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09 April 2014

**Gas Security of Supply Significant Code Review - Final Policy Decision -
National Grid Gas Transmission Consultation Response**

Dear Anjali,

Thank you for providing National Grid NTS (NGG) with the opportunity to respond to Ofgem's consultation on the Gas Security of Supply Significant Code Review (SCR) Final Policy Decision.

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 Gas Shipper Licence Condition 3. In support of this obligation NGG also undertakes the role of Residual System Balancer.

Through the development of the SCR, we note that Ofgem has listened to concerns raised by the industry and sought to address some of the principle concerns by way of revisions to the SCR Final Policy Decision. For example; the change to the calculation of NDM VoLL (Value of Lost Load) now reflecting a peak, rather than average demand in its derivation.

NGG supports the principle of the SCR: 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 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 measures proposed under the SCR, provided that such proposals retain clear accountabilities, roles and responsibilities amongst industry players that promote the continued supply of gas to consumers during times of system stress.

As part of Ofgem's 'Proposed Final Decision – Gas SCR, July 2012 (ref 111/12)' Ofgem proposed that the SCR may benefit from the inclusion of the development of a DSR methodology that may facilitate additional Demand Side Response (DSR) at pre GDE Stage 2, as this may reduce the likelihood, severity and duration of a GDE. Ofgem's Final Policy Decision continues to recognise the merits of developing and trialling a DSR mechanism and proposes that this is progressed through a licence obligation on National Grid Transmission, and outside of the SCR arrangements. Whilst we agree that developing a route to market for additional efficient DSR would complement the proposed cashout arrangements within the

SCR, our view is that any discussions associated with the development of a DSR mechanism have the potential to reduce the incentive for market players to come together and develop fully market based demand management arrangements. As such we believe that there continues to be merit in Ofgem consideration of a delay to the development of a centralised DSR mechanism until the incentives introduced by the implementation of the SCR have been fully assessed by industry. Nevertheless, should a DSR mechanism be progressed at this time we look forward to working with Industry to develop a mutually beneficial solution. If successful in attracting significant additional demand side volumes, a DSR mechanism could reduce the likelihood of moving into a GDE.

NGG believes that a prompt market based product for the provision of DSR is preferential to other potential products discussed during the SCR developments due to the additional flexibility these would permit participants in terms of both price and volume, the ability to include into System clearing contract, the transparency they provide and the ease of access for participants.

In order to be effective, and drive the correct behaviours, NGG believes the DSR methodology needs to establish key design principles, for example, clarity and agreement in respect of the form of pricing to be adopted for DSR Offers. The industry will need to establish whether offers submitted to a DSR mechanism are for the compensation value for the end user, the cost of gas or a combination of both. Clarity and simplicity around the key design principles should encourage the maximum number of potential market participants. It is also important for the methodology to consider how NGG, as the System Operator, has certainty that DSR offers will be available, that the incentives to deliver on DSR contracts are sufficient when required and that the DSR mechanism does not result in any additional process ambiguity during a time of system stress.

Within the Ofgem Final Policy Decision, paragraph 2.7 discusses the disconnection order within Stage 2 of a GDE, and how sites are disconnected in size order. It is the view of NGG that nothing within the SCR final decision or the proposed development of a DSR mechanism should change this and we consider that upon entry into Stage 2 of a GDE, Firm Load Shedding would continue as it would currently. The DSR methodology is therefore only concerned with the period between publication of a Gas Deficit Warning (GDW) and the end of Stage 1 of a GDE. It should allow a subset of Daily Metered demand the opportunity to effectively contribute to the mitigation of the risk of disconnection in Stage 2, by offering a price at which they would be willing to reduce a proportion or all of their demand during the period following a GDW, in order to try and prevent the need for progression to Stage 2.

