

Robin Dunne  
Domestic Market Management  
Ofgem

By Email:  
[robin.dunne@ofgem.gov.uk](mailto:robin.dunne@ofgem.gov.uk)

## Commercial Asset Optimisation

Contact	Raoul Thulin
Phone	07795354334
Email	raoul.thulin@rwe.com

Swindon, 13/03/2023

## Consultation on Inflexible Offers Licence Condition

Dear Robin,

RWE is a leading global energy player, with a 38 GW global generating capacity, and a clear target: to get to net zero by 2040. With its strategy 'Growing Green' (announced in November 2021) RWE expects to invest €50 billion gross in its core business globally -an average of €5 billion gross each year for offshore and onshore wind, solar, batteries, flexible generation and hydrogen.

In the UK, RWE is one of the largest power producers, accounting for around 15% of all electricity generated across a portfolio of onshore wind, offshore wind, hydro, biomass and gas, amounting to over 10 GW pro rata<sup>1</sup>(12 GW installed capacity) -enough to power over 10 million UK homes.

RWE is also one of the largest renewables generators in the UK, with a combined installed capacity of over 2.79 GW (pro rata) (4.8 GW installed capacity.) across our onshore wind, offshore wind, hydro and biomass assets. In addition to its growing renewables portfolio, RWE operates around 7GW of modern and efficient gas-fired capacity in the UK, making us one of the largest providers of firm flexible generation, which is crucial for security of supply.

Overall, and including its committed investments in projects already under construction, RWE expects to invest up to £15 billion in new green technologies and infrastructure in the UK by 2030.

We welcome the opportunity to comment on the proposals made in the Inflexible Offers Licence Condition consultation ("the Consultation"). This response is provided on behalf of RWE Generation UK plc.

In addition to responding to the individual questions in the consultation, we set out in Annex 1 our concerns with the approach taken in developing the licence change proposal. In broad terms, we consider that the proposals go well beyond the issue that Ofgem identified and that the licence condition as

### RWE Supply & Trading GmbH Swindon Branch

Windmill Hill Business Park  
Whitehill Way  
Swindon SN5 6PB  
United Kingdom

T +44(0)1793/87 77 77  
F +44(0)1793/89 25 25  
I [www.rwe.com](http://www.rwe.com)

Registered No. BR 7373

VAT Registration No.  
GB 524 921354

Supervisory Board:  
Dr Michael Müller  
(Chairman)

Board of Directors:  
Andree Stracke (CEO)  
Gunhild Grieve  
Peter Krembel  
Ulf Kerstin

Head Office:  
RWE Platz 6, Essen, Germany  
Private Limited Company  
registered at:  
Local District Court, Essen  
Germany  
Registered No.  
HR B 14327  
Share Capital:  
EUR15,030,000.00

Bank details:  
Deutsche Bank Essen  
Bank Code 360 700 50  
Account No. 105 127 500  
SWIFT: DEUTDEDE  
IBAN: DE05 3607 0050 0105  
1275 00

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drafted would be disproportionate and would undermine rather than enhance competition in the electricity market.

If there are any points in the attached on which further discussion would be helpful, please do not hesitate to get in touch.

Yours sincerely,

Raoul Thulin  
RWE Supply & Trading GmbH

By Email

**Annex 1**  
**RWE Generation UK plc response to Ofgem consultation – Inflexible Offers  
Licence Condition**

**Introduction**

We note that the real issue identified by Ofgem in the consultation document and the earlier call for input is quite a narrow one. While we understand Ofgem’s desire to address the specific behaviours that it has identified in order to achieve its principal objective, that of protecting the interests of consumers<sup>1</sup>, the Inflexible Offers Licence Condition (IOLC) proposed in the consultation document goes well beyond what is required, and will prohibit entirely legitimate conduct falling outside the “sharp practices” identified by Ofgem in the consultation.

As a general comment, our view is that most instances of “sharp practices” involving unfair exploitation of the technical characteristics of CCGTs are capable of being addressed by means of existing tools available to Ofgem. In particular, any submission of a zero PN that does not reflect the generator’s genuine intentions, and is done only to force an early offer acceptance by the ESO, is likely to amount to a “false or misleading signal” for the purposes of Article 5 of REMIT and should be tackled as such (as in fact it has on occasion in the past).

