

Arenko Response to Ofgem's Consultation on the Inflexible Offers Licence Condition

13th March 2023

About Arenko

Arenko is in pursuit of a zero-carbon grid worldwide and was established in 2014 to enhance the value of energy storage assets. We have been operating large scale battery assets since 2016 and now focus on developing our Software Platform 'Nimbus'. Arenko's Nimbus Platform is a product ecosystem that maximises portfolio performance at scale. Our modular products are founded on our experience controlling assets and provide proven technology that standardises, controls, dispatches and optimises energy storage assets. These products are built with a philosophy of openness & extensibility at their core so that our customers can master their own innovation. Whether via access to our trusted pool of third-party developers or through personal usage of the Product APIs, our customers have the freedom of choice.

We currently have over 210 MW of battery storage operational on our platform with a contracted pipeline in excess of 1.2 GW of stand-alone and co-located battery assets. We are active players in the Balancing Mechanism (BM), having delivered the first automated system to allow batteries to participate in the BM and lead on the BM Reserve from storage trial with National Grid ESO in 2021¹.

Introduction

We would like to thank Ofgem for the opportunity to respond to this Consultation. Arenko are eager to work with Ofgem and other industry stakeholders to help create efficient markets that prove affordable for customers, help improve grid management and contribute towards our Net Zero ambitions.

Arenko welcomes Ofgem exploring options to lower energy bills for consumers as we continue to navigate unpredictable and volatile global gas prices. We understand that increasingly high balancing costs are impacting consumers at a time of extraordinary pressure on energy bills.

We would also like thank Ofgem for taking on board our feedback in our response to the Call for Input in December 2022 and welcome steps taken to avoid capturing the normal behaviour of batteries within the Inflexible Offers Licence Condition (IOLC). However, we do have concerns that the IOLC, as drafted, risks unintended consequences that could distort wider markets that flexible technologies such as battery storage rely on to support their investment case. We believe Ofgem should take these concerns into consideration as part of an Impact Assessment before moving forward.

¹https://data.nationalgrideso.com/plans-reports-analysis/covid-19-preparedness-materials/r/trial_review_-_reserve_from_storage_in_the_bm

Overview of concerns

We have identified four potential unintended consequences of the IOLC which are of concern:

1. Compliance Risk

Ofgem must set out a clear definition of what is deemed as gaining '*excessive benefit*' alongside clear case-based examples of how it will be assessed in practice. Without this clear definition, market participants are exposed to a large compliance risk.

2. Market Distortion

We are concerned that the ICOC could potentially distort the wider energy markets. Firstly, the IOLC could have large implications for how generators operate in the BM, therefore impacting trading in the wholesale markets (day ahead and intra-day), resulting in skewing price spreads. Secondly, the IOLC could impact the liquidity and merit order of the BM itself. Speaking from a storage perspective, market distortions could fundamentally change the business models and investment cases for BESS assets in the UK. This is concerning, given that we need to be driving up investment in storage assets as we transition to Net Zero.

3. Energy Security

As mentioned above, the IOLC may impact liquidity in the BM, particularly if there is no clarity over how excessive benefit will be defined and measured. This could present a risk to the integrity of the BM as the main tool for balancing the system, and in the worst case, national energy security.

4. Higher Costs

If the IOLC leads to many assets being unable to respond to tight system conditions through the BM, this could lead to ESO having to take a larger number of alternative actions (for example through Reserve) at greater cost, which would run contrary to the intention of this change to reduce balancing costs.

Arenko encourages Ofgem to undertake a modelling exercise to assess the knock-on implications of the IOLC on market conditions, energy security and overall balancing costs. Within this exercise, the impact of new ancillary services and balancing tools should be accounted for, including the Reserve product suite due to go live towards the end of 2023 - which should also serve to lower balancing costs.

Following this analysis, any action from Ofgem should be narrowly targeted at the behaviour that they wish to capture and be accompanied by a robust Impact Assessment.

Other Reasons for high balancing costs

We are disappointed that Ofgem have not sought to look further into how ESO's own actions are contributing to higher balancing costs. Whilst we recognise the behaviour that this Licence Condition seeks to prohibit, participants would be less able to gain excessive benefit from the BM if the market was more competitive. Ofgem must now put pressure on the ESO to carry out the necessary reforms to increase competition and drive down costs.

We would like to take this opportunity to reiterate the continued issue of inefficiencies in the BM that are not aligned with the interest of consumers and creating higher than necessary balancing costs. Namely this comes down high levels of ‘skip rates’ (how often a plant is not dispatched in merit order), as we highlighted in our Call for Input response in December 2022. Arenko operate relatively small, flexible units and are still experiencing consistently being overlooked in the BM despite being the cheapest option available. This has been widely put down to antiquated IT systems in the Control Room not being equipped to deal with lots of smaller units coming onto the system.

