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13<sup>th</sup> March 2023

By Email to: [Robin.Dunne@ofgem.gov.uk](mailto:Robin.Dunne@ofgem.gov.uk)

**Dear Robin**

### **SSE Response to Consultation on the Inflexible Offers Licence Condition**

This response is the view of SSE plc (**SSE**) with a focus on the position of SSE's Energy Businesses: SSE Renewables; SSE Thermal; SSE Distributed Energy/SSE Solar and Battery; and Energy Portfolio Management, which provides the route to market for SSE Group companies. Our response also considers the impact of balancing costs on SSE Business Energy, our non-domestic supply business which supplies energy to c500,000 businesses and industrial consumers in Great Britain. Answers to the consultation questions are presented in an Appendix to this letter.

SSE recognises Ofgem's duty to protect the interests of existing and future consumers and notes that the costs of balancing ultimately feed into existing customer bills, increasing financial pressure and potentially exacerbating affordability issues. However, we do not agree that proceeding with the implementation of the Inflexible Offers Licence Condition (**IOLC**) is the best approach in the current circumstances or for the future operation of the market.

SSE has identified the following issues with the IOLC and draft guidance which we regard as fundamental:

- The proposed licence condition is not well targeted on the specific behaviour that Ofgem has identified as problematic and instead risks introducing a regulatory cap on the offer prices of all large thermal generators in certain circumstances.
- To the extent that certain observed practices are unacceptable, SSE considers that they could be adequately addressed using existing powers under REMIT<sup>1</sup>. The introduction of further obligations in this context would therefore not be consistent with good regulatory practice.

As outlined in our December response to the Call for Input, any intervention must be well considered and strike the important balance of maintaining investor confidence, to help accelerate the delivery of new low carbon infrastructure, whilst ensuring the market operates efficiently to deliver best value for existing and future consumers. Based on the current drafting of both the proposed licence condition and associated guidance, SSE's view is that IOLC falls short of achieving these aims.

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<sup>1</sup> We refer to [ACER Guidance on REMIT application 6th Edition Final.pdf \(europa.eu\)](#) section 6.3.2 which sets out a non-exhaustive list of potentially abusive behaviour and in particular refers to behaviour which attempts to secure a price which does not reflect the normal interplay of supply and demand.

By contrast, SSE is concerned that the proposed licence condition would risk negative unintended consequences by dampening signals to invest in new dispatchable capacity and low carbon flexibility. This would be particularly unfortunate given that establishing the right investment environment for such capacity is a core element of the Government's ongoing Review of Electricity Market Arrangements and will be a key enabler of delivering on ambitious targets to decarbonise electricity generation. Indeed, the IOLC may cause market participants to consider whether it is sustainable to invest in keeping existing assets open and place investment in future projects at risk.

In our recent discussion<sup>2</sup>, Ofgem indicated an intention to conduct an impact assessment (IA) of any proposed intervention. SSE welcomes this approach and would emphasise the importance that the IA considers customer interests in a broader context than simply short-term impacts on bills. The potential negative impacts on security of supply and the investment environment may lead to an overall detriment to existing and future customers.

The remainder of this letter sets out some further considerations which, in SSE's view, should be taken into account in determining next steps.

### Scope of the IOLC

The proposed drafting relies on two parameters to identify generators in scope of the IOLC: generators that have submitted a 0MW PN and which have a Minimum Zero Time (MZT) of >60 minutes. The consultation document refers to operators choosing to operate either flexibly or inflexibly – this appears to be a misapprehension that an asset operator “chooses” to set the MZT to greater than 60 minutes. This is not the case. The assets with longer MZTs to which this condition would apply are large mechanical objects and the common MZT range of 240-360 minutes is a sensible operational limit that reflects the responsible and prudent operation required to ensure the longevity of the equipment.

The combination of these two parameters means that large thermal assets will all be in scope of the IOLC, and therefore precluded from reflecting scarcity in offer prices even on occasions where system conditions mean it would otherwise be appropriate to do so. The proposed licence condition, as written, does not take account of scenarios when a unit may have a 0 PN for a legitimate reason.

This was evident in the market on 7 March 2023. At the point of the day-ahead auction<sup>3</sup> market prices did not support running all assets. Following the outcome of the auction, which is used to reoptimise plant running, National Grid Electricity System Operator (NGESO) published an Electricity Margin Notice followed by a request that the Winter Contingency Coal units run. In this example, relatively low prices resulted in units not being scheduled to run at the day ahead stage (0MW PNs) however, subsequent actions by NGESO indicated an expectation of a tight system margin and therefore that scarcity pricing may be anticipated.

### Imposing Structural Change

We do not believe that it is Ofgem's intention at this time to markedly change the design of the wholesale electricity market. We understand, as stated in the consultation, that the purpose of the intervention is to “*prohibit inflexible generators from undertaking specific behaviours that result in high priced offers being accepted outside of peak periods.*” The current drafting of the licence condition does not address this issue but does impose a structural change on the market that is likely to have a disproportionate and discriminatory impact on large thermal generators.

