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Statement of our decision to proceed with trialling a gas demand-side response mechanism

In this letter, we set out our decision to direct National Grid Gas (NGG) to proceed with trialling a gas demand-side response (DSR) mechanism. We are satisfied that the draft DSR methodology¹ that NGG have submitted has been developed in consultation with interested parties and is in a fit state to be progressed to trial.

Background to the development process

On 23 September 2014 we concluded our Gas Security of Supply Significant Code Review (Gas SCR). Our Gas SCR reforms will make changes to the market during a gas supply emergency. The reforms are summarised in our Gas SCR Conclusions² document and will take effect on and from 1 October 2015.

During the development of our Gas SCR reforms we found substantial evidence that the gas market could benefit from large consumers reducing demand voluntarily ahead of a possible gas supply emergency.

Our Gas SCR reforms incentivise shippers to better secure their supplies, and one way they can take to do this is entering into commercial negotiations for voluntary DSR with larger consumers. There appear to be clear situations where it would be mutually beneficial for both shippers and consumers to agree to commercial interruption (eg when higher gas prices make production of their goods or services uneconomic). However, some stakeholders expressed doubts that voluntary interruption would emerge of its own accord. As part of the Gas SCR, a number of stakeholders suggested the development of a centralised mechanism for DSR would be beneficial.

We saw merit in a DSR mechanism if it could overcome some of the barriers identified by stakeholders, whilst not distorting or foreclosing any market for commercial DSR. As such, when we published our Gas SCR conclusions document we also placed an obligation on NGG to:

- Develop a DSR methodology in accordance with a set of principles and in consultation with interested parties, and submit it to us by 1 March 2015;
- Run a trial of the draft DSR methodology if directed by us to do so, and submit a report on the outcomes of the trial to us alongside a final DSR methodology; and
- Implement the DSR methodology if directed by us to do so.

¹ <http://www.gasgovernance.co.uk/dsr/consultation>

² <https://www.ofgem.gov.uk/publications-and-updates/gas-security-supply-significant-code-review-conclusions>

On 27 February 2015 NGG submitted their draft DSR methodology to us for consideration.

Our position and next steps

We have reviewed the draft DSR methodology and the stakeholder responses³ NGG received to their consultation. We are satisfied that the draft DSR methodology has been developed in consultation with interested parties and is in a fit state to be progressed to trial over the summer.

Following the trial, NGG will submit a final DSR methodology to us along with a report on the results of the trial. We will then consider whether to direct NGG to proceed with implementing the proposed DSR mechanism set out in NGG's final DSR methodology. If we proceed, then implementation is expected by October 2016.

Lastly, we would like to commend NGG and industry participants on the work they have done developing the DSR methodology to date through an extensive series of workshops and bilateral meetings.

Further work on contractual arrangements

The draft DSR methodology currently sets out the contractual arrangements that would exist between NGG and shippers. In practice, it is likely that further contractual arrangements will need to be agreed between consumers, suppliers and shippers.

Whilst we are supportive of the decision to avoid proscribing these contractual arrangements in the DSR methodology itself, we are mindful that many of respondents to NGG's consultation raised some concerns in this area. In particular, respondents noted that:

- There is currently a lack of clarity over key contractual issues (eg possibilities for apportioning liabilities, timing for placing/updating/removing DSR offers);
- There is a risk that the complexity of required negotiations may deter participation; and
- There may be merit in establishing a voluntary standard pro forma DSR contract.

Part of the initial rationale for developing a DSR mechanism was that creating a simple mechanism would help provide a "route to market" for consumers that are less familiar with providing DSR. We also received feedback from some consumers that there was a lack of trust between consumers and suppliers/shippers.

In light of this, we are keen to ensure that this issue of contractual negotiations is properly addressed. We would like to understand how interested parties wish to proceed and we would be open to facilitating further discussions if this would prove worthwhile.

If you have any questions about this letter, or you would like to provide views on having further discussions on DSR contractual arrangements, please contact Amy OMahoney (email: Amy.OMahoney@ofgem.gov.uk).

Yours sincerely,

Frances Warburton
Partner, Wholesale Markets

³ <http://www.gasgovernance.co.uk/dsr/consultation>