Whilst we appreciate ESO’s intention to address the high ‘skip rates’ and upgrade their IT systems via the Balancing Programme, we note that these reforms are not moving fast enough to mitigate the high balancing costs we have been experiencing at present. Arenko believe that ESO’s actions also require urgent examination by Ofgem alongside the behaviour of some market participants.

Consultation Questions

1. Do you agree with our proposal to remove the ‘within the operational day’ requirement for submission of 0 MW PNs? Please provide reasons for your answer.

We welcome the recognition from Ofgem that submitting multiple 0MW PNs within the same operational day is standard operating procedure from many flexible storage units.

However, we note that by preventing some market participants from receiving ‘excessive benefit’, there will be an effective cap on the offers that can be submitted in the BM. There is a risk that this could fundamentally change how the BM, intra-day, and day-ahead markets operate. There then could be a knock-on risk of disrupting business models and investment cases for storage assets that operate in GB and rely on projected revenues from these markets.

If Ofgem is seeking to capture certain asset behaviours, we suggest instead, removing references to specific PN activity and using targeted wording, calling out exactly what Ofgem is looking to capture or exclude. For example, Ofgem should not rule out stating the exclusion of storage within the Licence Condition wording to avoid unintended consequences. We do however recognise that to do this, Ofgem may need to rely on the successful implementation of the Energy Bill², which will include a formal definition of storage, as set out below:

“Electricity Storage in the electricity system is the conversion of electrical energy into a form of energy which can be stored, the storing of that energy, and the subsequent reconversion of that energy back into electrical energy.”

2. Do you agree with our proposal to limit the scope of the condition to generators with an MZT greater than 60 mins? Please provide reasons for your answer.

If Ofgem go ahead with this Licence Condition, including an MZT requirement of 60 minutes or above, should ensure that the licence condition does not inadvertently capture flexible storage assets that have an MZT of well under 60 minutes.

² <https://bills.parliament.uk/bills/3311>

However, as mentioned above, to avoid unintended consequences, Ofgem should consider explicitly stating the assets and behaviours Ofgem is looking to capture or stating which asset types should be excluded, as opposed to referencing MZTs.

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

If Ofgem does move forward with this Licence Condition:

Firstly, we suggest that Ofgem includes a clear definition of *'excessive benefit'* within the licence condition. Backed up by clear case-based examples within the supporting guidance document.

Secondly, as mentioned above, we would suggest Ofgem considers refining the wording to capture only the behaviour that Ofgem seeks to prohibit.

4. Do you agree with our approach to considering excessive benefits, as set out in the draft guidance? Are there any other factors we need to consider for inclusion in the supporting guidance?

To reiterate, Arenko are still unclear on how exactly *'excessive benefit'* will be defined. We would like to request that Ofgem provides a definition of what they deem to be an *'excessive benefit'* within the Licence Condition, alongside case-based examples within the supporting guidance. If this is left up to interpretation, this presents a large compliance risk for BM participants, particularly given the lack of case history.

Having clearly defined examples or circumstances under which an investigation would take place will reduce the administrative burden of enforcing this licence condition for Ofgem and for licensees. In addition, providing some historical evidence of periods when specific actions have unduly increased BM costs would help industry identify the behaviour that Ofgem seeks to prohibit.

Conclusion

Whilst we are supportive of Ofgem seeking to lower balancing costs and therefore reduce costs borne by the consumer, we have highlighted some concerns around the unintended consequences that the IOLC may present.

We therefore ask, if Ofgem continues with progressing this Licence Condition, to consider the following:

1. **Clear Definitions** - Provide detailed guidance on how *'excessive benefit'*, and *'reasonable profit'* will be defined. The absence of this represents a major compliance risk to BM participants.
2. **Market Modelling** - Ensure that an Impact Assessment is undertaken to assess potential market distortion and its impacts on investment in storage technologies before moving forward. This must also include the expected market influence of the new Reserve product suite.
3. **Look at ESO's own actions** - Recognise the role ESO plays in market efficiency of the BM and therefore balancing costs, and seek to incentivise improvements.
4. **Targeted Wording** - Consider explicitly stating which behaviours Ofgem seeks to prohibit, including not ruling out the exclusion of storage and flexible assets, within the Licence Condition text.

Arenko would like to thank Ofgem again for the opportunity to engage in this consultation. If you have any questions regarding our response, please do not hesitate to contact me using the details below.

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