In respect of the SCR package as a whole; whilst NGG agrees that the mechanisms set out within the UNC and licensing structures provide incentives to Shippers / Suppliers to balance their daily energy position in normal market conditions, we are not convinced that the proposed mechanisms will, in themselves, ensure that they meet their contractual supply obligations in more extreme market conditions. We believe further enhancements to prevailing Shipper / Supplier licence obligations that oblige 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, a GDE. 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 monitoring and reporting on compliance with any such obligation.

The developments under the Electricity Balancing SCR and Electricity Market Reform (EMR) Capacity Mechanism further strengthen interaction between the Gas and Electricity markets with the potential for electricity VoLL and the proposed EMR Capacity Mechanism penalties to feed across into the Gas Cashout charges. It should be noted that these are a magnitude higher than the NDM VoLL of £14/therm. We believe that further consideration of this interaction is needed to fully understand the potential impact of the feed through of electricity balancing incentives into gas wholesale market prices.

NGG believes that following the SCR, and possibly alongside the development of any associated DSR mechanism, there are a number of financial credit related issues which require consideration and review by the Industry to ensure the continued efficient operation of the market. These issues are related to Energy Balancing security and Trade credit positions. As highlighted in the Energy Balancing Credit Committee (EBCC) response to the Proposed Final Decision document in July 2012 the introduction of NDM VoLL values into System Clearing Process has the potential to create prohibitively high financial credit requirements on the Industry. Additionally, with prices potentially increasing towards £14/therm, trade credit is likely to be squeezed and liquidity in the market may be impacted. Both issues are likely to lead to the need for the Industry to review current financial and credit risk management processes to ensure that they remain fit for purpose in light of the changes brought about by the SCR. In addition, the potential for electricity prices to influence gas prices may further exacerbate financial credit issues.

As we have previously highlighted in response to Ofgem's 'Proposed Final Decision – SOS SCR' document, significant industry change is scheduled for implementation during late 2015 and early 2016; the SCR, Project Nexus, EU Network Codes and associated changes are all major developments for the GB gas industry and therefore the timeliness of any decision is key to enabling successful implementation for industry as a whole in time for Winter 2015.

We attach specific comments on the Legal text and DSR Licence condition 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) or Claire Thorneywork at claire.l.thorneywork@nationalgrid.com (01926 656383).

Yours sincerely

A handwritten signature in purple ink that reads 'H Campbell'.

Helen Campbell

Appendix - NGG comments on the Special Condition 8I: Development and implementation of a Demand Side response Methodology for Use after a Gas Deficit Warning

NGG believes that in general the draft SC 8I Licence Condition sets out a structured and clearly defined set of provisions in respect of NGG Licence obligations for the development and implementation of a DSR methodology.

We note that the statutory consultation on the licence changes for all SoS SCR related licence changes will take place during Summer 2014. We are concerned that the Statutory consultation timescales may conflict with the SC 8I Licence drafting prescribed dates, in particular the obligation to deliver a DSR Methodology by 1 March 2015. We would therefore request that Ofgem remain mindful of the effect that any delay in their decision on implementation of, or amendments to, Draft Licence Condition SC 8I may have in respect of achieving these prescribed dates.

We have provided below comments on the drafting, which may further enhance the clarity of the Licence Condition and assist ourselves, our customers and our stakeholders during the development of the methodology:

Special Condition 8I: Development and implementation of a Demand Side Response methodology for use after a Gas Deficit Warning

Introduction

8I.1 The Licensee must:

- (a) develop a methodology (the "Demand Side Response Methodology") for assessing and accepting Demand Side Response Offers;
- (b) submit a draft Demand Side Response Methodology to the Authority for approval by 1st March 2015;
- (c) where Directed by the Authority to do so, run a trial of the approved draft Demand Side Response Methodology;
- (d) following such a trial, submit to the Authority a report on the outcome of the trial and a final version of the Demand Side Response Methodology amended to address issues identified by the Licensee during the trial; and
- (e) where Directed by the Authority to do so, implement the Demand Side Response Methodology.

