

Guidance

Inflexible Offers Licence Condition – Guidance

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This document provides guidance to our approach to interpreting and enforcing the Inflexible Offers Licence Condition (IOLC). The IOLC applies to electricity generators and prohibits licensees from obtaining an excessive benefit after revising their physical notification (PN) from a positive MW value to 0MW within the operational day, when their Minimum Zero Time (MZT) is more than 60 minutes.

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1. Version History

The first iteration of this guidance was published in August 2023, prior to that we consulted on two draft versions of the guidance in February 2023 and June 2023.

Version	Date Published	To be applied	Summary of Changes
1.0	August 2023	26 th October 2023 onwards	N/A

2. Introduction

Purpose

2.1. This document provides guidance to licensees and other interested parties on Ofgem’s intended approach to the interpretation and enforcement of the Inflexible Offers Licence Condition (IOLC). For ease of reference the wording of the licence condition is reproduced in full in Appendix 1. In developing this Guidance document, we have built upon and considered the responses received from stakeholders to our Call for Input published in November 2022¹, our Consultation published in February 2023² and our Statutory Consultation published in June 2023.³

2.2. Ofgem will have regard to this Guidance document when carrying out investigations into potential breaches of the IOLC. However, it is the licence condition itself which provides the definite framework against which compliance will be assessed. Our assessments will be inevitably case specific and must take into account the particular circumstances of each case. This means that the particular analytical methods used and evidence relied upon may vary across investigations. Ofgem will apply these guidelines flexibly, departing from them where appropriate to do so.

2.3. In the remainder of this section, we provide an introduction into how National Grid Electricity System Operator (NGESO or ‘the ESO’) use the Balancing Mechanism (BM) to balance supply and demand; describe the rise of balancing costs in recent years; describe when scarcity pricing is acceptable; and summarises what the IOLC prohibits. The next section discusses the specific requirements of the licence condition in greater detail.

Background

2.4. The ESO’s role is to co-ordinate and direct the flow of electricity onto and over the national electricity transmission system (NETS), in an efficient, co-ordinated and economic manner. It does this by procuring balancing services that are subject to transparent, non-discriminatory and market-based procedures.

¹ [Call for Input on options to address high balancing costs | Ofgem](#)

² [Consultation on the Inflexible Offers Licence Condition | Ofgem](#)

³ [Statutory Consultation on the Inflexible Offers Licence Condition \(IOLC\) | Ofgem](#)

2.5. The BM is NGENSO's primary tool to balance supply and demand in real time. In the BM, market participants signal to NGENSO for each given 30-minute settlement period⁴ the costs they are willing to pay or be paid to adjust their electricity output or consumption, as a deviation from the position they had notified to NGENSO ahead of gate closure⁵ for that settlement period. For electricity generators, a proposal to increase electricity output or decrease electricity consumption is known as an 'offer' and a proposal to decrease electricity output or increase electricity consumption is known as a 'bid'. NGENSO typically takes actions using the most competitively priced bids and offers, however operational and locational factors can sometimes result in more expensive bids and offers being accepted in order to solve a specific network issue.

2.6. NGENSO is informed in advance of the generators that are scheduled to run, and at what quantity of generation output, through the submission of a Physical Notification (PN). These are notifications from generators of the amount of electricity that they intend to produce during a given settlement period (suppliers also submit PNs to notify expected consumption). PNs can be modified until gate closure, which is an hour before the start of a settlement period. At this point, the market closes for that settlement period and a PN becomes a Final Physical Notification (FPN). The period between gate closure and the end of the settlement period is when NGENSO accepts bids and offers submitted by BM participants.

2.7. There has been a notable rise in balancing costs in recent years. While energy market volatility and societal impacts of the COVID-19 pandemic were key drivers of higher costs, we also observed higher costs as a result of behaviours by some generators. This included instances of generators with inflexible technical capabilities revising their PN from a positive MW value to 0MW, to send a signal to the ESO that the generation unit intends to cease generating electricity in the run up to and over the evening peak of demand (ie, when generation is needed the most). The generators would then submit inflated offer prices in the BM when their PN is 0MW. Once a generation unit ceases to generate electricity, it must remain at zero output for a set period of time in order to comply with the unit's 'minimum zero time' (MZT), which is a pre-determined technical capability of the generation unit.⁶ To avoid the

⁴ Whilst electricity transmission is continuous, for the purpose of trading and settlement it is considered to be generated, transported, and consumed within 30-minute blocks throughout the day known as settlement periods. Each offer / bid by participants and corresponding action taken by NGENSO in the BM corresponds to a specific settlement period.

