

National Grid Gas Plc and all  
other interested parties and  
stakeholders,

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Date: 14 October 2022

**Decision on the proposed modifications to the Demand Side Response ("DSR")  
Methodology of National Grid Gas plc's ("NGG") Gas Transporter Licence and  
Decision further to NGG's request for Derogation from Special Condition 9.22.3(c)  
of its Gas Transporter Licence.**

This letter sets out our<sup>1</sup> consent for NGG to revise the Gas Demand Side Response ("DSR") Methodology in accordance with Special Condition 9.22.4 of NGG's Gas Transporter Licence ("the Licence").<sup>2</sup> It also sets out our decision to grant the requested derogation for NGG to Special Condition 9.22.3(c) of the Licence, in accordance with Special Condition 9.22.12 of NGG's Licence. This will allow NGG to accept DSR Offers where a Gas Margins Notice<sup>3</sup> is in place as well as where a Gas Balancing Notification<sup>4</sup> is in place or within stage 1 of a Gas Deficit Emergency ("GDE"). The direction, which appears annexed to this letter, will give effect to this derogation decision (subject to the conditions specified therein).

## **Background**

Special Condition 9.22.1 of the Licence requires NGG to have in place and maintain the DSR Methodology for assessing and accepting DSR offers. NGG must review its DSR Methodology at least once in every period of two Regulatory Years in accordance with 9.22.4 and consult with interested parties for a period of no less than 28 days in

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<sup>1</sup> References to the "Authority", "Ofgem", "we" and "our" are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

<sup>2</sup> National Grid Gas plc, Gas Transporter Licence, Special Conditions:  
<https://epr.ofgem.gov.uk/Content/Documents/National%20Grid%20Gas%20Plc%20-%20Special%20Conditions%20Consolidated%20-%20Current%20Version.pdf>

<sup>3</sup> A Gas Margins Notice is information provided by NGG indicating a potential supply/demand imbalance for the following gas day.

<sup>4</sup> A Gas Balancing Notification is issued at NGG's discretion in advance of or during a gas day if a significant supply/demand event is experienced which instigates a material risk to the physical end-of-day balance.

accordance with 9.22.5. Within seven days following the consultation close NGG must submit to the Authority a report on the outcome of the review, a statement of any proposed revisions to the DSR Methodology, and any written representations that were received from interested parties pursuant to 9.22.6 of the Licence.

On 5 September 2022, NGG raised UNC822: '*Reform of Gas Demand Side Response Arrangements*'.<sup>5</sup> This modification sought to further incentivise uptake of the DSR product by introducing new reforms to the existing methodology. On the same day NGG made an application to Ofgem pursuant to Special Condition 9.22.12, requesting a derogation from Special Condition 9.22.5 so they may consult on the revisions to the DSR Methodology for 10 days instead of 28 days as prescribed by the Licence. On 7 September 2022 we published our decision to grant the requested derogation.<sup>6</sup> On 8 September 2022, NGG published its proposed amendments to the Gas DSR Methodology in accordance with the reforms embedded in UNC822.

The proposed amendments to the Gas DSR Methodology and UNC822 would allow NGG to accept DSR Offers where a Gas Margins Notice is in place. Special Condition 9.22.3(c) of the Licence allows NGG to accept DSR Offers only where a Gas Balancing Notification is in place or within stage 1<sup>7</sup> of a Gas Deficit Emergency. On 29 September 2022, NGG made an application to Ofgem pursuant to Special Condition 9.22.12, requesting a derogation from Special Condition 9.22.3(c).

## **Proposed amendments to the Gas DSR Methodology**

In accordance with Special Condition 9.22.8, we must assess any proposed revisions to the DSR Methodology and have particular regard to whether they are consistent with the objectives set out in Special Condition 9.22.3.

The proposed changes seek to enable NGG to:

- Administer an invitation to offer process in which Shippers may make commitments to offer Gas DSR on behalf of consumers in advance of a Winter Period;
- Introduce payments to Shippers as compensation for such consumers being available for DSR where DSR options are accepted in the invitation to offer process, including:
  - details of the invitation to offer process;
  - details of how NGG will assess DSR Option Offers received;

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<sup>5</sup> <https://www.gasgovernance.co.uk/0822>

<sup>6</sup> <https://www.ofgem.gov.uk/publications/decision-further-national-grid-gas-plcs-request-derogation-special-condition-9225-its-gas-transporter-licence>

<sup>7</sup> Stage 1 represents that there is the potential for a Gas Deficit Emergency. It allows for certain measures, such as maximising of NTS line pack and the use of Emergency Specification Gas.

