



UNC0835R

Review of Gas DSR Arrangements

Workgroup Meeting 1

2nd March 2023



Re-cap: DSR Reforms delivered for this winter

DSR Options

Tender process for next three winters

Shippers offer DSR option quantities, option price and exercise price

Within day and D-1 options

Obligation to offer DSR to NGT when supplies are tight

Extend lead-time

Extend the trigger to include a Margins Notice as well as GBN

Fuel-Switching

Extension of fuel-switching environmental permission

More information at: <https://www.gasgovernance.co.uk/0822>
<https://www.gasgovernance.co.uk/0833> and [Fuel switching direction \(publishing.service.gov.uk\)](https://publishing.service.gov.uk)

Reflections – where are we now?

Progress has been made but DSR is still not as effective as it could be

Response to the first options tender does not reflect potential DSR volumes

New products and reform of procurement and execution mechanisms could unlock additional volumes

Government direction on fuel-switching could help, although has limited life and coverage

Further reforms could remove barriers and broaden participation

Key Objectives of this Request

- Capture the remaining **barriers** to large industrial consumers' participation in the gas DSR scheme
- Consider how a **growth in DSR volumes** for winter 2023/24 and future years can best be achieved
- Work at pace with the industry and consumers to identify **potential solutions** to current barriers in 4 workstreams:
 - Enabling direct contracting for DSR between NGT and consumers.
 - A longer lead-time DSR product
 - Eligibility and aggregation
 - Review of existing DSR arrangements post implementation of Modifications 0822 & 0833
- Consider and **prioritise** a range of potential reforms for winter 2023/24
 - Early identification of what cannot be delivered for winter 2023/24 and timely decision making so that what is deliverable can be implemented
- **Produce a UNC Modification Proposal(s)** / other reforms that can be implemented for winter 2023/24

Objectives for today

- **Reflect on consumer and industry feedback**
- **Consider the issues associated with the following DSR workstreams**
 - NGT directly contracting with consumers for gas DSR
 - A longer lead-time product such as D-5

High Level Plan

Process		Key Dates	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23
DSR Reform Programme	Formulate workstreams for industry discussion		----->											
	Publish draft UNC Request Proposal	25-Jan-23	★											
	Meeting with large consumers & associations	30-Jan-23	★											
	Pre-mod discussion of draft request and overall DSR plan for 2023	02-Feb-23		★										
	Raise UNC Request	03-Feb-23		★										
	UNC Panel Meeting consider UNC Request proposal	16-Feb-23			★									
	UNC Request Workgroup meetings				★	★	★							
	Develop draft Mod Proposal(s)					----->								
	Finalise UNC Request Workgroup Report, inc draft Mod(s) and submit to Panel	06-Apr-23					★							
	Raise UNC Mod (s)	07-Apr-23					★							
	Panel consideration of UNC Request Report & New Mod(s)	20-Apr-23						★						
	UNC Mod(s) Workgroup meetings							★	★	★				
	Complete Workgroup Reports for UNC Mod(s)	01-Jun-23							★					
	WG Report(s) considered by Panel, Mod(s) issued to consultation	15-Jun-23								★				
	Mod(s) consultation close out	06-Jul-23									★			
	Final Mod Reports available for Panel	12-Jul-23									★			
	Panel decision(s) / recommendation(s)	20-Jul-23									★			
	Ofgem decision(s)	04-Aug-23										★		
	Licence changes e.g. to enable direct contracting and permit MN trigger												----->	
	Mod(s) Implementation activities													----->
Launch DSR Methodology consultation	08-Aug-23									★				
Close DSR Methodology Consultation	05-Sep-23										★			
Send Consultation Report to Ofgem	11-Sep-23											★		
Ofgem Approval of DSR Methodology	25-Sep-23												★	
DSR volumes available	01-Nov-23													----->
Second D-1 and WD Options Tender	Pre-tender communication and timetable issued	16-Aug-23									★			
	D-1 and Within Day options tender published	30-Aug-23										★		
	Tender period (15 bus days)												----->	
	Tender period closes	20-Sep-23											★	
	Offer evaluation period (10 bus days)													----->
	Notify tendering shippers of outcomes and options effective (deadline if no Ofgem referral)*	04-Oct-23												★
	Notify wider industry of aggregate tender outcomes	11-Oct-23												★
	D-1 and Within Day DSR options effective (deadline with Ofgem referral)	01-Nov-23												

* Plus potentially a 10 day reference to Ofgem for >£5m options fees.