⁵ Gate Closure is a point one hour prior to the start of a Settlement Period by which time generators submit to NGENSO their planned generation for that Settlement Period.

⁶ Generators' technical capabilities are known as dynamic parameters. The full list of dynamic parameters is set out in the Grid Code at BC1.A.1.5

generation unit from being unavailable for the evening peak the ESO therefore often had to accept these high-priced offers for several hours in advance of the evening peak of demand.

2.8. In certain situations, where the margin between available capacity and peak demand becomes tight, a scarcity premium may be included in offer prices. This price rise can provide a signal that has an important role to play in orchestrating supply to meet demand and may also incentivise investment in additional generation or demand side response. However, when high offer prices were combined with revisions of PNs to 0MW for units with lengthy MZTs, NGESO often had limited options available to maintain system security and incurred much higher costs.

2.9. The IOLC prohibits generators (with an MZT of longer than 60 minutes) from obtaining an excessive benefit from their BM offers when the generator has revised its PN from a positive MW value to 0MW within the operational day. In such cases, the generator's revision of its PN to 0MW could provide it with the ability to leverage its inflexible dynamic parameters to gain excessive benefit from its BM offers.

Interaction with Competition Law, REMIT and TCLC

2.10. The IOLC does not displace the application of competition law. It is complementary to it and targeted at the behaviour that has been described above. Ofgem does not intend to interpret the scope of the IOLC by reference to competition law and REMIT.⁷ The assessment of whether or not there has been a breach of the IOLC will be undertaken with reference to the framework of the IOLC and is different from the analytical framework for establishing unfair pricing under competition law, or pricing artificially under REMIT.

2.11. It should also be noted that our IOLC proposal to prohibit excessive benefits has similarities to the Transmission Constraint Licence Condition (TCLC), which prohibits excessive benefits being obtained from bids in relation to a transmission constraint period. However, TCLC is separate from IOLC, with a separate Guidance document. For example, there should be no presumption that a level of benefit which is not considered excessive under TCLC would not be considered excessive under the IOLC (or vice versa). In each case we will assess excessiveness on its merits, taking into account all of the circumstances of the case.

⁷ Regulation (EU) No 1227/2011 of the European Parliament and of the Council of 25 October 2011 on wholesale energy market integrity and transparency (Text with EEA relevance) (Retained EU Legislation) <https://www.ofgem.gov.uk/gas/wholesale-market/european-market/remit>

Enforcement

2.12. We will enforce the IOLC in accordance with our enforcement guidelines as they apply at the relevant time. These guidelines can be accessed on our website.⁸

2.13. Consistent with the enforcement guidelines, if, on our own initiative or following a complaint, we identify a potential breach under the IOLC, we may write to the licensee concerned, requiring them to provide cost and other relevant data, and asking them to explain the basis for their pricing (and any assumptions underpinning it).

2.14. Also as set out in our enforcement guidelines, we will assess whether it is appropriate to take enforcement action against our prioritisation criteria. For example, where the evidence of a potential breach is weak or any breach is likely to be trivial or there is no or minimal harm to consumers, an investigation would be less likely.

2.15. If a licensee is found to be in breach, it may face a financial penalty. The amount of any penalty imposed will be determined by the Authority in accordance with its published policy on financial penalties for licence breaches.

⁸ <https://www.ofgem.gov.uk/investigations/ofgems-powers>

3. The Inflexible Offers Licence Condition

Overview

3.1. Paragraph 1 of the IOLC provides that the licensee must not obtain an excessive benefit from electricity generation in respect of a Settlement Period in relation to which it has revised its Physical Notification (in respect of a unit which has a Minimum Zero Time of longer than 60 minutes) from a positive MW value to zero MW within the operational day.

