

5 December 2022

Energy UK response to Ofgem Call for Input**Responding to high balancing costs in winter 2021: Update and proposal to introduce a new licence condition**

1) 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.

Introduction

Energy UK agrees that high balancing costs are impacting consumers at a time of extraordinary pressure on energy bills and recognises Ofgem's responsibility to act in the interest of consumers. Energy UK and its members take seriously the challenge of working to lower energy bills, the primary cause of which is volatile and expensive international gas markets.

It is worth noting that market participants trading in the Balancing Mechanism (BM) are operating within the existing market design as defined by Ofgem and that the Review of the Balancing Market¹ did not identify market participants' behaviour to be inconsistent with market rules on the high-cost days that were analysed. It is also important to remember that any intervention or change to market structure by the regulator has the potential to weaken investor confidence in infrastructure essential to GB's energy security. That's why it is essential that any intervention be targeted to specific problem that Ofgem is seeking to address.

As currently presented, Energy UK members do not agree that the licence condition is targeted to the problem at hand. Its applicability criteria must be refined to address the specific behaviour in question and a number of clarifications must be made so that unintended consequences can be avoided. Energy UK firmly believes that the licence condition is too broad in its applicability. While we understand that the intention is to target the concerning behaviour that was identified as leading to higher balancing costs by the Review, not enough thought has been given to the impacts it may have on other types of assets, such as storage and flexibility.

As the licence condition is too widely cast, its introduction as currently presented risks having unintended consequences that will damage the market signals that encourage new flexible technologies to operate most optimally to support the transition to Net Zero.

Clarifications

We believe that the Call for Input should be clearer about the problem Ofgem is trying to solve. Ofgem should:

- Identify the gap in existing regulation that it is looking to bridge with this licence condition. We note that Ofgem has written to market participants reminding them of their obligations under

¹ [Review of the Balancing Market \(Final Report\)](#) - frontier economics, LCP & Cornwall Insight

existing regulations with respect to the identified behaviour, but has not attempted any enforcement proceedings using these tools.

- REMIT is designed to tackle market manipulation and already describes some of the tools that could be used to prevent such behaviour with Physical Nominations (PNs) and it would be good to understand why Ofgem do not consider these tools, especially around physical withholding, to be effective in this scenario.
 - And going forward, it will be helpful for Ofgem to set out how this proposed new licence condition interacts and works alongside the REMIT regulation.
- Be explicit in its definition of “excessive benefit”, what it understands and measures as excessive, clearly showing the impact on the interest of consumers.

Better targeted solution

We strongly believe that Ofgem should target any intervention to the specific behaviour in question. Members feel that the applicability criteria of this licence condition needs to be more targeted, and its scope better defined, to address the concerning behaviour identified in the Review of the BM.

If the issue that Ofgem is concerned by is about assets with long Minimum Zero Times (MZTs) who have changed their Physical Notifications (PNs) to run with little advance notice in order to artificially drive up BM revenues, then the licence condition should be targeted to this specific harm. (For example, by including specific references to technical parameters like MZT and MNZT that have the potential to exacerbate system margins when combined with excessive offers.) Otherwise, applying the condition to all generator licence holders may lead to unintended consequences.

Unintended consequences

Members shared concerns that the introduction of this licence condition could create unintended consequences, putting investment cases at risk, including by:

- Limiting market participants’ ability to respond to scarcity pricing and weakening investment certainty.
- Incorrectly capturing the behaviour of assets whose normal operating procedure involve submitting zero MW Physical Notifications.

Ofgem should explain how it intends to mitigate these risks. In particular, it is important to consider the different ways in which the proposal will impact different generation technology types. It is apparent from the Review and Ofgem’s letter that assets with long MZTs such as coal and CCGTs who decide to change their operating schedule at short notice (i.e. by PN’ing to zero in the hope of getting called on at higher BM prices and deriving an excessive benefit) are at the focus of this proposal. (As already mentioned, the licence condition therefore should be specifically targeted to address that specific undesirable behaviour.)

By contrast, flexible assets such as energy limited storage, may PN to zero in order to change their operating plans – reflecting re-positioning that represents a more optimal use for the system of that limited resource. As such, it would be illogical to penalise such assets for changing their plans to better reflect system needs and inhibit what is otherwise a participant behaviour that is also more efficient for the system as a whole.

Clarity on how this licence condition would work in practice is also essential. The wording and the text of the licence and guidance must be absolutely clear about who it should apply to and the conditions and scenarios in which it would apply. As well as defining what it understands as an “excessive benefit/amount”, Ofgem must be clear about the forecasting and benchmarking data it intends to use, and whether this data will be publicly available.

Some Energy UK members shared concerns around the implementation of this licence condition and the potential administrative burden linked to the assessment of market participant behaviour and/or excessive benefit. This burden would apply to both generators and Ofgem. We would like to understand the potential impact Ofgem sees this having on the administrative process.

Other causes of high balancing costs

We understand that Ofgem is looking to intervene in the market to protect the interest of consumers and is considering action which addresses market participant behaviour seeking to gain excessive benefit. Energy UK members, however, expressed concerns that this Call for Input is a narrow scope through which to look at reducing balancing costs.

We would like to make sure that Ofgem has considered inefficiencies in the market that are not aligned with the interest of consumers and creating higher than necessary balancing costs, namely the lack of transparency from NGESO on its approaches balancing the system.

Our members have raised concerns about NGESO’s lack of transparency and communication in relation to running decisions for balancing services. This lack of information (e.g. not knowing where assets will fall in merit order, or what volumes will be offered) limits market participants’ ability to operate generating assets in the most efficient way possible, which therefore increases system costs and consumer costs. The inference to be drawn from such limited transparency is that the Control Room continues to struggle to effectively call on assets in merit order and that this also needs urgent examination to help address balancing costs.