What are our customers and stakeholders saying?

Feedback from meeting with consumers on 30 January 2023

Feedback from Mod 0822 consultation process

Is your company interested in participating in gas DSR?

Yes



No



Undecided



What is preventing you from participating in DSR?

Volatility/variability of dema
inability to have a partial re
prefer to deal direct
surety of process uncertainty no flexibility Suppliers

worried about penalties

Type of Industry

bid size

mechanism

Risk & Liability

liabilities

Flexibility

Permits

Complicated bidding process

Aggregation

too much uncertainty risk > return

complexity and volume requirem

inability to refuse

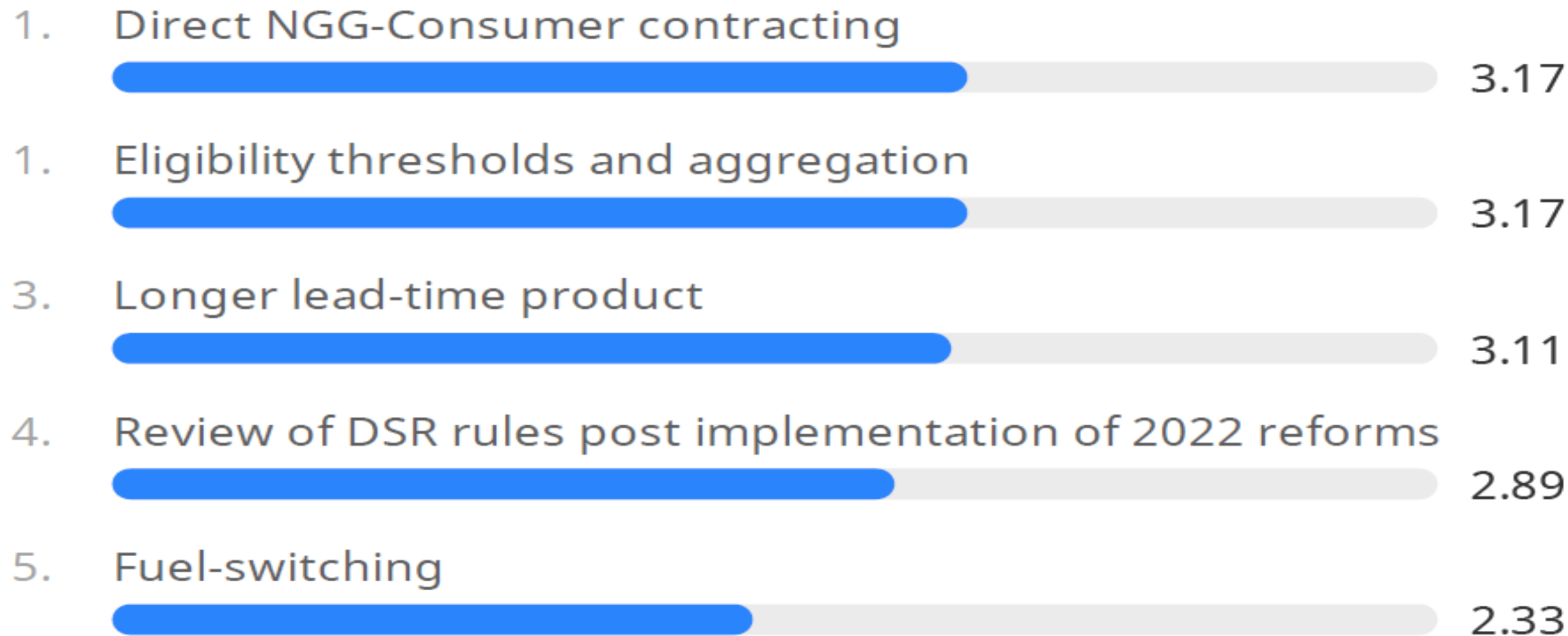
Operational/product constraint

Limited time to understand

Further feedback from consumer engagement

- Consumers can't readily access **terms and conditions** for a gas DSR service
- **More flexibility and reduced complexity** in the option tender process
 - Concern about frequency with which they might be called and the actual level of demand reduction required
- **Ramp-up times** post DSR exercise need to be considered
- Larger sites may need a longer **lead-time** to reduce gas demand
- Extension of **fuel-switching direction** is sought to help glass sector participate, less relevant for other sectors
- Guidance on **price** & view that the £5m aggregate option threshold acts as a cap