3.2. Paragraph 2 of the IOLC further provides that the licensee shall be considered to have obtained an excessive benefit from electricity generation in relation to a Settlement Period (where each of the other requirements of paragraph 1 is met) if each of the following conditions apply in relation to that Settlement Period:

- the licensee and the system operator enter into, or have entered into, Relevant Arrangements in respect of a Balancing Mechanism Unit owned or operated by the licensee; and
- under the Relevant Arrangements and in connection with an increase in electricity generation the licensee is paid or seeks to be paid, an excessive amount by the system operator.

3.3. The Relevant Arrangements referred to in paragraph 2 of IOLC are defined as the making an offer in the BM, irrespective of whether that offer is accepted.

Assessment of the IOLC

3.4. The remainder of this chapter discusses in detail the behaviour that is prohibited by the IOLC. The diagram in Figure 1 provides a high-level illustrative example of the steps Ofgem would expect to take in considering whether a breach of the IOLC has occurred.

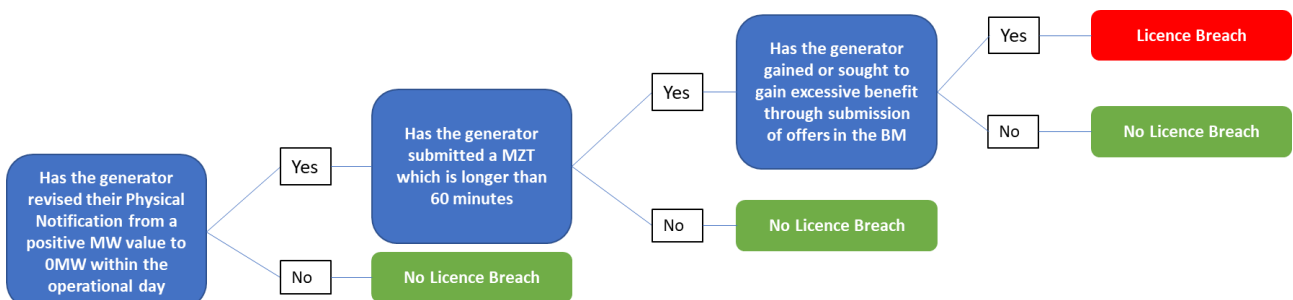


Figure 1 – Pathway of compliance under the IOLC

3.5. Licensees are encouraged to establish their pricing strategy and be ready to provide evidence that they can use to show they have not gained an excessive benefit in circumstances where the IOLC is (or may be) engaged. If any circumstances suggest a potential breach, Ofgem may write to the licensee concerned, giving them an opportunity to respond. Licensees may be invited to provide an explanation on how they have not gained an excessive benefit from their pricing. Supporting evidence should be submitted to Ofgem for assessment.

3.6. We are aware that on occasion some generators might price high in the BM in order to not be taken by the ESO. In such cases, we would expect the generator to be able to provide evidence that this was their intention rather than there being any attempt to obtain an excessive benefit. However, wherever possible and in accordance with Grid Code⁹ rules, a generator should reflect that it is unavailable via its dynamic parameters, for example through a reduction in Maximum Export Limit (MEL).

Is the benefit excessive?

Overview

3.7. Any revisions to PNs within an operational day and MZT submissions will be verifiable from relevant balancing data. Therefore, we would expect the main part of our assessment of potential breaches of the IOLC to relate to whether the offer price resulted in the licensee obtaining an excessive benefit.

3.8. In practice this means that when a generator has revised its PN to OMW within the operational day and where a generator offers to export power for those settlement periods – the generator must not submit BM offer prices at a level which would result in them obtaining an excessive benefit, were those offers subsequently accepted by the ESO.

3.9. In enforcing the IOLC, we will focus on the price of those offers submitted in the BM which apply to levels of output from OMW to a BM unit's Stable Export Limit (SEL)¹⁰, as this is where the inflexibility occurs.