Some Energy UK members with smaller, more flexible BMUs are consistently being overlooked despite being the cheapest option available to the Control Room. Whilst we appreciate NGESO’s intention to address ‘*skip rates*’ (how often a plant is not dispatched in merit order) via the Strategic Balancing Capabilities Review Workstream², we note that the specific industry workshop on skip rates has been delayed several times. Energy UK members argue that this issue also requires urgent examination to help address balancing costs.

Linked to the above, members have raised concerns about not being able to rely on the quality of information published by NGESO, which also contributes to market inefficiencies. This issue was also identified as one of the drivers of high costs in the Review of the Balancing Market³, specifically the under forecasting of wind and over forecasting of demand on tight days. A recent example of this ongoing issue can be found in October 2022’s forecast, which included data that was already out of date by the time of publication.

As market participants act on the basis of available information, their behaviour could be different (and more efficient) if they received more accurate information from NGESO and had greater confidence and certainty around being dispatched in the BM. We would like Ofgem to consider these factors more fully,

² [Balancing Strategic Review](#)

³ p.64, [Review of the Balancing Market \(Final Report\)](#) - frontier economics, LCP & Cornwall Insight

including the direct/indirect impact of the lack of information and transparency on market participant behaviour and rising balancing costs.

Dynamic parameters

Members also raised the fact that a BSC Issue Group looked at problems with dynamic parameters preventing parties from managing their running regimes. (E.g. insurance may limit the number of starts, emissions limits stop unlimited running hours, etc...) As Ofgem's letter⁴ on the issue indicates, at present market participants may only signal their unwillingness to run by setting very high prices in the BM. Therefore the intent behind setting very high prices may indicate an unwillingness to run, rather than to seek excessive benefit. While the Issue Group agreed that changes should be made to dynamic parameters, we note that NGESO has not taken this decision forward.

Energy UK believe that increasing competition is key to lowering balancing costs. We note that NGESO has considerably further to go in making systems changes to facilitate the participation of smaller assets in balancing services. Ofgem must encourage NGESO to move forward with accommodating smaller assets as this will increase competition and benefit consumers.

Energy UK firmly believes that the basis for effective competition is a level playing field. We would urge Ofgem to consider any potential distorting effects from the licence condition on the level playing field given its applicability only to licenced generators.

2) 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?

We believe that the applicability criteria for the licence condition needs to be better defined and targeted to the problem identified by Ofgem. This text of licence condition would therefore need to change to reflect this.

In any case, as currently presented, the text of the licence condition is still too vague and ambiguous, with greater clarity needed on what behaviour Ofgem defines as concerning and what benefit it considers as excessive. The licence condition should not be implemented without Ofgem first clarifying of a number of points. As mentioned above, specificity is key to avoid unintended consequences.

1. The following terms require explicit definition in the text of the licence condition.
 - "Excessive benefit/amount" – what is meant by excessive, what is the benchmark for a benefit to be considered excessive, what data will be used to assess this, over what timeframe will excessive benefit be considered, how will costs (including opportunity costs) be assessed?
 - "Submitting a Physical Notification of zero MW"
 - We are not clear whether this means setting a zero PN or changing to a zero PN. We think it should be the latter.
 - Clarity is also needed on the timeframe. If it's changing to zero MW PN within the same operational day, it needs to be reflected in the text. The guidance should explain how prior positions are to be treated, e.g. where a zero PN was submitted at Day Ahead.

⁴ [Open letter on dynamic parameters and other information submitted by generators in the Balancing Mechanism](#)

2. Guidance:

- The text of the licence condition and guidance should be very clear about the scenarios and conditions under which it would apply to avoid incorrectly targeting assets which submit zero PNs in normal operating procedure.
- The guidance should clarify how expectations of cash out prices will be taken into account when assessing whether there has been an excessive.

3. Paragraph 3.b requires clarification:

- The licence condition is to apply in periods only after a generator had submitted a zero MW PN, however:
 - It is not clear is whether it applies in any circumstance e.g. irrespective of whether more generation is required on the system or not.
 - Or will this condition only take effect only if more generation is needed on the system?
- If no further changes are to be made to the drafted licence condition, then greater clarity is needed for paragraph 3.b. - should it read (additions in red):
 - Either: "An increase in generation of electricity by a particular generating plant, whether **or not** there is an overall increase in electricity generation, "
 - Or: "An increase in generation of electricity by a particular generating plant, **when** there is an overall increase in electricity generation."

3) 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?

Yes, Energy UK believes the list (or the categories in the list) to be broadly correct. However, we consider that these factors require detailed explanation and expansion to ensure that generators can interpret and comply with the licence condition. The methodology, references, benchmarks that will be used in the assessment need to be provided.

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

The effectiveness of the new licence condition will be dependent on the clarity of Ofgem's proposed guidance document, which has not yet been made available. It is important that market signals for scarcity remain to support investment in flexibility, while extreme returns are tackled. As outlined in more detail in our answers to Question 1 and 2, the accompanying guidance should explicitly clarify:

- A fuller definition of a number of terms (excessive benefit/amount, submitting zero MW PN).
- The data against which excessive benefit will be assessed.
- How this licence condition could work in practice, and a list of the scenarios and conditions in which it would apply.
- Whether the licence condition would apply to all licensees, or whether it should be limited (e.g. to assets that have long MZTs; and exclude application to assets that are 50MW or less).
- How Ofgem plans to assess whether a market participant was seeking to gain excessive benefit after submitting a zero MW PN.