We consider that if implemented as proposed, this new licence condition would have the effect of removing scarcity revenue entirely for certain technologies of a certain size and could have an adverse impact on the market and market participants. Ofgem, ACER and NGESO have consistently noted the importance of

<sup>2</sup> Call on 7 March 2023.

<sup>3</sup> [Market data | Nord Pool \(nordpoolgroup.com\)](https://www.nordpoolgroup.com)

scarcity value in the energy market.<sup>4</sup> The design of the capacity mechanism (**CM**) is predicated on generators being able to earn market revenue that captures some of that scarcity value. The impact of the IOLC on generators holding existing CM contracts and also the implications for future CM auctions should be considered as part of the proposed IA.

The current market design principles, which have been in place for almost a decade, are the result of detailed consideration as part of Ofgem's Electricity Balancing Significant Code Review (**EBSCR**) and are intended to ensure "*cash-out prices signal scarcity accurately and increase incentives to innovate and invest in flexible technologies.*"<sup>5</sup> The EBSCR sought to address shortcomings in the previous arrangements which resulted in dampened signals for investment in flexible generation. The potential impact of the IOLC on investment signals is another critical area for the IA to assess.

### Consequences

SSE has committed to spending £24bn over the next decade as part of its Net Zero Acceleration Plan<sup>6</sup>. The commitment is based on the existing market structure. Fundamental change to that design can only result in a review of these investment decisions in the context of a market which reduces the ability of some generators to recognise scarcity in their pricing.

Within the Energy White Paper<sup>7</sup> government acknowledges that short term dispatchable capacity that can flex as required when the wind is not blowing and the sun is not shining will be needed to ensure security of supply. These plants also provide other valuable services to the power system, such as inertia, frequency response and voltage control, that together enable system security.

As it stands, without urgent policy action to support low carbon flexibility, the target of net zero power by 2035 could face a significant undersupply of critical capacity. Aurora estimates a requirement for up to 30GW of de-rated low carbon flexible capacity by this time, with a significant role for thermal generation with abatement<sup>8</sup>. However, these projects are all reliant on fair and predictable revenue returns including being able to earn inframarginal and scarcity rent.

### Role of NGESO

SSE would welcome further consideration from Ofgem of how best to take forward suggestions made in relation to NGESO's role in the prevalence of high balancing costs. This includes feedback to Ofgem from: the Review of the Balancing Market<sup>9</sup>; by the majority of the respondents to the Call for Input, and during workshops held last year to inform this work.

Within its analysis of possible interventions to address high balancing costs, Frontier Economics noted that the behaviour of NGESO could have a material effect on balancing costs. In particular:

#### 1. Forecasting improvement

Actions taken as well as the forecasts produced by NGESO influence market behaviour and can result in high prices. NGESO's lack of transparency and communication in relation to operating decisions for balancing services limits market participants' ability to properly assess market conditions and leads to inefficiencies as seen on 7 March. The quality of information published by NGESO is also often poor. As noted within the Review of the Balancing Market, on each of the ten days analysed, NGESO's "*expected forecast margin was between 300MW and 2.4GW lower than*

<sup>4</sup> [Open letter on trends in balancing costs in 2021 | Ofgem](#), [ACER Guidance on REMIT, 6th Edition](#) and [National Grid Electricity System Operator Winter Outlook October 2022](#) page 18

<sup>5</sup> [Electricity Balancing Significant Code Review: Final Policy Decision | Ofgem](#)

<sup>6</sup> [SSE on track to invest £24bn+ this decade in GB clean energy | SSE](#)

<sup>7</sup> [Energy White Paper \(publishing.service.gov.uk\)](#)

<sup>8</sup> See [Net Zero power by 2035 The future of dispatchable generation in GB webinar](#), Aurora Energy Research

<sup>9</sup> [Review of the Balancing Market Final Report](#) page 75, Frontier Economics, LCP, Cornwall Insight.

outturn. With more accurate forecasts, ESO may have been able to avoid accepting some offers from less flexible plant<sup>10</sup>.

## 2. Further clarification of the principles of NGENSO's decision making.

The need for clarification and transparency from NGENSO cannot be overstated. As recently as February 2023 NGENSO has shown that it does not have due regard for costs imposed on GB consumers. NGENSO is understood to have warmed two coal units, contracted as part of winter contingency measures for use by an interconnected system operator, while having no method by which costs can be shared between system operators. This means that the whole cost instead fell to GB consumers, rather than the consumers of the other country which benefitted from the action.

## Conclusion

As explored in our response to the Call for Input in December, Ofgem should focus efforts on enforcing under the current REMIT regime rather than developing a new condition which has wider, more serious implications than intended.

