

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

Background to ENGIE

ENGIE is a global energy player, focused on renewable energy and low carbon distributed energy infrastructures. In the UK ENGIE owns First Hydro which comprises two pumped storage stations with a combined generation capacity of 2.1GW and the ability to store almost 12GWh of electricity. ENGIE also owns a UK retail business supplying electricity and gas to I&C customers, Storengy, a gas storage facility in Cheshire and is part of a J/V with EDPR which operates and develops offshore wind projects in Scotland.

Key Points

- ENGIE agrees that option 4 is the best option from those set out in the Call for Input to address the high balancing costs seen last winter.
- The draft licence condition does not seem to address the problem identified.
- The licence condition may create practical problems for Ofgem as an unintended consequence: flexible generators will often change their PNs to zero and increase prices within day for legitimate reasons.
- Given the importance of the guidance, it is disappointing that such guidance has not been available for review at the same point as the draft licence condition.
- ENGIE asks that Ofgem consults on the guidance ahead of the implementation of this licence condition, should Ofgem decide to proceed with its introduction.
- ENGIE questions whether the Balancing Reserve product being introduced by the ESO could avoid the need for the ESO to take the kind of actions seen last winter.

Response to Call for Input questions

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.

Of the 4 options presented in this Call for Input, ENGIE agrees at a high level that option 4 will best prevent the behaviour that caused last winter's high balancing costs.

However, the draft licence condition is not defined precisely and we are unclear as to whether it addresses the issue seen last winter. Therefore its efficacy will much depend on the practical implementation. Without seeing the guidance it is not possible to say whether option 4 will prevent this behaviour. The licence condition may however lead to a requirement for substantial data requests to generators who change their PNs to zero and increase prices within day for legitimate reasons.

The draft licence is defined so widely that any automated monitoring of the market will trigger questions about normal market actions that are necessary for the market to achieve an efficient outcome and for assets to respond to changing market and asset circumstances.

The outcome of this is that flexible assets and indeed any assets that legitimately change their PNs within day could be under daily scrutiny. We don't object to this scrutiny but market wide, this has the potential to be a large, resource-intensive and time consuming task for Ofgem.

Turning to the measure of 'excessive benefit', it is unclear how this will be determined to know whether a benefit is excessive. This is a large gap in the approach suggested by Ofgem. The volatility in input costs and also the potential cashout exposure in the event of a trip will need to be considered. It is also worth noting that the cashout price can be strongly impacted by interconnector trades which are currently the main contributor to high balancing costs.

ENGIE notes that the ESO is introducing a new Balancing Reserve product that will be procured at day ahead. This is very similar to option 3 in Ofgem's Call for Input. ENGIE would not advocate for option 3 or the new balancing product as these to an extent foreclose the market for the fine tuning of supply and demand to the day ahead stage. ENGIE has repeatedly made the point to Ofgem and BEIS that the bulk of energy tagged offers and revenues in the BM go to thermal generators with an FPN of zero at gate closure – meaning 'inflexible' generators are being rewarded for their inflexibility at the expense of flexible generators. A balancing reserve market will just exacerbate this.

Setting this aside, the new balancing reserve market would avoid the need for the ESO to take the kind of actions seen last winter that have led to this Call for Input. We would therefore ask whether the proposed licence intervention is also needed. If Ofgem concludes that it is still required, there should be a sunset clause / review of ongoing need to allow the new balancing reserve product to be established.

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?

The licence drafting does not address the behaviour that has led to this Call for Input. The drafting repeatedly refers to Submitting a Physical Notification of zero MW. This should read as reducing a Physical Notification to zero MW. Without this change, a licensee could be in breach of its licence if it has a PN of zero and either has an offer accepted which is deemed to be excessive or has submitted a 'sleeper' offer indicating that it does not want to run. Please see the next point for more on this.

We question why a licence breach would be considered if an offer is priced at what might be considered an excessive level but is not accepted. Generators may use BM pricing to indicate that whilst available, they do not wish to operate or if they do, they need to be sufficiently remunerated. Offers for First Hydro

may for example be priced at higher levels than previously seen within day in order to preserve water for use at a later point or to reflect the marginal cost of importing power to restock the upper reservoir.

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?

