CONSULTATION RESPONSE

EFET
European Federation of Energy Traders

EFET response to Ofgem's consultation on Inflexible Offers Licence Condition

17 March 2023

The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent and liquid wholesale markets. We build trust in power and gas markets across Europe, so that they can underpin the sustainable and secure supply of energy and enable the transition to a carbon-neutral economy. EFET currently represents more than 120 energy trading companies, active in over 28 European countries. For more information, visit our website at www.efet.org.

We appreciate the opportunity to comment on the Ofgem consultation on introducing a new Inflexible Offers licence condition. In our view, the revised and elaborated proposal for the introduction of a new IOLC would be a disproportionate response to the identified problem. First, REMIT (potentially also Competition Law, Licence Breach or Breach of Industry Codes) already offers a comprehensive framework for investigating and addressing potential cases of market abuse. We do not think that a new licence condition would be the right response. This effectively seeks to extend the reach of market abuse legislation without the proper parliamentary scrutiny that would ordinarily accompany such a change being enacted in law. Second, in addition to trying to prevent the specific behaviour identified by Ofgem, the revised proposal and its expanded scope (i.e. its extension beyond the operating day) threaten to create considerable uncertainty and affect a fundamental principle of market functioning – scarcity pricing. This, in turn, risks market distortions and unintended consequences.

Energy prices should be allowed to reflect the true value of scarcity during times of system stress and high demand for power; similarly, when energy is in abundance prices should be allowed to reflect the value of displacing that generation which would give signals for storage operators. Only undistorted prices give an accurate signal for dispatch, on one hand, and for investment and divestment, on the other hand. As all prices across the different wholesale market timeframes are related and reflect an expectation of future imbalance prices, overrestriction (which can also be self-imposed due to regulatory uncertainty) of bidding behaviour in the BM would distort price signals and bidding behaviour across the different timeframes.

We remain of the opinion that the most beneficial way forward would be to strengthen competition in the Balancing Mechanism (BM), as that would help to improve price signals and reduce the costs of the mechanism to consumers more generally. We are pleased to see that Ofgem has recognised the need for such improvements in the section discussing the responses to the consultation on responding to the high balancing costs.

At the moment, we see three distinct blockers to participation in the BM, namely:

1) Behavioural issues: The Control Room is used to dispatching larger assets as it is easier to do so and that is how they have always operated. This is evidenced by

increasing ‘skip rates’. Therefore, even if smaller assets endure the costs and effort required to participate in the BM, there is currently no guarantee of being dispatched.

2) System capability issues: Until there are significant upgrades to the Control Room systems, the dispatch process remains highly manual which does not support efficient dispatch of smaller assets.
3) Reliability over participation: There is little experience with the participation of distributed energy resources (DER) which does not give the Control Room enough comfort that it will provide the required response. This could be improved by greater visibility and a larger level of participation to improve learnings.

Facilitating the (more active) participation of a diverse range of market participants, including demand response and energy storage, as well as smaller units, would help to improve competition, enhance flexibility and security of supply, and reduce the carbon intensity of the BM. Therefore, we believe there are a number of issues which need to be addressed across the short to medium term in order for there to be a significant improvement in the operation of the BM.

Furthermore, in reference to the statement that in case of continuous concerns regarding high balancing costs Ofgem “may consider further options for intervention regarding a price cap in the BM,” once again, we would advise strongly against such changes. A price cap, as the previous consultation document recognised, would dampen price signals, which would affect investment, security of supply, and competition. Setting the level of the cap would also be difficult and would need to involve regular reviews and potential adjustments to reflect changing market conditions, which would create uncertainty for market participants. Should there be a need for further action, we would consider some of the other options discussed in the previous consultation to be more appropriate (e.g. introducing a new NGESO Balancing Service to procure firm reserve and/or clarifying “good industry practice” in the Grid Code).

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.

No, in our view that would be a disproportionate response to the identified problem. Removing the “within the operational day” requirement would extend the scope of the measure significantly beyond the behaviour in question. The impact would be restricting the possibility for scarcity pricing of a large amount of the BM capacity.

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.

Given the specific issue that the licence condition is intended to address, we understand why Ofgem might propose limiting its scope to generators with long MZT times. However, the current proposal will limit the ability of a large amount of BM capacity to scarcity price and as mentioned above, we would consider the measure to be unnecessary given the availability of existing rules and frameworks for addressing and investigating concerns about market abuse.

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?

We maintain that the proposal would be a disproportionate response to the identified problem, given the availability of market integrity rules and related investigative powers.

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?

In our view, the definition of “excessive benefits” leaves considerable room for interpretation, which creates uncertainty for market participants and concerns about pricing scarcity in fear of being in breach of the licence condition. The effect would be limiting the possibility for scarcity pricing of a large part of the BM capacity.