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By email only

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OVO response to Ofgem's 'Call for Input on options to address high balancing costs'

Dear Robin,

OVO welcomes Ofgem's continued engagement with stakeholders to improve the current market arrangements to address high balancing costs.

A key risk to retailers is generator bidding behaviour in the Balancing Mechanism resulting in extreme cashout prices. OVO strongly supports interventions that will reduce the costs incurred by the ESO to balance the system and ultimately reduce costs passed to consumers.

Following assessment of the options, OVO agrees with the preferred option of a new licence condition that would prohibit generators from gaining excessive benefit after they have reduced their PNs to zero. Furthermore, we would encourage wider consideration of excessive BM profits across all periods.

OVO has provided detailed responses to the Call For Input questions in Appendix 1.

Should you have any questions, please contact policy@ovoenergy.com.

Kind regards,

Stephen Harris

VP Trading and Portfolio Management, OVO Energy

Appendix 1 - OVO responses to Call for Input questions

Q1) Do you agree that our preferred option will effectively prevent the behaviour that caused last winter's high balancing costs? Please provide reasons for your answer.

OVO supports the preferred option of a new licence condition that would prohibit generators from gaining excessive benefit after they have reduced their PNs to zero.

We believe this could prevent the behaviour that leads to high balancing costs as long as:

- the assessment of **excessive benefit is clearly defined** - additional criteria have been suggested in our response to question 3.
- there are **meaningful impacts to generators where a breach is identified**

Q2) Is the proposed licence condition drafting in Annex 1 sufficiently clear? Are there any drafting edits or additions that you would encourage us to consider?

Whilst we agree with the proposed licence condition drafting, we would encourage wider consideration of assessing excessive BM profits for all periods.

Q3) Do you agree with the initial list of factors to consider when assessing excessive behaviour? Are there any other factors that you would encourage us to consider?

OVO has assessed the initial list of factors and has the following comments:

b. Has the offer price changed significantly after revising the PN to zero?

Comparison of offer prices across the day: We agree with assessing offer prices to other periods where the generator has run for much lower profits.

We consider the offer price should only reflect the costs associated with the turning off/on of the plant with any margin being tightly applied. However, our experience has demonstrated that generators will include cashout risk in their calculated start up cost as a profit hurdle. This offer price can be objectively justified to be very high if all offer prices in the market are extremely high. Furthermore, we believe that offer prices will always change significantly after PNs are changed. As a consequence, we query the potential effectiveness of introducing this control as an assessment factor for excessive behaviour.

e. To what extent is the offer price in line with the market's valuation of scarcity? Who will be evaluating market scarcity? We have concerns that this could result in a circular assessment whereby it does not provide the outcome to determine excessive benefit.

A consideration could be to set a cap on the valuation of scarcity. There is

currently a £6k price associated with the loss of load value and we think that an offer price maximum could be set to be below this level. However, without having a better understanding of what the offer prices are likely to be in low margin events it is very difficult to assess price risk on a forward basis. This hampers liquidity in future periods as the true cost of shape at delivery is such an unknown because it is not linked to anything concrete and is dependent on the behaviours of a few market participants.

f. **What and how have other costs been factored into the offer price?** We would expect several of these elements to have been factored into the investment decision.

OVO has considered other factors that we would encourage Ofgem to consider in developing the assessment of excessive behaviour:

- **Comparison of offer prices in period:** Is the accepted offer price cheaper than other offer prices for the same settlement period? We think this should be a key flag for determining whether a generator is engaging in sharp practices by utilising dynamic or system constraints.

- **Peak period offers:** - we would welcome clarification that Ofgem have considered that making changes to the rules to discourage certain behaviours observed last winter, doesn't have an inadvertent outcome of discouraging plant from dispatching earlier in the day so that they can remain available for high BM prices in the evening.

Q4) Is there any specific information you would like to see in the accompanying guidance related to interpretation and enforcement of the new licence condition?

OVO would welcome clear guidance on the enforcement action and penalties where a breach is confirmed of excessive benefit.

We would like to see tighter controls applied by National Grid where they are flagging PNs for system reasons versus energy reasons. We believe that any accepted offer that relates to keeping a plant available for a later period should be flagged as for system reasons. We consider a system flag to be an indication that a BM offer is not necessarily delivering the best value energy balancing action. Where an offer is used for energy balancing actions, this doesn't necessarily mean it is the one that would have been used if there wasn't a system constraint. Any plant that is running through the afternoon demand trough because its MZT would prohibit it coming on later when it is needed, should automatically be flagged as for system reasons. This should then automatically result in an assessment of the associated BM offer price and appropriate action taken against the generator.

As an example, last winter some generators were getting paid for 7-8 hours of high BM offers when they were only needed for 1 or 2 hours at the peak. Focusing on addressing this issue should see high balancing costs being reduced by around half as they would

then run for their MNZT (minimum non zero time). If participants then increase their MNZT, this would be captured under market rules of having accurate plant dynamics.