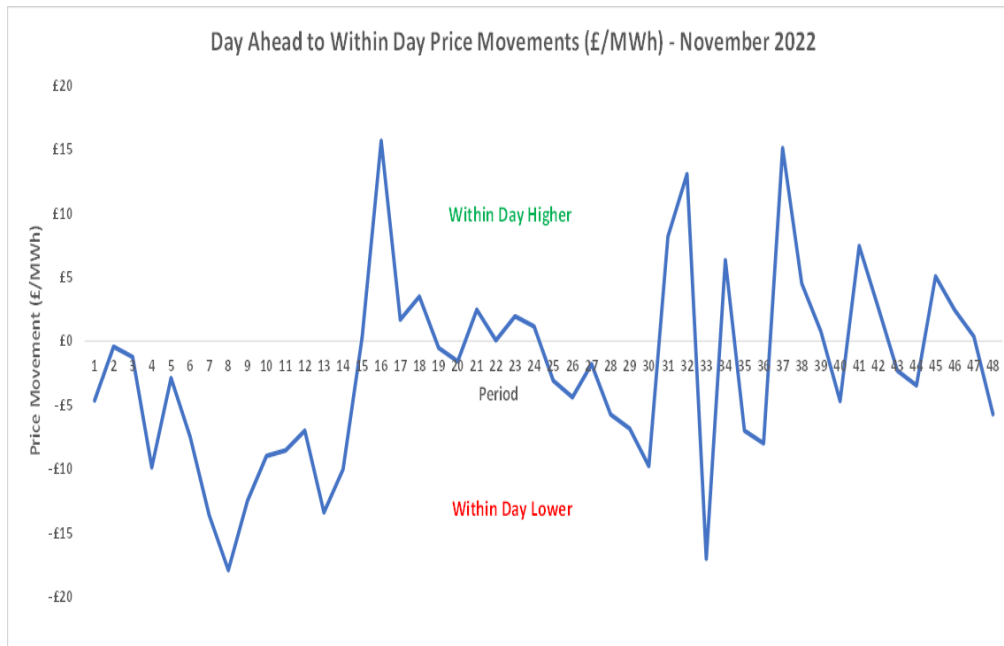
ENGIE has the following comments on Ofgem's list of factors it will consider to determine if there has been a licence breach

To what extent is the offer price in line with prices in similar periods of scarcity? If a generator trips, it will be exposed to the higher of its offer price and the cashout price for its imbalance. The cashout rules therefore incentivize pricing at the marginal offer price. The examination of whether offer prices are in line with similar periods of scarcity should extend to whether offer prices are in line with other accepted offers seen in the market at that time.

Overall system tightness One of the proposed criteria that will form part of the assessment is the extent of scarcity on the system. Our perception of the behaviour that led to the high balancing costs seen last winter is that the ESO was in the main seeking to procure reserve. These actions were not taken on days where scarcity was indicated; there were no EMNs or capacity market warnings for example. In linking the licence condition to scarcity, Ofgem may exclude the behaviours it is seeking to prevent. Scarcity should be used as a negative indicator i.e. if there is no scarcity and there are high prices then this will be an indication that all is not well. Whereas, if there is scarcity then high prices will be legitimate and part of an efficiently functioning market, providing strong investment signals.

What and how have other costs been factored into the offer price? We have seen very high within day input cost volatility and extreme uncertainty about the potential exposure to such cost changes. This requires an increased risk premium when pricing in the balancing mechanism. Therefore, it is important to recognize the way in which risk premia change over time.

To what extent is the offer price in line with the market's valuation of scarcity? As per the above point on input price volatility, there can be a wide differential between day ahead and within day prices as the graph below shows – these are average prices so absolute differences will be much wider. Whilst pricing changes between day ahead and within day may be a factor in Ofgem's assessment of a licence breach – these are a normal part of a functioning market.



What this does highlight is that whilst the behaviour seen last winter is easy to identify, precisely defining the licence condition and the guidance to address this behaviour is much more challenging. If it is too tightly defined there is the possibility that it will be circumvented, too loosely and it may initially capture generators that ordinarily both set their PNs to zero and for various legitimate reasons, change their prices within day.

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 guidance should be very clear about the scenarios and conditions under which it would apply to avoid incorrectly targeting assets which submit zero PNs and change their prices within day as part of their normal operating procedure. It should also clarify the data against which excessive benefit will be assessed.

Ofgem should consult on this guidance - it is essential that the market has a clear understanding of the actions that would constitute a licence breach.. Ofgem recognises the importance of the guidance in the Call for Input; intuitively, drafting such guidance will not be simple and so it would be worth sharing a draft with the industry as soon as practicable. Further, if the guidance is updated then there should be a consultation process.

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