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By email only to Robin.Dunne@ofgem.gov.uk

14th March 2023

Dear Robin

Subject: Response to OFGEM consultation on Inflexible Offers Licence Condition (IOLC)

Shell welcomes the opportunity to provide input into OFGEM's proposed change to enhance the efficient operation of the Balancing Mechanism (BM). We have experience of participating in the BM for several years and have engaged in all reviews of the BM throughout 2022.

As noted in our response to the recent CFI, we supported the proposed licence condition in response to the very specific market behaviour of changing PNs to zero within the operational day. We also noted that we didn't believe this change would address the key issues in the BM, which we see as lack of competition and automation.

As OFGEM has now proposed to extend the timeframe for the licence condition to cover any period rather than just within the operational day, we recommend that further analysis is undertaken to ensure that the proposed change results in the desired market outcome and does not have any unintended consequences. We are concerned that by removing the ability to PN to zero at day ahead without the IOLC applying, it will remove the flexibility for assets to respond to changing market conditions, such as varying demand, wind, and price signals. This may result in more balancing activity having to be undertaken by the National Grid ESO (NGESO) control room in real time when they only have access to marginal units in the BM, rather than in earlier timeframes when the whole market can respond to signals.

We welcome the clarity on the MZT limit and that the proposed level will therefore exclude assets such as batteries which may routinely submit a PN of 0 MW as they respond to market price spreads.

We welcome the Guidance note published alongside the consultation but ask that it is extended to include specific guidance and case studies on what behaviours would constitute 'excessive benefit' and 'reasonable profit', which are missing from the current guidance. For example, if prices have been set at scarcity levels by high Offers accepted with interconnectors or other generation, will it be considered 'reasonable profit' for assets subject to the IOLC to raise their Offer prices to the scarcity levels paid to other generation to manage their risk? Without this level of detail there is a risk that there will be different interpretations across market participants which will make administering the licence condition very time consuming and may not drive the desired outcome.

We note that OFGEM understands there are limitations caused by the lack of system automation in the NG Control Room, which are forecast to be addressed by the Balancing Capability Change Program over the next 4 years to 2026. As these planned enhancements are fundamental to a step change to competition and efficient utilisation in the BM, we ask that OFGEM creates KPIs around the delivery of this program which it monitors closely with NGENSO.

We note that OFGEM has rejected the proposed Balancing Reserve product as presented by NGENSO. We understand the rejection criteria, but as this was one of the reforms also suggested by OFGEMs in its response to enhancements to the BM, we believe a revised product would provide an effective tool for NGENSO, allowing them to secure reserve volume at the day ahead timeframe.

We consider the specific questions raised in the consultation in more detail further below.

If you have any questions regarding our responses, we would be happy to discuss further.

Yours sincerely,

Melanie Ellis
Regulatory Affairs Manager

Question 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.

As described above, we believe it is necessary to model scenarios to validate the proposed changes and provide comfort that there will be no unintended consequences of extending the IOLC to any time rather than limiting it to within the operational day timeframe. We are concerned that it will remove flexibility to respond to changing market conditions, such as demand, wind, and prices, which will lead to more activity needed in the BM rather than ahead of time in the market. It may also have an impact on the forward, intra-day and day-ahead markets which needs to be explored.

Question 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.

We are pleased that OFGEM has addressed our concerns around the licence condition applying to battery storage as they routinely submit PNs of zero MW as they respond to market spread signals.

We note that the consultation includes a summary of the number of BMUs in each MZT time bracket (Figure 1 – MZT of BMUs on page 17), but that this does not show the proportion of the BM volume captured by the proposed limit. As explained above, this will be important to understand to assess what BM volume can respond to scarcity pricing and what knock-on effect this may have on other markets.

Question 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 don't find the licence condition drafting in Appendix 1 to be sufficiently clear. We note that it references a separate guidance which it says will be updated as necessary, which we comment on in our response to question 4. It also references that market participants could be requested to provide information but does not provide any details of what this might look like and how long a participant would have to provide.

We note that under section 2 (d) the licence condition is intended to apply even if an asset did not win a BM contract but simply put an Offer price in the BM. We don't believe this should be the case as some assets may signal, they don't want to be scheduled, by including a high Offer price. This would also be administratively burdensome for OFGEM.

Question 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 draft guidance does not provide sufficient detail for market participants to understand how 'excessive benefit' and 'reasonable profit' will be calculated and evaluated.

The guidance says that a 'reasonable profit' is one which is 'commensurate with a level of profitability that is in line with an average for the GB electricity generation sector.' Can OFGEM please provide details of how it will calculate this average profitability of an average GB electricity generator.

It is also necessary to include case studies to provide worked examples of how OFGEM reviews and evaluates compliance for participants to ensure they comply. We would also like to understand the logistics of how OFGEM will manage the review in terms of process and resource. What data will participants be required to provide and in what timeframe?

We note that allowable variable costs include anticipated costs of plant failure, which is the probability of plant failure multiplied by the cost of plant failure. There is likely to be significant variation in participants views on their probability of plant failure as it will depend on risk appetite, portfolio risks and mitigations, market prices and view on weather risk. It will therefore require OFGEM to consider each price on an asset-by-asset basis which is likely to be very time consuming. Therefore, we believe that case studies including where scarcity prices are seen, are important to establish a common understanding.