

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around the inclusion of a price cap and the impact it may have on behaviour, potentially creating a target price and also restricting parties from expressing their true VoLL.

As a result of the updated proposed final decision for the SCR and the potential inclusion of a DSR tender, we believe that a review of energy balancing credit arrangements would be prudent to ensure they remain fit for purpose post implementation.

Question 3: Do you have any suggestions for how the volume cap in straw man 2 or 3 should be set?

In the absence of a security of supply requirement which could be used to generate a volume requirement there are a number of options:

- A percentage of the estimated maximum volume of DM demand available
- A proportion of the volume offered in the tender
- A volume which reflects an issue on the network, this may be the loss of largest supply, or a spike in demand of x% e.g. the loss of the pipeline at a major entry point

We outline an alternative approach to assessing the DSR tenders to be accepted within Question 10 of this consultation response.

Question 4: Do you think the volume cap in straw man 2 or 3 is sufficient to prevent inefficiently high DSR bids from being accepted?

As discussed in our answer to Question 1 of this chapter; setting the volume cap would ideally be referenced to a security of supply standard. Given this would give a requirement of zero currently to meet the EU defined standard then another methodology would need to be developed or a higher level of security defined. The extent to which this limits the price exposure is dependant on its definition and the bidding behaviour exhibited by the market. These are both unknown at this time.

The second impact on DSR tender bids would be what unsuccessful parties are paid if and when they were interrupted. Therefore, on its own, we do not believe that a volume cap is sufficient to manage potential market inefficiency; a secondary incentive on payment for unsuccessful parties is required.

Question 5: Do you have any views on whether or not straw man 2 should be paid-as-bid?

Although we understand the economic theory behind pay-as-clear, we think that straw man 2 would be enhanced through the use of pay-as-bid. Pay-as-bid aligns with all other OCM energy actions including those actions the Residual Balancer would be taking at the same time as exercising DSR and the majority of other energy products. In our opinion it would seem logical to align the DSR product with the standards currently seen in the market to prevent any unintended consequences in market behaviour.

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Question 6: Do you have any ideas for how a fixed budget for straw man 3 could be set?

The fixed budget could be set using an estimate of the maximum potential participation volumes and multiply by a proportion (e.g. 60-80%) of that volume by the calculated fixed option fee. However, there are potential issues with setting a budget as it is likely to be a relatively arbitrary number. In the case where participation is high, the budget would likely be exhausted. It is feasible that through the tender a large volume at an exercise price only marginally different to the highest one accepted which exhausted the budget could then be excluded, in this instance we would consider that the concept of a budget may be too rigid.

Question 7: Should any volume cap or fixed budget be known to the market ex ante?

The impact of volume or budget cap on the market for DSR would depend on how competitive the market is likely to be. If the volume cap is very close (or above) the volume of all eligible parties, it is not likely to have an impact on bidding behaviour, if it is below the volume of eligible entrants it would be expected to have an impact on bidding behaviour.

Question 8: What do you think of the rationale for having fixed option fees in straw man 3? Why might they be necessary to ensure sufficient participation and competitive bidding?

The consultation suggests that the fixed option fee is there to encourage participation in the product, NGG feel, on balance, that the incentive around participation created from the current proposed design of a end consumer getting no compensation if they do not participate in the tender should be sufficient to encourage high levels of participation, the additional incentive of a fixed option fee therefore shouldn't be needed.

Question 9: How could the fixed option fees could be determined?

The consultation describes that the option fee could be there to encourage participation rather than to subsidise the provision of "back up" options and fuels. In this instance it may be that the fixed option fee should be based upon an estimate of the administrative cost of submitting a tender, thereby meaning that the consumer is not financially exposed to the costs of providing the bid.

Question 10: Do you have an alternative design package that you think better meets the aims of the DSR tender than the three set out here?

As described in Question 9 of the previous chapter our preferred approach would be to provide an unconstrained, market based facility for VoLL(s) to be submitted. However, should the final solution result in a tender, an alternative option for deciding which bids to accept would be to not have an explicit price cap but generate a price curve from the offers received in the DSR tender, and accept all bids up to where there is a significant price break in the curve, this could include:

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- Methodology using the tenders received to determine the volume of the tenders which are accepted, at a high level this could be based on the deviation from the previously accepted bid.
- Additionally the methodology could provide a number of levels of compensation dependant on where the bid is relative to the highest accepted bid price in the tender.

Benefits of this approach:

- No price or volume cap is known prior to the tender opening, the market dictates the prices accepted, mitigating target price concerns
- No upfront cost due to exercise only bidding.
- Should encourage cost reflective bidding behaviour as the further away from the highest accepted price in the tender a end consumer is the lower the level of compensation they are paid.

Concerns with this approach:

- Needs there to be a large population of offers otherwise divergence could happen too quickly.
- Potentially complex, this could have the effect of being a disincentive on participation.