If the view is taken that additional measures are needed, the IOLC should not be used as an opportunity to regulate prices within the normal operation of the balancing market. We believe that Ofgem has not given appropriate weight to the impact of the proposals on the normal operation of the Balancing Mechanism<sup>2</sup> and this will inevitably create an imbalance between generators’ competitiveness. It is therefore likely that the proposed licence condition will not have the effect claimed for it, and indeed will have the opposite effect, undermining price signals, the efficient operation of the balancing market and security of supply (the objectives identified by Ofgem in paragraph 1.9 of its consultation document).

In our response to the call for input, we made a number of suggestions that we believe would have narrowed the proposal to better deal with only the circumstances that Ofgem had identified as problematic. In particular, we suggested that the licence condition should focus on periods when a unit has changed a PN from non-zero to zero and when that is within a set period ahead of real-time. However, even this would capture the perfectly legitimate behaviours of CCGTs responding to market signals when, for example, renewable resources outturn higher than was forecast at the day-ahead stage. In such circumstances, flexible, dispatchable plant such as CCGTs should turn off within day if market conditions dictate.

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<sup>1</sup> Section 3A Electricity Act 1989

<sup>2</sup> Section 11E (4) Electricity Act 1989

In paragraph 1.8 of the consultation document, Ofgem identifies the particular practices of concern, targeted by the proposed IOLC. These are: “We saw instances of generators notifying the ESO that they intended to cease generating electricity for a particular period before significantly increasing the price of their offers to the ESO to continue generating during that period.” In other words, the conduct of concern arises from reductions of the PN to zero. There is therefore no basis for prohibiting conduct involving the unchanged submission of a zero PN.

By widening the proposal to all settlement periods in which a BMU with an MZT of more than 60 minutes submits a zero PN<sup>3</sup>, the licence condition would capture an overly wide range of circumstances that have nothing to do with the flexibility or otherwise of generating units. These include:

- Early starts, when a unit is dispatched to come on, for example, in the morning and the System Operator wants the unit to synchronise earlier
- Extensions to PN runs, when a unit is dispatched to come off at night but the System Operator wants the units to continue generating for a period of time
- Over-night run-throughs when the system operator requests generation when the unit would otherwise shut down
- Within-day ‘two-shifts’ when spreads for some gas units are negative in the middle of the day and they are therefore dispatched to turn off
- BOA runs on units that are not economic to run in the forward markets.

The proposed IOLC would also prohibit a situation where a generator with a MZT greater than 60 minutes submits zero FPNs, unchanged throughout the morning period and into the afternoon and evening, while submitting offers at a price based on supply and demand. This conduct is entirely legitimate, and not a “sharp practice”, but would nevertheless be assessed by reference to the ‘excessive benefit’ test. The measure Ofgem proposes therefore appears arbitrary and disproportionate, as it is not confined to the issue that has been identified. Instead, as is apparent from Table 1 and paragraphs 3.10 to 3.14, Ofgem seems to be using this as an opportunity to regulate BM offer prices, with no justification. The category of “Day ahead PN submission” in Table 1 reflects normal market practice – it is for a generator to decide whether or not to dispatch, based on the price signals at the time.

For the reasons set out above, the proposed IOLC is hugely disproportionate and Ofgem should reconsider its approach entirely.

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<sup>3</sup> This should in any event refer only to a FPN of zero, as explained below.

## **CCGT Minimum Zero Time**

In order to understand the impact of the proposed IOLC, it is important to understand the underlying factual context.

CCGTs are designed for high efficiency operation, not for repeated short run cycles and shutdowns of circa 60 minutes.

The boilers are there to capture exhaust heat from the gas turbines and recover a significant portion of this energy by boiling water and passing the resulting superheated steam through a steam turbine.

To maximise heat transfer and recover as much additional energy as possible, the boilers incorporate a very large number of thin walled metal tubes, and headers, and comprise several sections operating at different temperatures and pressure, exceeding 500degC and 100bar.

The boilers themselves are very large and expensive items costing tens of millions of pounds and will only survive a certain number of cycles due to the stresses on the metal components through each heating cycle. Lots of short cycles will rapidly consume the material lifetime of the components.

Additionally there are major problems that arise when reintroducing heat to the boiler quickly. Consequently the OEM control systems will generally not allow operator restarts in timeframes of the order of 1 hour. And even if attempting to restart after a couple of hours, the operations team will have to manually intervene in the run-up sequence. They need to use their skill, expertise and judgement to coax the unit through the run-up sequence, intervening to balance conditions in the boiler drums and control the inevitable temperature, pressure and water level deviations, and avoid breaching critical levels which would cause an automatic shutdown to protect the unit.

