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## Commercial Asset Optimisation

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## Statutory Consultation on Inflexible Offers Licence Condition

Dear Luke,

RWE is a leading global energy player, with a 38 GW global generating capacity. 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 (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 and is committed to support meeting the UK governments policy objectives of net zero in the power sector by 2035.

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

As we set out in our response to the February consultation, the proposed licence condition, while intended to prevent a very narrow set of behaviours, would have a potential impact on a wide range of perfectly acceptable behaviours in the Balancing Mechanism (BM).

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We recognise the small improvement in the draft licence condition, which specifies that only changes to zero within the same Operational Day would be relevant to the IOLC. We also note the changes to the accompanying guidance that refers explicitly to the tests of reasonableness that might be applied when assessing offer prices, which are helpful in establishing what may or may not be caught by IOLC. However, we remain of the opinion that the licence condition as drafted would be disproportionate. By limiting the ability of flexible generators to price according to liberalised market principles and thereby discriminating against them, the IOLC would undermine rather than enhance competition in the electricity market.

While not wishing to repeat all of the points made in our response to the February consultation, we do consider that most of those points still stand. In this response to the Consultation we will primarily focus on improvements to the licence condition and/or the accompanying guidance that we consider necessary to avoid unintended consequences and undue discrimination. As a general point, the guidance gives Ofgem significant discretion and is therefore wholly inadequate as the basis on which a generator can safely assess whether its pricing exposes it to the quasi-penal consequences of infringement of the IOLC. However, we set out some specific points below.

In the Consultation document (paragraph 3.8), Ofgem makes reference to the behaviour that the IOLC would target being the gaining of excessive benefit by using the “inflexibility created by dynamic parameters to extract high priced BM offer acceptances over a long duration.” However, the IOLC as worded would also apply to a much wider set of circumstances including many where Minimum Zero Time (MZT) plays no part in constraining the flexibility available to the ESO. The IOLC is therefore not sufficiently tailored to the circumstances it is intended to address. As such, although Ofgem makes a number of points in response to feedback that the IOLC would be discriminatory (paragraphs 3.4 to 3.8), Ofgem exclusively refers to circumstances where MZT is a relevant consideration. In the consultation document, Ofgem has not addressed circumstances where MZT is not a constraint and therefore has not sufficiently dealt with the issue of discrimination since IOLC would essentially apply only to one particular type of generator (CCGTs) even though the key criterion for differentiating between technologies (MZT) is often not relevant to flexibility. We therefore continue to consider that the IOLC does discriminate unduly as long as it continues to apply to plant with  $MZT > 60\text{min}$  in circumstances where MZT has not impacted the ESO’s ability to dispatch the plant flexibly. An example of such circumstances is provided below.

In our response to the February consultation, we set out a number of legitimate behaviours that would be caught by IOLC. For example, a unit that has run throughout the day but has changed its overnight PN to zero due to changing market conditions does not restrict the duration of offer acceptances that might be issued to keep the unit running where the indicated

time at OMW is significantly greater than the unit's MZT. It would therefore be wrong to apply the IOLC and thereby treat such a unit differently from any other unit offering power in the BM. In such circumstances, the dynamic parameters play no role in the ESO being able to instruct a short addition to a run and hence should be outside the scope of the IOLC. A change, at least to the guidance, to indicate that where dynamic parameters did not lead to inflexibility and were not a constraint on the ESO's actions, the IOLC would not be applied would be a helpful clarification. This would help to more clearly target the policy on the intended behaviours and would avoid discrimination between types of generators without a justifiable reason.

In order to minimise the actions that the ESO is required to take in the BM, it is important that units that are able to flexibly respond to price signals, such as CCGTs, are not discouraged or penalised for their flexibility to turn off when fuel spreads are negative and back on when positive. Absent such responsive dispatch, the ESO will have to intervene where the market could and should make such adjustments more efficiently.

We would therefore also reiterate our suggested changes in relation to identifying circumstances where a generator has changed its PN to zero in response to market signals. This could, at a simple level, be by reference to being able to demonstrate that fuel spreads, including the cost of carbon, were negative at the time that any output was bought back. This can be objectively verified and would therefore not add uncertainty, although we would highlight that there may, of course, be additional grounds as to why a generator has reasonably changed a PN to OMW. That change would help to ensure that reasonable behaviours were not treated any differently from other market participants and again would help to more clearly target the policy on the intended behaviours and avoid discrimination.

With regard to the evidence that Ofgem might take into account when assessing if profit margins are excessive (paragraph 2.13), a reference to comparable generators which have not revised their PN to OMW within the operational day is listed. However, generators do not have access to information as to whether or not a particular competitor unit has revised its PN within day. It would therefore not be possible for generators to refer to or to provide such a comparison to Ofgem in the event of an investigation. We agree that this is a useful comparison, but would note the difficulty for a generator in accurately assessing it. Given the serious consequences of infringement of the IOLC, it is essential that a generator should be able to assess its compliance in advance of submitting BM offers. To do so, it needs to have a robust means of assessment. The description of this benchmark should therefore be amended to ensure that a generator is not held to a level of knowledge that it cannot in reality attain.

We also note with some concern the reference to what appears to an absolute level of benefit in paragraph 2.12 of the draft Guidance. Ofgem states that:

“In addition to the costs 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 obtain a total 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.”

This indicates that Ofgem will assess the benefit not only from the perspective of £/MWh, but also from the perspective of total benefit. This means that a large CCGT that offers a large volume is more likely to see its offer price considered excessive than a smaller CCGT offering the same price in £/MWh. This is clearly discriminatory – the volume accepted in these circumstances is a matter for the ESO, not for the generator, and we therefore urge Ofgem to make it clear that the excessiveness of a benefit is to be assessed on a £/MWh basis, and not on a £ basis.

Further, in relation to the same paragraph (2.12), the comparison with the expected income in the absence of a change of PN may lead to perverse outcomes. Where a unit has set its PN to OMW as a result of negative fuel spreads, an Offer Price that returns the same income as if the unit had continued to run would be a loss-making offer. This cannot be an intended outcome and we urge clarification for such circumstances.

In paragraph 3.7 of the Consultation, Ofgem refers to the typical use of large generation plant to provide headroom. We agree that this is often the case, but it does highlight that once at SEL, the flexibility to generate above SEL is not constrained by MZT and therefore, in order to ensure that the IOLC is targeted at the particular behaviours that are identified in the consultation, it should apply only to Offer prices for generation up to SEL. Generation above SEL is no different from any other plant that Ofgem describes as flexible and it would therefore be discriminatory to treat such offers any differently.

Whilst we understand Ofgem’s rationale in seeking to prevent generators earning ‘excessive benefits’ as a consequence of its primary duties to consumers, we do consider that any intervention, if implemented, must be designed to have the minimum impact possible in circumstances other than the specific behaviours that have been identified as problematic. This is a requirement of the Electricity Act 1998, which sets out the manner in which the Authority must regulate the market.

Yours sincerely,

Raoul Thulin  
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By Email