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for energy consumers

To All Interested Stakeholders

Email: NESORegulation@ofgem.gov.uk
Date: 25 March 2026

Dear colleagues,

Decision to update derogation from a requirement of Article 6(4) of the Electricity Regulation for the Demand Flexibility Service

On 30 January 2026, we[1] received a proposal from National Energy System Operator ("NESO") to extend and amend a derogation provided under Article 6(14) from a requirement of Article 6(4) of Regulation (EU) 2019/943 (the "Electricity Regulation"), as amended by The Electricity and Gas (Internal Markets and Network Codes) (Amendment etc.) (EU Exit) Regulations 2020 for its Demand Flexibility Service ("DFS"), a balancing energy product.

We previously provided a derogation to allow NESO to dispatch balancing energy via the DFS ahead of gate closure through our 21 November 2024 decision. NESO has requested for amendments to the derogation to align with changes proposed to the service design which we have issued a decision on separately.

This letter sets out our decision to approve amendments and extension to the derogation for the DFS, in accordance with Article 6(14) of the Electricity Regulation. This updated derogation expires 31 August 2028.

Background to NESO request

The DFS intends to attract volumes of demand response not currently engaged in other balancing service provision, but which could provide energy response in line with system operator instructions. The DFS was originally developed to provide an additional system security tool for winter 2022/23. A second iteration improved the service ahead of winter 2023/24, designed for the same purpose of providing an enhanced system security option.

As the system margins outlook for winter 2024/25 improved on previous years, NESO repositioned the DFS to become a "within-merit" service, allowing consumers (both domestic, and industrial and commercial) to "turn down" their demand to support system margins when commercially competitive. NESO explained that the nature of the participants within this service means that dispatch within gate-closure time scales (as

[1] The terms "we", "us", "our", "Ofgem" and "the Authority" are used interchangeably in this document and refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

required under Article 6(4) of the Electricity Regulation) was not feasible, and so we approved a derogation allowing dispatch at up to 8 hours ahead of real time.[2] We understand that DFS dispatches realised approximate balancing cost savings of £700,000 over the first year of use following this approach, showing that demand-side response can be competitive to other market offerings and overall save the consumer money. In its latest submission to us, NESO noted confidence that DFS dispatches over this period had not created market distortions.

NESO has now proposed to introduce new aspects to the service, including the option to procure demand turn up, providing further commercial opportunity for demand-side provision of balancing energy.[3] However, demand turn up and demand turn down actions are likely to occur at different times of the day, and NESO presents a case that dispatching demand turn up actions to meet system needs while remaining in line with the previous Ofgem derogation could be challenging for both NESO and providers.

Further, NESO has identified that having the option to indicate to market occasions where demand turn up and demand turn down events may occur on the same day (or in close proximity) provides significant potential for optimisation, including for demand shift opportunities. Such dispatches would necessarily extend the dispatch time of the latter action beyond eight hours if dispatches of the earlier action were made in line with the "eight hours ahead" principle.

Therefore, NESO has requested to extend the time for dispatch to up to 12 hours ahead of real time (and, in some instances, in excess of 12 hours).

The previous derogation we provided was due to expire 31 March 2027. NESO has requested to extend the derogation to the end of 2030, stating that this aligns with the route to Clean Power 2030.

Decision rationale

Dispatch ahead of gate closure

NESO had been operating DFS with a derogation in place which allows for dispatch up to eight hours ahead of real time. We continue to agree with NESO that there is a need for participants in this market to receive dispatch instructions ahead of gate closure timeframes, mainly due to the downstream processes necessary to mobilise the response and the manual nature of most of the assets involved.

We considered the need for NESO to have earlier dispatch times in certain circumstances. We also agreed with NESO's articulation that there may be net benefit in making dispatch

[2] On the principle that NESO expressed this to be as close to real time as possible.

[3] Other changes proposed include reduction of the minimum bid volume to 0.1 MWh and the capability for NESO to account for locationality in procurement (of both demand turn up and turn down dispatches). Our decision on these aspects is covered in our decision published on the same day as this decision.

decisions of some DFS actions earlier when this aligns with other needs, particularly where this couples with demand shifting.

