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Consultation on Inflexible Offers Licence Condition

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Thank you for the opportunity to respond to the above consultation. We do not believe that the latest version of the proposed licence condition should be implemented as it moves beyond addressing the bidding behaviour that Ofgem is seeking to prevent.

As a result, we believe that the proposal could result in a solution which is disproportionate, results in undue discrimination, would affect the majority of Balancing Mechanism (BM) capacity and could result in promoting inefficient trading behaviour in pre-gate closure market timescales to the detriment of customers.

The proposal is not a proportionate response to the issue that Ofgem wants to address

In Ofgem's previous publication on this issue in November, which contained the initial proposal for the new licence condition, it was stated that "*The objective of our proposed intervention is to prohibit generators from participating in the combination of behaviours and sharp practices that led to last winter's high balancing costs*"¹. The combination of behaviours concerned was described as being "*when high offer prices were combined with a reduction of PNs to zero, lengthy MZTs and limited spare generation capacity available to meet peak demand*"². In order to address this combination, the document stated that the licence condition "*would be targeted at situations when PNs are revised to zero with little advance warning for the ESO, for example when PN revisions occur on the same day as the settlement period that the PN relates*"³.

We were unable to make a proper assessment of the licence modification at that time as the associated guidance, which is a key element of the arrangements, had not yet been issued. However, we at least understood that Ofgem was seeking to address the issue in a specific, targeted and proportional manner. In particular, Ofgem noted that the approach was "*best placed to directly reduce the market behaviours we saw last winter (and therefore reduce balancing costs) without disrupting existing trading arrangements or impeding price signals during periods of scarcity*"⁴. The ability to be

¹ Responding to high balancing costs in winter 2021: Update and proposal to introduce a new licence condition (4 November 2022) page 5

² Ibid page 4

³ Ibid page 8

⁴ Ibid page 11



able to price scarcity was also noted as having *“an important role to play in orchestrating supply to meet demand and may also incentivise investors to bring forward additional generation when there is scarcity of capacity”*⁵.

The latest proposal moves away from this approach as it:

- Applies to all circumstances where a zero PN has been declared for the unit and settlement period concerned, not just when a unit is reduced to zero; and
- Only applies to plant that have submitted a Minimum Zero Time of greater than 60 minutes.

The new approach is now not aimed at addressing the specific behaviour which had been identified as the rationale for intervention in the November document. Therefore, we do not believe that it is a proportionate response to the issue which it is supposed to address.

The proposal appears to result in undue discrimination

The new proposal is now focused on a new aim. The latest document says that *“these changes ensure generators have two options for participating in the BM”*⁶. The two options are identified as:

- *Generators may either follow the ‘flexibility path’, through which their units are operated flexibly in response to market and system conditions, and where generators have the ability to efficiently price scarcity into their BM offers. When the margin between available capacity and peak demand becomes tight, we anticipate that the scarcity premium in the price signal should encourage investment in new production or demand side response, which will be to the benefit of energy consumers.*
- *Or alternatively, generators may follow the ‘inflexible path’, through which their units are operated in a manner that limits their responsiveness to market and system conditions. In such circumstances we expect generators’ BM offer prices to reflect their costs plus a reasonable profit that is not excessive. It is not in consumers’ interests for generators to gain excessive benefits as a result of their inflexibility.*⁷

We are concerned that Ofgem has effectively made an arbitrary choice to impose different treatment for particular types of plant in the market. Ofgem, has explicitly stated in the consultation paper and the draft guidance that “flexible” plant will be allowed to price scarcity, whereas “inflexible” plant will not.

Ofgem has not explained why flexibility is a relevant consideration when determining whether or not a generator is able to reflect scarcity. In Ofgem’s own words above, scarcity pricing should reflect *“when the margin between available capacity and peak demand becomes tight”*. The proposals as outlined would prevent a sizeable proportion of the market from being able to reflect this, simply based on whether or not it is deemed flexible, not on the difference between supply and demand at the time.