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Comment [NG1]: Moved from 8I.5 to make that provision work more clearly

Part A: Development of a Demand Side Response Methodology

8I.2 The Licensee must develop a Demand Side Response Methodology in consultation with interested parties.

8I.3 The Licensee must use reasonable endeavours to ensure that the Demand Side Response Methodology is developed in accordance with the principles set out in paragraph 8I.4 (the "Demand Side Response Methodology Principles").

Comment [NG2]: New words added to this clause otherwise 8I.2 is a straight repetition of 8I.1. These new words make the clause cover 'How' National Grid will develop the methodology

8I.4 The Demand Side Response Methodology Principles are that the Demand Side Response Methodology must:

- (a) ensure that any party making a Demand Side Response Offer is a party to the Uniform Network Code;
- (b) set out the criteria for determining in respect of which "DMC" Supply Point Components a party may not make Demand Side Response Offers;
- (c) allow the Licensee to accept Demand Side Response Offers only where a Gas Deficit Warning is in place or within Stage 1 of a Gas Deficit Emergency;
- (d) demonstrate compatibility with existing market arrangements by setting out how any Demand Side Response Offers accepted by the Licensee are to be treated as Eligible Balancing Actions and included in the System Clearing Contract, System Marginal Buy Price and System Marginal Sell Price;

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(e) promote and further facilitate parties making Demand Side Response Offers to the Licensee through open and transparent market-based arrangements;

(f) not unduly preclude the emergence of commercial interruption arrangements;

(g) minimise distortions and unintended consequences on existing market arrangements and the principle of self-balancing in the wholesale gas market; and

(h) ensure that Demand Side Response is procured in a manner consistent with the Licensee's duties under the Act and, in particular, the Licensee's obligation to operate the pipe-line system to which this licence relates in an efficient, economic and co-ordinated manner.

Comment [NG3]: This is the correct reference to an SO obligation – see Special Condition 8A, para 3)

Deleted: (and, in particular, the Licensee's duty to maintain an efficient and economical pipe-line system) and its obligations under this licence.

Part B: Approval and publication of the Demand Side Response Methodology

8I.5 The Licensee must consult with interested parties on the draft Demand Side Response Methodology before submitting the draft Demand Side Response Methodology to the Authority. The draft Demand Side Response Methodology submitted by the Licensee must be accompanied by any written representations (including any proposals that have not been accepted by the Licensee) that were received from interested parties during the consultation process and have not been withdrawn.

Comment [NG4]: Moved to 8I.1b

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8I.6 In considering whether to approve the draft Demand Side Response Methodology, the Authority may have regard to whether it is consistent with the Demand Side Response Methodology Principles.

8I.7 Where the Authority approves the draft Demand Side Response Methodology, it may direct the Licensee to:

(a) conduct a trial of the draft Demand Side Response Methodology; and

(b) publish the draft Demand Side Response Methodology

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in accordance with Part C of this condition.

8I.8 If the Authority does not approve the draft Demand Side Response Methodology, it may Direct the Licensee to consult with interested parties and submit to the Authority for approval a revised draft Demand Side Response Methodology in accordance with any conditions and within such a timescale as may be set out in that Direction.

Part C: Trial and implementation

8I.9 Where the Authority directs the Licensee to conduct a trial pursuant to paragraph 8I.6 above, the Licensee must:

(a) conduct a trial of the draft Demand Side Response Methodology in order to assess the level of prices offered for the provision of Demand Side Response and

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effectiveness of the Demand Side Response Methodology proposed by the Licensee; and

- (b) within 28 days of the end of the trial, submit to the Authority a report on the outcome of the trial and any proposed changes to the draft Demand Side Response Methodology proposed by the Licensee.