Attempts to return CCGT's after only a small number of hours at zero load come with a high risk of failure, and a loss of generation to the system at short notice.

These factors lead to the setting of a Minimum Zero Time for CCGTs, invariably of more than 60 minutes, and generally up to 6 hours, in order to minimise this risk. This aligns with Ofgem's open letter to the industry dated 29 September 2020<sup>4</sup> and avoids a risk-adjusted, commercially based submission of Dynamic Parameters and prices.

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<sup>4</sup> <https://www.ofgem.gov.uk/publications/open-letter-dynamic-parameters-and-other-information-submitted-generators-balancing-mechanism>

## **Adverse effects of the proposed IOLC**

The proposed IOLC would apply almost exclusively to CCGTs which are, as explained above, incapable of operating normally with an MZT of 60 minutes or less, and typically require significantly more. Ofgem's claim in paragraph 3.2 of the consultation, that generators have the choice between a flexibility path and an inflexible path, is therefore based on an entirely incorrect assessment of the facts. If "inflexibility" is defined by reference to a MZT greater than 60 minutes, as it appears to be, Ofgem's approach excludes all CCGTs from what Ofgem describes as flexible operation. This appears to be clear from Figure 1 and paragraph 3.8 of the consultation document.

The implications are therefore damaging to the market given that this type of generator serves a crucial role on the system in providing dynamic, flexible, dispatchable generation that is needed for security of supply and will continue to serve a crucial role as units convert to include CCS or the ability to run on hydrogen. This failure to promote efficiency is inconsistent with Ofgem's duties<sup>5</sup>.

The exclusion of all CCGTs from flexible operation and from pricing for scarcity also conflicts with EU Retained Law obligations derived from EU Regulation 2019/943 and Commission Regulation 2017/2195, the Balancing Guideline. In particular, the proposed IOLC would be contrary to the requirements of Article 3 of Regulation 943, which provides that regulatory authorities must ensure that electricity markets are operated in accordance with the following principles:

- “(a) prices shall be formed on the basis of demand and supply;
- (b) market rules shall encourage free price formation and shall avoid actions which prevent price formation on the basis of demand and supply;
- (c) market rules shall facilitate the development of more flexible generation, sustainable low carbon generation, and more flexible demand;
- ...
- (f) market rules shall enable the decarbonisation of the electricity system and thus the economy, including by enabling the integration of electricity from renewable energy sources and by providing incentives for energy efficiency;
- (g) market rules shall deliver appropriate investment incentives for generation, in particular for long-term investments in a decarbonised and sustainable electricity system, ...and shall facilitate fair competition thus ensuring security of supply;”

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<sup>5</sup> Section 3A (5) Electricity Act 1989

Article 6 of Regulation 943 is also relevant. In particular, it provides that:

- “1. Balancing markets, including prequalification processes, shall be organised in such a way as to:
  - (a) ensure effective non-discrimination between market participants taking account of the different technical needs of the electricity system and the different technical capabilities of generation sources, energy storage and demand response;
  - (b) ensure that services are defined in a transparent and technologically neutral manner and are procured in a transparent, market-based manner;”

In addition, Article 304 of the Trade and Cooperation Agreement between the EU and the UK, imposes very similar obligations in relation to price formation and non-discrimination.

The proposed IOLC is incompatible with these requirements, in that it inhibits price formation in accordance with principles of supply and demand, to a significantly greater extent than required in order to secure the objectives pursued by Ofgem. It also creates obstacles to the development of flexible CCGT generation (notwithstanding Ofgem’s artificial classification of a “flexible” and an “inflexible” path, CCGT generation is inherently flexible). It also interferes with investment signals and creates risks to security of supply. Furthermore, it discriminates between market participants on the basis of their technologies (because only CCGTs are targeted).

RWE therefore believes that the licence condition as proposed is disproportionate and far wider than what is required, when it should instead be narrowly targeted to achieving the effect Ofgem is seeking<sup>6</sup>. As such to implement the proposal would again be inconsistent with Ofgem’s duties under the Electricity Act 1989.

If the IOLC is considered necessary, the proposal should be therefore limited to revisions of PNs from greater than zero to zero at short notice, in order to avoid catching legitimate conduct such as instructions to extend runs. It should also be limited to revisions of PNs to zero where the revision cannot be justified by reference to changed market conditions.