3.10. In order to assess whether a benefit was excessive, we will consider whether the price(s) offered was set at a level which meant that the benefit that the licensee was either paid or sought to be paid in relation to a revision of its PN to OMW within the operational day was

⁹ [Grid Code \(GC\) | ESO \(nationalgrideso.com\)](#)

¹⁰ Stable Export Limit (SEL) – the minimum value a BM Unit can, under stable conditions, export to the National Electricity Transmission System.

significantly greater than the benefit they would have obtained had they not revised their PN to 0MW (ie, the profit the generator would have obtained had it generated in line with the positive PN previously submitted).

3.11. In general, we would expect this assessment to involve two main parts – an analysis of the costs and benefits to the licensee of generating in the period in question, and an analysis of whether the level of profit priced into the offer was reasonable. These are discussed in turn below.

Costs and benefits of generating

3.12. The benefit that a licensee obtains or seeks to obtain through its offer prices is the profit associated with those offers (or implied profit, had those offers been accepted). That is, the revenue obtained less the cost incurred to run the plant which includes opportunity costs of the licensee increasing its generation. Similarly, the benefit that a licensee would have obtained had it not revised its PN to 0MW, is the revenue that would have been obtained had the unit dispatched in line with the original positive PN, less the costs that would have been incurred.

3.13. Given this, one consideration in our assessment of whether a licensee's offer prices have breached the IOLC will be the costs that were or would have been incurred by the generator as a result of having an offer accepted or generating to its positive PN.

3.14. The bullets¹¹ below set out some examples of the potential costs that a licensee may face where it has an offer accepted, or when running to a positive PN. This list is not intended to be exhaustive, nor is it the case that all costs listed will definitely be relevant to a particular generation unit when assessing if an offer is excessive:

- **Variable costs** – these are the costs that vary with the level of generation output. They can be considered as the opportunity cost of input associated with each increment of output. Typical examples of variable costs include fuel, operating costs, emissions, wear and tear on plant and government subsidies. Variable costs also include the anticipated costs of plant failure, which is the probability of plant failure multiplied by the cost of plant failure, and the opportunity cost of exceeding emissions limits.

¹¹ We do not expect these factors to have fixed values. The values may vary over time. We would expect any variance to be fully explained.

- **Avoidable fixed costs** – these costs are not variable but must be borne if the plant generates output. These costs should not be confused with sunk costs. Sunk costs cannot be avoided in the short run even if the plant generates zero output. Therefore, avoidable fixed costs can be considered as the opportunity cost of the inputs that could have been avoided if generation output was zero. A typical example of avoidable fixed costs are the costs of starting the plant, including, for example, the number of starts/running hours the plant may have each year.
- **Shutdown costs** – these are the costs of reducing a plant’s generation output to zero when generating immediately prior to the settlement period under consideration. They can be considered as the opportunity cost of resources required to cease generation output, including any lost revenue that could be avoided if the plant had continued with a non-zero level of generation.

3.15. We recognise that, at times, the costs or benefits associated with having an offer accepted by the ESO will be uncertain. For instance, this could be the case where repeated running of a unit is expected to create additional maintenance costs – but those will not be realised until much later in the unit’s lifetime. Another example could also be the risk associated with having an offer accepted, but then being unable to deliver due to an operational issue. Where uncertainty exists, it is important that any assumptions made to estimate the costs or benefits associated with an offer acceptance are based on a robust and fully documented methodology, and well evidenced. Critical assumptions should be revisited and refined as more information comes to light.

Reasonable profit

3.16. In addition to costs, as noted above, licensees may seek to recover a reasonable level of profit via their offer prices. While what is reasonable will be dependent on the circumstances of the case, we consider that it would not be reasonable for a generator to be paid (or seek to be paid) a total profit margin in pounds (£) that is significantly greater than that which would have been expected had the generator not revised its PN to OMW within the operational day and had instead generated in line with its positive PN.

3.17. Given this, a key element of our assessment is likely to be an analysis of the prices (and implied profit margin) at which the unit’s output had been sold prior to the PN being revised to OMW within the operational day. We are also likely to have reference to the specific pricing strategy of the generator – and the controls which exist to ensure that profits are limited to a

level which would not be significantly greater than those which would be obtained absent a revision of a PN to 0MW within the operational day.