Unrelated technical characteristics of the plant are not a relevant consideration on whether a generator is able to reflect scarcity. A generator is still capable of submitting

⁵ Ibid page 4

⁶ Consultation on Inflexible Offers Licence Condition (15 February 2023), page 15

⁷ Ibid page 15



different prices in different half hours even if its technical characteristics do not allow it to turn on and off physically for individual periods at short notice. Ofgem appears to be content with the generators reflecting scarcity in offers in the day ahead market or other pre gate closure timescales, even though the generator would be equally constrained operationally by its physical technical characteristics. It should be no different in post gate closure timescales.

Additionally, the definition of flexible in this context is very specific. It relates to whether a generator has a Minimum Zero Time of greater than 60 minutes and where it has declared a Physical Notification of zero for the period concerned. Therefore, even if physical inflexibility were a relevant consideration in whether or not a generator was able to price scarcity, which it is not, restricting the ability of generators to do so based on one specific measure results in treatment which is even more arbitrary.

We believe that treating a class of generation on this basis therefore amounts to undue discrimination between classes of market participant.

Also, the level of MZT that a generator declares is not a choice that a generator is able to make. This is a technical characteristic and the licensed generator sets this parameter in order to operate the unit safely and efficiently. Therefore, it is incorrect to believe that the licence condition could result in generators making efficient trade-offs in respect of whether to bid longer MZTs or participate in pricing scarcity. There is some scope for operators to push their plant harder and provide more flexible values for certain parameters, if market conditions mean that this may be suitably rewarded to make the associated increase risk to the plant worthwhile. However, Ofgem made it clear in its previous communications on this that it does not want operators to do this, as it does not believe that the Grid Code allows it.

The proposal would affect the majority of GB BM Capacity

We note that analysis is included in the latest consultation document showing the number of BM Units which have MZTs in certain ranges. It gives the impression that the vast majority of BM units would be unaffected by the proposal⁸. A more reflective analysis would analyse the capacity affected. We estimate that this proposal could in reality impact just under 60% of BM units by capacity. This means that Ofgem is effectively price capping over half of the GB capacity in the BM.

The proposal could result in inefficient behaviour in pre-gate closure market timescales

This is likely to result in inefficient outcomes. Generators sell into the markets ahead of gate closure, but are only able to sell power if there are purchasers willing to do so at appropriate prices. Both buyer and seller will make decisions based on views of what prices can be achieved in different channels. Expectations of BM prices influence what market prices will be prior to this, as it affects willingness to buy and sell power in these timescales.

So, for instance, a purchaser of power is less likely to buy at the day-ahead or within-day timescales, in respect of periods of scarcity, if it perceives that the imbalance price will not be able to reflect that scarcity. This is because they will know that it will be cheaper for them to opt for imbalance prices rather than the scarcity related prices

⁸ Consultation on Inflexible Offers Licence Condition (15 February 2023), Figure 1, page 17



being offered in the other market timescales. This could result in increasing short positions being taken into gate closure, which in turn would result in the ESO having to balance a larger proportion of demand, rather than undertaking a more residual balancing role. This may result in actions being taken which would have been less efficient than if generation had been scheduled ahead of time in reaction to prior market trading decisions.

Therefore, we are concerned that the present proposals could in reality result in less efficient balancing actions having to be taken and in a higher proportion of actions being taken through the BM itself.

Therefore, we would not support the implementation of the proposal in its current form.

Our response to the specific questions raised are as follows:

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 do not agree with this proposal. As we mention above, this in combination with the proposal to also limit application of this licence condition to stations with MZTs of greater than 60 minutes results in undue discrimination and the potential for inefficient market outcomes.

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 do not agree with this proposal either for the reasons given above and in response to our answer to question 1.

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?

The drafting appears clear in terms of delivering Ofgem’s intent. However, it is the intent which concerns us.

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 seems to be no more specific than the principles that were contained in the November document. In particular, the November document allowed for the principle of pricing scarcity. This has been removed from the guidance and replaced with the principle that only “flexible” plant may price scarcity.

The guidance should be more precise on what would be regarded as an excessive benefit. Companies need to set frameworks within which operational and trading colleagues can operate and this is incredibly difficult to do in order to meet high level, non-specific principles.



We would be happy to discuss any of the above concerns with you bilaterally should you wish.

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