Please rank the workstreams in your preferred order of priority, with 1 being the highest and 5 the lowest.



Shipper views on DSR option arrangements (Consultation responses to Mod 0822)

*[The DSR options arrangements]
“place significant liabilities on the shipper, essentially as billing agent for passing payments on to the customer”*

“Where NGT already has a relationship with large customers, we are unsure why shippers are being asked to take on these liabilities”

“We do not believe that the liabilities on the shipper are reflective of the potential benefits”

“Require processes to be in place for posting offers onto the DSR Locational Market, including at weekends when many non-domestic suppliers are not open for business”

“They have little or no benefit to the shipper”

“It feels the right thing to do although it does add risk and complexity for shippers”

“A bilateral contract structure...is likely to be more straightforward to arrange than the back-to-back arrangement proposed here”

Direct Contracting

Direct Contracting – Key Issues

At present, NGT contracts for DSR through the UNC with shippers. Could / should NGT contract directly with the consumer who will physically deliver the demand reduction?

Key issues

- Legal assessment
- Residual role of the shipper & information requirements
- Standard conditions of contract
- Procurement mechanism
- Means of feeding exercise costs into determination of system prices
- Funding and payment arrangements
- Supplemental to, or instead of, existing arrangements
- NGT resourcing

Direct Contracting & The Gas Act

- Paragraph 5(c) of the [Gas Act](#) requires only licenced parties (i.e. shippers) to “arrange” with a transporter for gas to be taken out of a pipe-line system
- If NGT contracted directly with a consumer for DSR, the shipper would retain this role (booking capacity, paying transportation charges, receiving gas allocations etc)
- A NGT-consumer DSR contract would constitute an agreement by the consumer to alter its rate of offtake in certain circumstances but the transportation arrangements for delivery of that gas to the consumer remain with the shipper via the UNC
- NGT already contracts with non-shippers via NEAs and NExAs which contain provisions to help manage flow rates on and off the system
- By establishing a DSR contract with a consumer, NGT would not be taking on any functions of a shipper



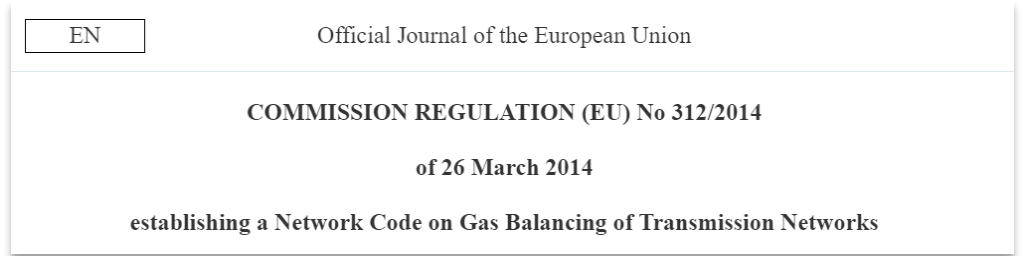
Gas Act 1986

5 ^{F68}[Prohibition on unlicensed activities]

- (1) Subject to section 6A below and Schedule 2A to this Act, a person who—
- (a) [^{F69}otherwise than by means of a gas interconnector] conveys gas through pipes to any premises, or to a pipe-line system operated by a [^{F70}gas transporter];
 - [^{F71}(aa) participates in the operation of a gas interconnector;]
 - (b) supplies to any premises gas which has been conveyed to those premises through pipes; ^{F72}...
 - (c) arranges with a [^{F70}gas transporter] for gas to be introduced into, conveyed by means of or taken out of a pipe-line system operated by that transporter [^{F73}; or
 - (d) provides a smart meter communication service,]
- shall be guilty of an offence unless he is authorised to do so by a licence.