Other considerations

3.18. As part of our assessment, we may also consider the costs and benefits of other generators. This could be relevant where, for example, we are assessing the reasonableness of information on costs that has been submitted to us by a generator, or forming a view on the level of profit which would likely have been earned had the generator dispatched in line with its original PN.

3.19. For the avoidance of doubt, on occasions where changing market circumstances lead to units revising their PN to 0MW within the operational day to avoid running at a loss, the IOLC does not require generators to submit offer prices which would also be loss-making. In such circumstances, we would expect the subsequent BM offers to reflect their costs plus a reasonable profit as set out above.

4. Appendices

Annex 1– Licence condition

Condition 20B. Inflexible Offers Licence Condition

1. The licensee must not obtain an excessive benefit from electricity generation in respect of a Settlement Period in relation to which it has revised its Physical Notification (in respect of a unit which has a Minimum Zero Time of longer than 60 minutes) from a positive MW value to zero MW within the Operational Day.
 2. For the purposes of paragraph 1, the licensee shall be considered to have obtained an excessive benefit from electricity generation in relation to a Settlement Period (where each of the other requirements of paragraph 1 is met) if each of the following conditions apply in relation to that Settlement Period:
 - a. the licensee and the system operator enter into, or have entered into, Relevant Arrangements in respect of a Balancing Mechanism Unit owned or operated by the licensee; and
 - b. under the Relevant Arrangements and in connection with an increase in electricity generation the licensee is paid or seeks to be paid, an excessive amount by the system operator.
 3. For the purposes of paragraph 2 the reference to an increase in electricity generation by the licensee in respect of a particular Settlement Period means an increase in comparison to the licensee's Physical Notification of zero MW.
 4. This licence condition shall be interpreted and enforced in accordance with guidance published by the Authority.
 5. Before this condition comes into force the Authority shall publish the guidance referred to in paragraph 4.
 6. Before the Authority publishes the guidance referred to in paragraph 4 the Authority shall consult:
 - a. the holder of any licence under section 6(1)(a) of the Act; and
 - b. such other persons as the Authority thinks it appropriate to consult.
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7. The Authority may from time to time revise the guidance referred to in paragraph 4 and before issuing any such revised guidance the Authority shall consult such person as specified in paragraph 6 setting out the text of, and the reasons for, the proposed revisions.
8. The licensee shall provide to the Authority, in such manner and at such times as the Authority may reasonably require, such information as the Authority may require or deem necessary or appropriate to enable the Authority to monitor the licensee’s compliance with this condition.
9. In this condition:

“Balancing Mechanism”	means the mechanism for the making and acceptance of offers and bids to increase or decrease the quantities of electricity to be delivered to, or taken off, the total system at any time or during any period so as to assist the system operator in coordinating and directing the flow of electricity onto and over the national electricity transmission system and balancing the national electricity system pursuant to the arrangements contained in the BSC
“Balancing Mechanism Unit”	means a unit of trade within the Balancing Mechanism
“Minimum Zero Time”	means either the minimum time that a Balancing Mechanism Unit which has been exporting must operate at zero or be importing, before returning to exporting or the minimum time that a BM Unit which has been importing must operate at zero or be exporting before returning to importing, as a result of a Bid-Offer Acceptance, such minimum time being as per the most recent notification by the licensee to the ESO pursuant to the Grid Code
“Operational Day”	has the meaning given in the Grid Code ¹²
“Physical Notification”	means a notification of the intended level of generation made by the licensee to the system operator for a period

¹² Currently the Grid Code definition is “The period from 0500 hours on one day to 0500 on the following day.”

	pursuant to the notification arrangements established by BETTA and the BSC
“Relevant Arrangements”	means arrangements entered into by the licensee and the system operator within the Balancing Mechanism, and the entering of such arrangements shall include the making of an offer by the licensee whether or not that offer is accepted by the system operator
“Settlement Period”	has the meaning given in the Grid Code ¹³

¹³Currently the Grid Code definition is “A period of 30 minutes ending on the hour and half-hour in each hour during a day.”