The reference to a PN of zero should also be clarified. Footnote 6 in the draft Guidance explains that “Submitted a PN of 0 refers to any settlement period where the FPN is 0”. However, there is a fundamental difference between a PN, which may be varied numerous times before the settlement period, and the FPN which, as its name suggests, is final. As currently drafted, the submission of a zero PN for 18:00, early in the morning, followed by the submis-

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<sup>6</sup> Section 11E (4) Electricity Act 1989

sion, for 18:00, of a later non-zero PN and finally a non-zero FPN, would trigger the IOLC because the generator “has submitted a PN of 0MW”. It is unacceptable that a critical element of a prohibition such as the proposed IOLC should be left to be interpreted in guidance rather than on the face of the measure itself, particularly where the condition and the guidance refer to two distinct concepts that have their own respective definitions. This is a recipe for uncertainty and unfairness.

We also have significant concerns about the concept of “excessive benefit”. Although the guidance provides some explanation of the term, experience of the same test in the TCLC shows that it is highly subjective and provides no clear basis for determining offer prices, in a process that must be repeated many times a day. The interpretation of the excessive benefit test in the IOLC is made even more difficult by the indication in the guidance that there should be no presumption that a benefit that is not excessive under the TCLC will also not be excessive under the IOLC. This is far too unclear to be able to form a legitimate basis for pricing offers.

**Specific 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, we do not agree with this proposal. In circumstances where NGEN has sufficient notice of plant running and availability, units are simply competing on total costs. Units that Ofgem describes as ‘inflexible’ may or may not be overall more costly than others, but by extending the applicability of the licence condition, Ofgem is removing the ability of the market to form prices based on supply and demand since it would remove the ability of a large section of generators to price at market reflective prices.

- 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.**

No, we do not agree with this proposal. The issue that Ofgem describes arises not because of what is described as being ‘inflexible’ but because high prices are being charged when the NGEN has limited options, which may be an entirely appropriate response to scarcity. While some units may appear more costly due to their dynamic parameters, it is disproportionate to then prevent all such units from offering market-based prices in all circumstances when they are not running. If it is their ‘inflexibility’ that drives them to look more expensive than others, then they will not be dispatched, and this will send the signal to invest in more flexible plant.

In the consultation document, Ofgem has not demonstrated that the cost incurred by NGEN in balancing the system would have been different had the



MZTs of the units being dispatched during periods of high prices been shorter. To do so would require an assessment of which actions would have been taken had MZTs been different and what prices would have been submitted. Provided that a generating unit is not economically withholding its capability or in breach of competition law, the dynamics are largely irrelevant and making such a distinction in the application of the proposed licence condition is inappropriate, arbitrary and discriminatory.

**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 disagree with the approach taken in the draft licence condition overall. However, if implemented, the licence condition should refer to FPNs (Final Physical Notifications) rather than PNs since PNs can change prior to Gate Closure and are therefore not relevant in this context.

The definition of Balancing Mechanism Unit makes reference to a 'trading unit', which has a specific meaning in the BSC and is therefore not helpful. The reference to 'within the operational day' should be reintroduced and a further test of whether the change can be justified by reference to changed market conditions added.

The reference to 'within the operational day' should be reintroduced and a further test of whether the change can be justified by reference to changed market conditions added.

Further, if no other changes are made, narrowing the circumstances to which the condition would apply to only those settlement periods in which wholesale prompt prices are insufficient to dispatch a unit economically would significantly improve the proposal. Such a change, whether in the licence condition itself or in the accompanying guidance would assure the market that the changes are indeed targeted at the issue that Ofgem has identified.

**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?**

The guidance would need to be more specific as to how Ofgem would assess a reasonable profit and how the industry average might be established, for example over what time period. Considering settlement periods in isolation is not an appropriate indication of reasonable profit. If, as Ofgem acknowledges, scarcity pricing has a role to play in a well-functioning market, it cannot be reasonable that certain participants are not able to price in this way. It is apparent from the consultation that it is not the dynamic capabilities of plant that is the direct cause of the high costs, since a unit that is unable to switch off and on as quickly as other units may offer its output at a total cost that is competitive with other units. Therefore, as long as NGESO dispatches in or-

der of total cost (rather than the price in an individual settlement period), a competitive market will still function with a full range of dynamic parameters being offered with those that most closely reflect the ESO's requirements having a competitive advantage to the extent that their additional flexibility is required.