However, we found that while NESO's submission explained the rationale for varying the dispatch timings, this did not identify a clear and consistent timeline or rule set for DFS dispatches. We have therefore decided to allow for dispatch ahead of gate closure time, and to set the following principles within which NESO should conduct dispatch / tendering of the DFS.

Subject to never being earlier than 24 hours ahead,[4] we expect NESO to optimise DFS dispatch in line with its best view of efficiency. We expect that this means NESO will look to align decision timelines with other operational decision points[5] and align with the processes of other actors to maximise available volumes, while dispatching as close to real time as this allows for. We recognise that this represents a tension which NESO will need to manage, but consider that this allows for the most effective use of the DFS. We also expect that dispatch should generally move closer to real time over time as both NESO and industry participants improve the digitalisation and other capabilities and understanding of service provision. We consider that NESO's proposal fits within these principles.

We considered setting fixed dispatch times, noting that these can be easier for the market to manage. We determined that NESO can still do this if valuable, but there is greater flexibility for NESO to establish and learn from making dispatches in line with varying system needs and industry processes. This is especially true for demand turn up actions which have not been tested through the DFS before and for coordination of demand turn up and demand turn down events.

We note that NESO reserves the capability to test the service, where this is in the consumer interest. We consider that NESO may make use of such functionality to supplement live service requirements to help understand the optimal approach to DFS dispatch, subject to being mindful of economic and efficient operation. We acknowledge that tests may utilise dispatch timings that do not fully align with the principles set out above, but they should always adhere to the "never more than 24 hours ahead" limit, and should always seek to maximise consumer value (including learnings and optimisation of the service).

We note that NESO has introduced a locational aspect to procurement of DFS. This may mean NESO is able to utilise DFS to help manage system constraints (rather than using the

[4] For clarity, we consider that this 24 hours applies to the latest settlement period under consideration. For example, if NESO has a desired four hour period for DFS delivery which it intends to procure through a single tender event, the earliest time dispatch could be made would be 24 hours ahead of the last settlement period, ie 20.5 hours ahead of the first settlement period. This should not be seen as an incentive for NESO to delay the period between bid assessment and outcome notification.

[5] For example, decision points driven by interconnector auction timings.

DFS for energy balancing actions). For clarity, such constraints actions are not covered by the scope of Article 6(4) and thus this derogation and should be appropriately flagged by NESO.

Derogation duration

We recognise that NESO's proposal to amend the DFS represents an appropriate point to reconsider the duration of the derogation.

We considered a balance of the risks of a longer derogation period against the benefits of being able to confirm that negative market interactions are not occurring as a result of the alternative rules, especially in light of the changing regulatory and market environment.

We particularly note the increasing volumes of consumer flexibility that will come from half-hourly settled providers as the market-wide half hourly settlement ("MHHS") programme continues. While we agree with NESO that the DFS has been key in encouraging nascent consumer flexibility, we consider that the interaction of the DFS with the MHHS roll-out should be checked at a time that is both suitably early to understand any negative aspects but also long enough to properly understand those aspects.[6] We agree with NESO that the DFS presents a tool that can be effective in support of Clean Power 2030 aims.

We therefore decided not to align with NESO's proposal of 2030, but instead to set a date for expiry of this derogation of 31 August 2028. We considered this means that NESO will have at least one summer and one winter with full MHHS in place on which to understand the market response and the interactions with the DFS, and this will allow for a suitably informed decision on the future direction of the service. We also set the date of 31 August 2028 as **we consider this allows sufficient time for the information and learnings from winter 2027/28 to be included within any NESO submission for extension, which we would expect to be made by 1 July 2028.**

For clarity, we expect that reviewing the derogation at this point in time could result in outcomes including revision of the service design and / or use case, or extension of the service as-is. Reconsidering this situation with the right data should allow for the most informed decision to enable demand side flexibility to continue to grow and contribute to Great Britain ("GB") system flexibility and support the journey to Clean Power 2030 in the most economic and efficient fashion. We also recognise that further strategic work on consumer-led flexibility is being undertaken, and any subsequent request can also then include views established through this work.