Without due explanation of why further regulation is required there is a risk of measures being poorly targeted and the regulatory burden on companies increasing without a corresponding benefit to consumers. There is consequently a real risk of unintended consequences of intervention, negatively impacting on market participants and ultimately consumers if investor confidence is weakened and investment in flexible generation is stifled at a time when such investment is crucial to meet decarbonisation targets.

We would welcome the opportunity to have an open and collaborative discussion with Ofgem and other market participants to allow these complex market issues to be discussed and explored in an open forum. In our view, this may provide an efficient means of sharing Ofgem's concerns and expectations in a timely manner that facilitates better understanding by all parties of the market context.

Yours sincerely,

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<sup>10</sup> Ibid, page 35

## Appendix 1: Answers to 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.*

SSE continues to agree that market participants should be discouraged from acting in a manner which exacerbates a system issue. We do not agree, however, with the proposal to remove the “*within the operational day*” requirement. Our view is that whilst this may appear to be a minor wording change it is an unpredictable change to market conditions that will have a detrimental impact on future delivery of flexibility. The immediate consequence of this change in drafting is that the licence condition would have much wider scope than was originally intended and is therefore less well targeted at the specific concern that it was designed to address.

It is not appropriate to indicate that all 0 MW PNs are potentially problematic or indeed that PNs should never be changed within-day (and potentially right up to gate closure). SSE considers there would be unintended consequences of a broad measure such as this, which ignores the ongoing re-optimisation of plant dispatch that might underpin such behaviour. The consultation document notes that storage assets are routinely re-optimised through the day but ignores the fact that the planned running of thermal assets may also be revised in response to market conditions.

Large thermal generators cannot be expected to operate without fair access to inframarginal rent and, when appropriate, scarcity value. As discussed above, the current market design with PAR1 cashout was intended to increase market volatility to reflect, through price signals, that investment was needed.

Given the change in scope of the licence condition and the associated consequences we welcome the indications from Ofgem that a thorough impact assessment will be required before implementing such a change.

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.*

While we understand that the application of the MZT > 60 minutes condition is intended to recognise flexibility we do not think this is an appropriate parameter. Taken in conjunction with the removal of the “*within the operational day*” requirement in identifying relevant 0 MW PNs it is notable that the proposed licence condition will capture all large thermal generators with a 0MW PN.

There is no sensible rationale for precluding such units from setting offer prices to reflect system scarcity.

We infer from the consultation, draft licence condition and guidance that there is a misapprehension within Ofgem that an asset operator “chooses” to set the MZT to greater than 60 minutes. This is simply not the case. Generators do not choose the “inflexible path” in preference to the “flexible path”. The assets with longer MZTs to which this condition would apply are large mechanical objects. The common MZT of 240-360 minutes is a sensible operational limit that reflects the responsible and prudent operation required to ensure the longevity of the equipment. While there may be circumstances in which the unit can become available more quickly this is generally limited to when the unit comes offline unexpectedly (trips) in which case the unit has not de-loaded and cooled in the same manner as during a normal, planned shutdown.

Cycling turbines in this way over a long period will cause stress on the component parts and will result in increased maintenance for the asset.

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?*

There is some ambiguity between the licence drafting and the policy intention as stated in the consultation document. The licence drafting allows for a generator to be paid an amount that is not excessive. Where system margins are genuinely very tight it would be possible to present an objective justification for pricing to reflect scarcity (following the same principles as Ofgem has set out in explaining the role of scarcity prices). However, as set out in Paragraph 3.2 of the consultation document this would not appear to be the policy intention. SSE would therefore welcome clarificatory statements within the licence condition to remove any ambiguity as to whether scarcity pricing should be seen as reasonable within specific periods in which the system margin is very low.

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?*

SSE sees real value in Ofgem developing detailed guidance on market conduct, setting out how and when generators may expect to earn scarcity value. In particular, setting out the types of factors that should be considered when assessing whether prices in a given context may be considered excessive. Whilst we recognise that this cannot, and should not, attempt to define every circumstance that may arise in the market, the high-level principles would be a valuable regulatory guide to licensees for their day-to-day operations. We consider that this would be of significant benefit in itself and does not require a new licence condition to be introduced, given the existing scope and coverage of REMIT.

The conditions within Paragraph 2.2 are somewhat contradictory. Condition a requires that relevant arrangements are entered into between the licensee and system operator while condition d applies either to being paid or seeking to be paid and excessive benefit. Ofgem must be clear when the condition will apply.

Further detail and clarification must be provided as to what Ofgem considers to be Reasonable Profit and Other Factors. As drafted, there is a high risk that any assessment of these factors is necessarily subjective. For example, where the Reasonable Profit test is reliant on being “*in line with an average for the GB electricity generation sector*” it is important to note that generators would be blind, to a certain extent, when making such a comparison as they would not have all of the facts necessary to assess profit levels (e.g. other generators may have to take account of issues not identifiable to third parties but which impact on their costs).