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8I.10 Following completion of the trial and the making of submissions to the Authority pursuant to paragraph 8I.9 above, unless the Authority directs otherwise, the Licensee must:

Comment [NG5]: It would be useful for this clause to be timebound, for example 'unless the authority directs otherwise within 28 days'

- (a) develop appropriate modifications to the Uniform Network Code and other processes and systems to enable it to implement the Demand Side Response Methodology;

- (b) once the modifications, processes and systems are complete, implement the Demand Side Response Methodology as soon as is reasonably practicable; and

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- (c) publish the final Demand Side Response Methodology on its website and in such other manner as the Authority may direct.

Part D: Exception to compliance with condition

8I.11 The Licensee is not required to comply with this condition to such extent and subject to such conditions as the Authority may from time to time direct.

8I.12 The Authority may, following consultation with the Licensee and interested parties, direct that the Licensee must temporarily or permanently cease operation of the Demand Side Response Methodology.

Part E: Revising the Demand Side Response Methodology

8I.13 The Licensee must, if so directed by the Authority and, in any event, at least once in each Formula Year, review and, if appropriate, revise the Demand Side Response Methodology in consultation with interested parties.

8I.14 The consultation must allow a period of not less than 28 days in which interested parties can make representations or objections to the Licensee.

8I.15 Within seven days after completing the consultation, the Licensee must send to the Authority:

- (a) a report on the outcome of the review;

- (b) a statement of any proposed revisions to the Demand Side Response Methodology that the Licensee (having regard to the outcome of the review) reasonably considers would better achieve the Demand Side Response Methodology Principles; and

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- (c) any written representations or objections (including proposals for revising the statement that have not been accepted by the Licensee) that were received from interested parties during the consultation process and have not been withdrawn.

8I.16 The Licensee may revise the Demand Side Response Methodology only in accordance with any revisions set out in the statement required by paragraph 8I.15(b) and only if the Authority consents to that revision.

Part F: Interpretation

8I.17 In this condition:

"Demand Side Response" means the provision of gas to the Licensee by a contracting party in respect of a specific "DMC" Supply Point Component.

"Demand Side Response Offer" means an offer to provide Demand Side Response.

"Gas Deficit Warning", "Eligible Balancing Actions", "System Clearing Contract", "System Marginal Buy Price", "System Marginal Sell Price" and "DMC" Supply Point Component" shall bear the same meanings as are given to those terms in the Uniform Network Code.

NGG comments on Legal Text.

Fall Back SAP – Business Rule 1.6, Legal Text TPD Q 4.1.5

The current business rules and legal text have a multi way approach to calculating a the Fall back SAP, however if there are no trades for the current day then the Fall back SAP under the current drafting has the potential to be 50% of the last robust SAP. We therefore consider that the text should be amended to prevent this situation from occurring.

Proposed Text:

4.1.5 For the purpose of this Paragraph 4.1, in respect of a Day in a Stage 2+GDE:

- (a) **“Fall Back SAP”** shall be a value in pence/kWh calculated as follows:
 $(0.5 \times \text{Preceding SAP}) + (0.25 \times \text{Median Trade Value}) + (0.25 \times \text{VWA})$;
(i) If either the Median Trade Value or the VWA equal zero then the Fall Back SAP shall be the Preceding SAP
- (b) **“Median Trade Value”** shall be the median Market Offer Price for the Day in pence/kWh, where (when the Market Transactions for the Day have been ranked in order of Market Offer Price, and number 'n') the median Market Offer Price is (if n is odd) the Market Offer Price of the Market Transaction that is ranked $(n+1)/2$ or (if n is even) the arithmetic mean of the Market Offer Prices of the two Market Transactions ranked $n/2$ and $n/2 + 1$;
- (c) **“Preceding SAP”** shall mean the System Average Price in pence/kWh on the most recent Day on which none of the conditions set out in Paragraph 4.1.4 existed; and
- (d) **“VWA”** means the amount calculated as System Average Price in pence/kWh for the Day in accordance with Section F1.2.1(c).