- establishment of a £5m cap on the aggregate value of DSR options for any Winter Period, which may be exceeded if NGG requests and Ofgem does not veto the request;
- Details of the obligations that would apply to a Shipper if a DSR Option is accepted.
- Extend the trigger for opening the DSR market from the issue of a Gas Balancing Notification to also include issue of a Margins Notice at the day ahead stage;
- Other minor housekeeping changes.

In its Gas DSR Consultation Report submitted to the Authority on 28 September 2022, NGG considered that the proposals in UNC822, which are reflected in the proposed revisions to the DSR Methodology, better facilitate the DSR principles set out in Special Conditions 9.22.3(e)-(h).

Special Condition 9.22.3(e) states that the DSR Methodology must promote, and further facilitate, parties making DSR Offers to NGG through open and transparent market-based arrangements. During stakeholder engagement, NGG have been informed that DSR arrangements have not been put in place between Shippers, suppliers and consumers because the incentives to do so have not been considered sufficiently strong when judged against the probability of a gas shortage arising. NGG consider that the proposed revisions will address this deficiency by enabling DSR Option Fees to be accessed via an invitation to offer process, whereby such options will be sought and procured using an open, market-based method.

Special Condition 9.22.3(f) states that the DSR Methodology must not unduly preclude the emergence of commercial interruption arrangements. NGG state that it is clear to them through stakeholder feedback that, contrary to preventing the emergence of a DSR market, the availability of Option Fees is a necessary step to facilitate the emergence of a gas DSR market.

Special Condition 9.22.3(g) states that the DSR Methodology must minimise distortions and unintended consequences on existing market arrangements and the principle of parties balancing their own positions in the wholesale gas market. NGG note that they would only be permitted to utilise the DSR tool to curtail demand at times when there is a projected supply deficit within the bounds of its residual balancer role, and that Shippers as primary balancers will retain incentives to balance their own portfolios.

Special condition 9.22.3(h) states that the DSR Methodology must ensure that DSR is procured in a manner consistent with NGG's duties under the Gas Act 1986 and, in

particular, the licensee's obligation to operate the pipeline system to which this licence relates in an efficient, economic and co-ordinated manner. NGG consider that the introduction of an invitation to offer process to procure DSR Options in advance of a Winter Period with an aggregate cap on such payments of £5m represents fair value for the industry by facilitating a means of insurance and mitigation against the occurrence of a GDE, where the economic consequences would be far greater. NGG propose to have the option to accept DSR Options up to an aggregate value greater than the proposed cap, subject to the Authority not vetoing the proposal within 10 business days of receiving the request from NGG.

Furthermore, NGG state that the proposed changes are designed to enable voluntary demand curtailment to emerge, thereby helping to mitigate the risk of a GDE occurring and the disruption and inefficient network operation that would result due to reduced quantities of gas flowing through the network and parties that wish to offtake gas being prevented from doing so.

NGG did not receive any consultation responses with respect to the DSR Methodology. However, there were ten responses to the UNC822 consultation where nine supported implementation and one provided comments.<sup>8</sup>

## **Our view**

We recognise that potential DSR participants may incur costs in order to be available to offer DSR should it be needed, and this was reflected in stakeholder feedback at industry events<sup>9</sup> held by NGG. Therefore, we consider it appropriate that the DSR tool should be adapted to administer an invitation to offer process, which includes the introduction of payments to compensate consumers for their DSR availability. We consider that the process described by NGG to facilitate this invitation to offer promotes offers through open and transparent market-based arrangements, as the invitation will be issued to all Gas Shipper Users and the criteria for NGG to select DSR Offers is pre-set and described in the DSR Methodology.

The DSR Option payments have been capped at an aggregate level of £5m per Winter Period. NGG have added a process to the DSR Methodology which allows NGG to accept offers above this level. NGG would submit a report to the Authority to allow Ofgem the opportunity to veto the acceptance of offers above the cap. We consider it appropriate to

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<sup>8</sup> UNC822 consultation responses are available on the website of the Joint Office of Gas Transporters: <https://www.gasgovernance.co.uk/0822>. These responses have been fully considered and further detail can be found in our UNC822 decision document published on our website on 14 October 2022.

<sup>9</sup> UNC Transmission Workgroups and meetings with industrial manufacturers.

have a cap and a veto process allowing NGG to present the case to exceed this cap to ensure that the DSR tool remains economic and efficient. We note that NGG state that the Options cap could be reviewed and potentially increased in subsequent DSR Methodology reviews. We support the principle that this cap should be kept under review to ensure both the economic and efficient nature of the tool, but also for it to remain realistic and efficient to administer.

We consider it important to have a functional DSR tool to prevent or lessen the impact of a GDE, especially considering the increased uncertainty in European gas markets created by the Russian invasion of Ukraine and of the current high and volatile gas prices. Therefore, we deem it appropriate for extra measures to strengthen the tool, such as the options payment, to be introduced. Following NGG's stakeholder engagement and the real-world evidence from Beast from the East,<sup>10</sup> where no DSR offers were made following the issue of a Gas Balancing Notification, we consider that the inclusion of options payments is necessary to allow a functional DSR tool to operate. On this basis, we do not consider that strengthening the existing DSR tool to enable it to function as intended will preclude the emergence of commercial interruption arrangements.

