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Responding to high balancing costs in winter 2021 - Call for Input
Sent by email to Robin.Dunne@Ofgem.gov.uk

Dear Robin Dunne

Thank you for the opportunity to respond to the call for input on high balancing costs. We believe that extreme pricing observed in the Balancing Mechanism is a sign of an uncompetitive market. We recognise scarcity pricing has an economic utility and signifies requirement for new investment, however a situation where consumers are concurrently paying for scarcity prices, a capacity mechanism and a strategic reserve is one where they are not well served. Ultimately, only increased competition (on an even playing field) will resolve short term balancing issues in the market however we agree an intervention is justified until then.

However, the proposed intervention misses the mark and has a large potential for unintended consequences. The behaviour the proposed interventions are trying to target are exhibited by a handful of large thermal plant weaponsing their physical constraints. It is important that other providers and valuable investment signals (eg for more flexibility) are not hurt by any measure.

Of all the options we believe imposing a price cap (via a change to Capacity Market rules) could be the most efficient enduring fix. Before then a clarification of the licence condition may also be valuable. It is important any measure can be introduced within a year while longer term investment signals are also given attention.

## Suggested Interventions

### 1. Price cap on BM offer prices

This is our favoured position, it is most unambiguous, resistant to gaming and guaranteed to deliver intended results with minimal unintended consequences. Rather than a generalised cap via the BSC we would favour implementation via the Capacity Market rules, effectively a Reliability Option mechanism without central dispatch. This would not eradicate scarcity pricing from the Balancing Mechanism (and thus wholesale markets) altogether, but prevent certain thermal generators earning a double payment via the Capacity Market and scarcity prices.

Effectively participants would need to choose between fully merchant operation or trading in some of the market potential for taking a Capacity Market obligation. This would have the added benefits of improving some long standing problems with the Capacity Market, such as

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incentivising greater T-1 participation and better defining acceptable delivery (eg offering into the BM below the price cap).

We would encourage the use of a defined fix cap rather than a complex mechanism to derive this. This would have benefits for market certainty and by allowing market participants to opt-in to the price cap via a CM contract a more arbitrary approach can be justified

**2. Changes to bid/offer structures**

This is a poor option and we would advocate it be immediately removed from consideration. Allowing more complex matrix offers simply furthers the technology specific nature of the Balancing Mechanism towards thermal generation and would also reduce the transparency of an already opaque market.

Changes in the other direction to simplify BM bids have merit (namely to increase competition/transparency and potentially enable clearing auctions) however would represent fundamental changes to operating practices and systems for the most mission critical balancing. Therefore, could not be implemented quickly and at worst could take well over a year of investigation before being dropped (eg EBS).

**3. A new NGESO balancing service to procure firm reserve**

This approach does have merit and addresses a highly perverse signal currently where the least flexible plant are rewarded most in the BM. In a utilisation payment only market dynamic, fast responding assets are not compensated for the insurance value they provide the system (see more detail here) and a firm reserve service could fix this

However, with this option the key is in its implementation. We are not encouraged by the latest Balancing Reserve product scoped out by NGESO (which only allows participation from Large Power Stations). At worst some designs could further lock in excessive scarcity rents for these large thermal plant if they are given dominion over a novel service.

**4. A new licence condition preventing excessive benefit after submitting a zero MW PN**

We would strongly discourage Ofgem from pursuing this approach as it is both too specific and too broad to achieve the desired effect. It is too specific in that scarcity rents could occur after a non-zero MW PN and it is easy to conceive how this could be gamed (eg using other smaller assets on site to sustain a near zero but technically non zero PN).

It is also too generic as it would capture all technologies, not just large thermal plant. For example, battery storage submits a zero FPN the majority of the time and experiences a

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highly volatile revenue distribution (given it only accesses flexibility value which is indexed to market volatility).

**5. Restrictions on amending PNs after day ahead**

This approach could reduce the targeted behaviour however involves a much larger industry debate around the timescales of balancing actions and Gate Closure. Therefore it doesn't deserve consideration on the grounds of ease implementation. This debate will touch on many aspects of REMA and likely play out over years.

**6. Clarifying 'good industry practice' in the Grid Code**

This approach has a low risk of unintended consequences and could be implemented relatively quickly therefore merits further investigation. We would encourage any clarification to address the commercial weaponisation of negative physical characteristics (eg long start up or required zero output times).

## Specific Questions

**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.**

Amending the licence to prevent excessive profit after submitting a zero FPN is unadvisable. Changes to the generation licence will impact many providers and technologies and a condition as vague as this will create undesirable consequences. Restricting the requirement to occurring after a zero MW PN could be easily gamed.

**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 term 'excessive benefit' is not sufficiently clear, this is evident from the nebulous definitions given in the list of factors. This has detrimental impacts to market confidence (in comparison to say a defined cap); a good comparison is the TCLC which is the cause of must market uncertainty.

**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?**

The list of factors put forward will create great difficulty in administering this requirement, for example the 'market's valuation of scarcity' is a highly non-trivial to establish and could be argued is itself a oxymoron, given a time of reduced competition is when a market ceases to function to produce a singular consensus on price.

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

We believe establishing clear guidance will be very difficult for the reasons above.

For any responses to this document please contact:

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