Our conclusion: The Gas Act does not prevent NGT contracting directly with consumers for Gas DSR

Direct Contracting & EU Balancing Code



- The [EU Balancing Code](#)* permits TSOs to undertake balancing actions through either ‘short term standardised products’ or use of ‘balancing services’
- Counterparties to ‘short term standardised products’ are only envisaged to be shippers (Arts 7(3) and 3(5))
- BAL Code contains no restrictions on parties with whom a TSO may contract for ‘balancing services’
- A DSR arrangement with a consumer would appear to be consistent with the definition of ‘balancing service’ (Art 3(7))

Our conclusion: The Balancing Code does not prevent NGT contracting directly with consumers for Gas DSR as a ‘balancing service’

* As amended by the [The Gas \(Security of Supply and Network Codes\) \(Amendment\) \(EU Exit\) Regulations 2019](#)

Direct Contracting and the NTS Licence

- A Licence change would be required to Special Condition 9.22

Part A: The Demand Side Response Methodology

9.22.2 The licensee must have in place and maintain a Demand Side Response Methodology approved by the Authority.

9.22.3 The licensee must ensure that the Demand Side Response Methodology:

a) ensures that any party making a Demand Side Response Offer is a party to the Uniform Network Code;

- The NTS Licence also currently requires that the DSR Methodology...

d) demonstrates compatibility with existing market arrangements by setting out the manner in which **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;

‘Eligible Balancing Actions’ are balancing transactions effected between NGT and a shipper under the terms of the UNC

Direct Contracting: Residual Role of the Shipper

- The shipper would need to be informed of any DSR execution in sufficient time to reduce its output nomination for the consumer and (other things being equal) its gas procurement and input nominations
- Should the consumer or transporter be obliged to make this communication?
- If the consumer is connected to a GDN, NGT would inform the GDN according to current procedure
- What wider transparency measures would be required for industry?

Direct Contracting: Conditions of Contract

- We would expect to develop standard conditions of contract to ensure no undue preference
- We would envisage consulting on the terms with both consumers and shippers
- The terms should make provision for what happens if the consumer is no longer able to provide the service (e.g. ceases trading)

Direct Contracting: Procurement and execution mechanism

- An ‘option and exercise’ arrangement procured via tender appears most suitable and aligns with the BAL Code for procurement of ‘balancing services’ (Art 8(3))
- Initial view: up to a 3 year duration with an option to run additional tenders in Y+1 and Y+2
- At present, DSR is exercised via a locational trade on the OCM; this method is unlikely to be suitable for exercise directly with consumers
 - OCM trades are delivered by way of a ‘Trade Nomination’ which only shippers can effect
- Exercise directly with the consumer would therefore constitute an instruction to reduce flow but would not be delivered as an ‘energy trade’
- However, exercise would still constitute a ‘balancing action’ as defined by the BAL Code and therefore the costs would need to feed into the calculation of system prices according to the BAL Code Art 19(3)

Direct Contracting: Funding & Payment

- We believe that NGT should remain cash-neutral to DSR option and exercise costs
- If funding / cost recovery continues to be managed through balancing neutrality, this could result in payments from balancing neutrality to non-shippers
- Need to consider the cost recovery arrangements / invoicing to consumers – whether from NGT or via Xoserve

Direct Contracting – Initial Assessment Summary

Pros	Cons
Removes the resource burden for shippers managing both the NGT and consumer interface for DSR	Non-shippers potentially involved in the balancing neutrality processes
Addresses feedback of a disproportionate risk / reward balance for shippers	Greater resourcing requirements for NGT (procurement and execution)
No requirement for I&C shippers to have 24/7 cover	
Potential for faster consumer response via direct communication when exercised	
Potential for more DSR volumes to be offered	

Questions for the Workgroup



Longer lead-time DSR product

Longer lead-time DSR product – Key Issues

- Legal assessment
- Optimal lead-time
- Trigger for exercise
- Certainty of requirement
- **Market Impacts**
 - Balancing incentives
 - Expansion of NGT's role in the market
 - Risk of flight from (more useful) prompt DSR products