We note that the proposal to extend the trigger for accepting DSR Offers to where a Margins Notice has been issued is inconsistent with Special Condition 9.22.3(c), which states that DSR Offers must only be accepted where a Gas Balancing Notification is in place or within stage 1 of a GDE. However, NGG has applied separately for a derogation from this Special Condition. During Stakeholder engagement hosted by NGG comments were made by stakeholders that a longer lead-time for NGG to alert Shippers and exercise DSR would improve their ability to participate. Although we understand this to potentially mean a lead-time of weeks or months, we consider that it is appropriate to extend the DSR window to include the issue of a Margins Notice as it may increase the opportunity for some consumers and their Shippers to participate.

We consider that the extension of the DSR window to the issue of a Margins Notice remains in line with the other DSR obligations under 9.22.3 of the Licence as a Margins Notice indicates the potential for a supply/demand imbalance and, therefore, the DSR window remains only for times of system and market stress. Shippers are still incentivised to act as the primary balancers through the balancing regime.

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<sup>10</sup> An extreme weather event that occurred in Great Britain in March 2018 and led to a supply/demand imbalance in the gas market.

Additionally, we consider the changes to the DSR Methodology to be consistent with the UNC822 Modification proposal. Our decision on UNC822 has also been published on our website on 14 October 2022.

### **Our Decision and next steps**

Pursuant to Special Condition 9.22.7, we have reviewed the proposed amendments submitted on 28 September 2022 and hereby consent to NGG making the changes to the Gas DSR Methodology.

Furthermore, we have reviewed NGG's derogation request submitted to us on 29 September 2022 and, in accordance with Special Condition 9.22.12, we have decided to grant the requested derogation to NGG to allow NGG to accept DSR Offers where a Gas Margins Notice is in place as well as where a Gas Balancing Notification is in place or within stage 1 of a GDE. The direction, which is issued in the Annex to this letter, will give effect to the derogation decision.

This letter constitutes notice for the purpose of section 38A of the Gas Act 1986 of the Authority's reasons for its decision, and a copy has been made available on our website.

**Dr Adrian Richardson**

**Head of Energy Security of Supply**

For and on behalf of the Gas and Electricity Markets Authority

## **ANNEX - Direction Notice**

To: The Company Secretary, National Grid Gas plc

### **Derogation by Direction issued to National Grid Gas plc by the Gas and Electricity Markets Authority pursuant to paragraph 9.22.12 of Special Condition 9.22 Part D of the Gas Transporter Licence in respect of implementing and maintaining the Demand Side Response Methodology for use after a Gas Balancing Notification.**

1. This derogation by Direction is issued by the Gas and Electricity Markets Authority (the "Authority") under paragraph 9.22.12 of Special Condition 9.22 Part D of the Gas Transporter Licence in respect of the NTS (the "Licence"), granted or treated as granted under section 7 of the Gas Act 1986 (the "Act") to National Grid Gas plc (the "Licensee").
2. Paragraph 9.22.2 of Special Condition 9.22 provides that the Licensee must have in place and maintain a Demand Side Response Methodology approved by the Authority.
3. Paragraph 9.22.3(c) of Special Condition 9.22 provides that the Licensee must ensure that the Demand Side Response Methodology allows the licensee to accept Demand Side Response Offers only where a Gas Balancing Notification is in place or within stage 1 of a Gas Deficit Emergency.
4. Paragraph 9.22.12 of Special Condition 9.22 provides that the Licensee may apply to the Authority for a derogation relieving the Licensee of any of its obligations under this condition.
5. The Authority hereby directs under paragraph 9.22.3(c) of Special Condition 9.22 of the Licence as follows, that the Licensee must ensure that the Demand Side Response Methodology:  
  
"allows the licensee to accept Demand Side Response Offers only where a Gas Margins Notice is in place, or where a Gas Balancing Notification is in place or within stage 1 of a Gas Deficit Emergency;"
6. The considerations and reasons for the Authority's decision, in accordance with the Authority's duty under section 38A of the Act to give reasons, are set out in the Authority's decision letter to the Licensee, dated 14 October 2022.

7. The Direction shall take effect on and from 14 October 2022 and remain in effect until revoked or varied in writing by the Authority.
8. The Authority may revoke or vary this direction upon reasonable notice in writing to the Licensee.

Dated: 14 October 2022

Signed for and on behalf of the Authority

**Dr Adrian Richardson**

**Head of Energy Security of Supply**

Authorised for that purpose by the Authority