We consider that extending the DFS derogation out to mid-2028 (from 2027) should provide further market confidence in the medium-term viability of the service as a route to

[6] For clarity, we expect NESO to routinely monitor for any negative effects, and propose amendments as appropriate.

market and our continued support for the longer-term involvement of demand side flexibility in electricity balancing and its role in achieving Clean Power 2030 targets.

Article 6(14) requirements

Requests for a derogation from Article 6(4) of the Electricity Regulation are made under Article 6(14). In support of any derogation request, Article 6(14) sets out requirements for NESO to:

a) Include a description of measures proposed to minimise the use of specific products,[7] subject to economic efficiency;
b) a demonstration that the specific products do not create significant inefficiencies and distortions in the balancing market; and
c) where applicable, the rules for converting balancing energy bids from specific balancing products into balancing energy bids from standard balancing products.

NESO provided a description of how the DFS will comply with aspect a). We agree that as the service is utilised in-merit, this limits its use to cases where it is economically efficient to do so.

Further, as DFS is dispatched ahead of gate closure, it is being compared against some actions which remain available to NESO later, and the price of those actions may vary. We understand that NESO may choose not to accept DFS volumes where they are priced similar to alternatives and the value of the actions is uncertain.[8]

We consider that these two points do meet the requirement of minimising dispatch, subject to economic efficiency.

Against point b), NESO explained in its submission that DFS volumes remain small, and that this is a natural guard against market distortions. Additionally, NESO sets out that it compares DFS primarily against other pre-gate closure actions. Finally, NESO considers that using DFS as an in-merit tool mitigates distortive effects.

We mostly agree with these arguments. Particularly, we consider that only using DFS when in merit and compared against other actions used for similar purposes means that market distortions should be minimised. We accept the argument that smaller volumes generally present lesser distortive effect, but any effects still need to be minimised. We consider that NESO's principles for using the DFS mean that any distortive effects are minimised. However, NESO needs to continue to monitor the wider market for impacts from the DFS, particularly as volumes grow in this market.

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[7] The DFS is a specific product. Specific balancing products are locally activated products, defined in GB as being "different to standard products". Standard balancing products are harmonised products with other EU Transmission System Operators. GB does not currently have access to standard products.

[8] We expect that NESO can remain transparent on dispatch decisions. We also recognise that, inherently, dispatching earlier introduces uncertainty, and NESO's expectations may not be realised.

Additionally, we considered NESO's argument that the DFS itself solves a market distortion by allowing participation from resources that may otherwise be unable to engage in the market. We consider that NESO has retained a design that encourages capable providers to enter more mature NESO markets, but that the DFS plays a continued role in access to markets for some resources. We consider that this supports the case that the DFS minimises one distortion without introducing a different, disproportionate distortion. We expect that NESO will continue to remove barriers to other markets where appropriate.

Finally, As GB does not currently have access to standard balancing products, we agree that item c) is not applicable at this time.

Further analysis on these points is provided in our 2024 derogation, and remains valid.

Decision

Based on our analysis of the information submitted to us by NESO as required by Article 6(14) of the Electricity Regulation, the dispatch timeline processes described above, and the technical requirements of such a product designed in this manner, we hereby:

- Grant the Transmission System Operator a derogation under Article 6(14) of the Electricity Regulation from the requirement of Article 6(4) paragraph 2 of the Electricity Regulation for the Demand Flexibility Service.

Our decision to derogate NESO from this requirement of Article 6(4) of the Electricity Regulation is effective as of 9 April 2026, at which point it will replace any previously active derogation for this service. Our decision to provide this derogation shall apply until 31 August 2028 and replaces our 2024 derogation decision. For clarity, any subsequent product or continuation of this product beyond that date would require NESO to request further derogation from the requirements of Article 6(4) of the Electricity Regulation if not brought into compliance.

If you have any queries regarding the information contained in this letter, please contact NESORegulation@Ofgem.gov.uk.

Yours sincerely,

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For and on behalf of the Gas and Electricity Markets Authority

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