Longer Leadtime Product: Legal Assessment

Gas Act

- We have not identified any barriers to implementing a longer lead-time DSR product in the Gas Act

EU Balancing Code

- The BAL Code establishes the principle that shippers have the primary balancing role and the TSO acts as ‘residual balancer’ (Recital 5, Art 4(1))
- ‘Residual’ does not necessarily constrain the TSO to within-day and D-1 actions; it is balancing activity that’s outside the scope of what the shipper can/will do
 - The existence of the GB emergency arrangements implicitly recognise that NGT residual balancing actions at D-1 and within day might not be sufficient
- A TSO’s use of ‘short term standardised products’ for balancing are only for within-day and day ahead timescales (Art 7(1)), however there is no prohibition on use of a ‘balancing service’ with a longer lead-time, provided that it is still suitably ‘short term’ (Art 3(7))
- A TSO must only use a ‘balancing service’ where short-term standardised products “*will not or are not likely*” to provide the response needed. (Art 9(1)(c)). “*Will not*” contemplates the use of balancing services before short-term standardised products are used

Longer Leadtime Product: Licence Impact

- A Licence change would be required in relation to the circumstances under which DSR could be exercised
- Special Condition 9.22.3 requires that NGT must ensure that the DSR Methodology...

c) 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;

* To enable implementation of Modification 0822, a derogation from Ofgem is currently in place that permits NGT to also accept DSR offers when a Margins Notice is in force.

Longer Leadtime Product

Optimal Lead-time

- Some consumers have indicated they would need between 2-5 days' notice to reduce their gas demand, though some could reduce to a minimal load in a shorter timeframe
- NGT produces a Margins Notice forecast up to D-5 which could be used to inform exercise
- D-5 might therefore strike a balance between what will work for consumers and system conditions that are reasonably forecastable, though would have a high degree of uncertainty this far out

Procurement Mechanism

- Inclusion within an option tender for within-day and D-1 DSR is likely to be most efficient

Exercise Trigger

- NGT assesses expected available supply against forecast demand up to 5 days ahead in the Winter Period
- Where a supply deficit >14 mcmd* is forecast for D-5, a D-5 DSR option may be exercised

* NGT has a target forecast error of 13.7 mcm on its D-2 to D-5 demand forecasting incentive

Longer Leadtime Product

Execution method

- Potentially depends on whether direct contracting is pursued, but the OCM is a prompt-only platform
- If exercise is off the OCM, how would exercise costs feed into the calculation of system prices?
 - BAL Code Art 19(3) and NTS Licence SPC 9.22.3(d) appear to require this
- A 'reduce to' service rather than a 'reduce by' service may be preferable (could also be applied to prompt DSR products)

Uncertainty of requirement

- At D-5, NGT would have less certainty that the market would be short of gas
 - In January 2022, the average demand forecast error was in the region of ~ +/-40 mcmd at D-5
- Unlike within-day and D-1 DSR options, NGT would need to commit to exercise at D-5, even if the need does not ultimately materialise
 - NGT could potentially revoke an exercise instruction but we expect consumers would need certainty
- Should NGT take such pre-emptive action when with hindsight it may be that such intervention wasn't required?

Longer Leadtime Product: Potential Market Impacts

- **Balancing incentives**
 - Assuming exercise prices feed into cashout prices, there is a risk that a high SMP buy price is set that does not reflect supply/demand fundamentals on the day
- **Expansion of NGT's role in the market**
 - NGT has traditionally confined its role to D-1 and within day balancing actions
 - To what extent does industry believe that a D-5 product encroaches on the shipper's role?
 - Current NTS Licence SPC 9.22.3(g) requires NGT to ensure that its DSR methodology *“minimises distortions and unintended consequences on existing market arrangements and the principle of parties balancing their own positions in the wholesale gas market”*
- **Risk of flight from prompt DSR products**
 - If a D-5 product is available, this may attract offers from parties that could otherwise offer within-day / D-1
 - NGT could prioritise acceptance of prompt DSR offers in its assessment

What are the Workgroup's views about progressing further with proposals for a D-5 DSR product?

